

Ventura Administration Telecommunications Strategic Plan

**Minnesota Planning
Department of Commerce
Department of Administration
Department of Trade & Economic Development**

December 14, 1999

TABLE OF CONTENTS

I.	Ventura administration MISSION STATEMENT AND GOALS for telecommunications.....	1
	A. Healthy Vital Communities.....	1
	B. Current State Goals for Telecommunications Regulation	1
	C. Ventura Administration Goals for Telecommunications	1
	D. Desired Outcomes	3
	E. Roadmap for this Strategic Plan.....	3
II.	STATE OF THE STATE’S TELECOMMUNICATIONS INFRASTRUCTURE.....	4
	A. Methodology	4
	B. State of the State’s Telecommunications Infrastructure	5
	C. Status of Telecommunications Competition in Minnesota.....	12
	D. Telecommunications and Economic Development	14
III.	THE NEED FOR REGULATORY REFORM	15
	A. Traditional Rationale for Government Regulation of Telecommunications Services	15
	B. Technology’s Impact on Telecommunications Regulation	21
	C. Federal Regulatory Reform Has Changed the Role of States.....	25
	D. What Other States Are Doing.....	25
IV.	BUILDING A NEW FRAMEWORK FOR TELECOMMUNICATIONS REGULATION IN MINNESOTA.....	26
	A. Focus on Essential Services and Competitive Markets.....	26
	B. A Need to Update Legal Definitions	28
	C. Recommendations.....	35
V.	UNIVERSAL SERVICE	37
	A. Background.....	37
	B. Analysis and Findings	53
	C. Recommendations.....	70
VI.	LOCAL COMPETITION.....	72
	A. Background.....	72
	B. Telecommunications Act of 1996 Local Competition Provisions	72
	C. FCC Local Competition Rules	74
	D. State Implementation of Telecommunications Act of 1996	80
	E. State Law.....	84
	F. Analysis.....	94
	G. Recommendations.....	106
VII.	CONSUMER PROTECTION AND SERVICE QUALITY REGULATION	110
	A. Background.....	110
	B. Retail Service Quality.....	111
	C. Consumer Education Efforts	113
	D. Analysis.....	114
	E. Recommendations.....	116
VIII.	EXTENDED AREA SERVICE.....	117
	A. Background.....	117
	B. MPUC EAS “Super Order”	117
	C. Analysis and Filings	118
	D. Recommendations.....	124

IX.	AREA CODE EXHAUST/NUMBER CONSERVATION	126
	A. Background.....	126
	B. Federal Law	126
	C. State Law.....	127
	D. Analysis.....	127
	E. Recommendations.....	128
X.	LONG DISTANCE REGULATION.....	129
	A. Background.....	129
	B. Federal Law	130
	C. State Law.....	130
	D. Analysis.....	132
	E. Recommendations.....	133
XI.	REGULATION OF CABLE SERVICES.....	135
	A. Background.....	135
	B. Federal Law	140
	C. State Law.....	142
	D. Analysis.....	143
	E. Recommendations.....	148
XII.	TAXES AND FEES	150
	A. Background.....	150
	B. Analysis.....	151
	C. Recommendations.....	153

Maps

1. Fiber to the World
2. Local Number Portability
3. CLASS Services
4. ISDN
5. xDSL
6. Frame Relay Service
7. ATM
8. Connecting Minnesota
9. Connecting Minnesota
10. Municipal Telecom Facilities
11. Cities without Cable
12. Cities with Cable
13. Cable Systems with 750 MHz
14. Facilities-Based Competition
15. Wireless Competition

Tables

1. Central Offices Fiber To The World
2. ISDN
3. UNE Loops
4. Local Competition Framework
5. Current High Cost Support
6. Low-Income - Current Form
7. Density Zones
8. Access Reform Impact
9. Increase in TAP Participation
10. TAP Changes
11. High Cost Funding
12. State Universal Service Funding
13. HHI
14. UNE's NE, MN, NY
15. Local Competition Framework
16. Current EAS Allocation
17. Current EAS
18. EAS Rates without Transfer Rates
19. Long Distance Market Share
20. Percentage of Total Toll Revenues
21. PEG Comparison
22. Revenue From Sales Tax
on Telecom Equipment
23. Surcharge Amounts

APPENDIX A

Inventory Profile Form Used to Collect Telephone Exchange Data

APPENDIX B

Inventory Form Used to Obtain Cable Television System Information

APPENDIX C

Inventory Profile Form - Municipal Electric Utilities Telecommunications Network

APPENDIX D

Comparative Discussion of Nebraska, New York and Texas State Laws Regulating Telecommunications Regulation

APPENDIX E

Discussion of Connecticut Cable Regulation

APPENDIX F

Comparative Analysis of Federal and State Telecommunications Regulatory Definitions

APPENDIX G

- Calculation of High Cost Residential Fund
- Chart Showing Breakdown for Geographic Deaveraging Density Categories

APPENDIX H

Estimates of Telephone Subscriber Rates for the United States, Minnesota and Selected States

APPENDIX I

Full U.S. Commerce Department Report

APPENDIX J

EAS "Super Order" - Full Text

I. VENTURA ADMINISTRATION MISSION STATEMENT AND GOALS FOR TELECOMMUNICATIONS

Minnesota shall transition from a non-competitive regulatory environment to a consumer oriented telecommunications marketplace. High quality, fairly priced voice, data and video transmission services and capabilities shall be available to every resident, business and government office of the state.

A. Healthy Vital Communities

Telecommunications regulatory reform is an important piece of Governor Ventura's Big Plan for the State of Minnesota. One of the key components of the Governor's "Healthy, Vital Communities" initiative is to promote "Telecommunications as Economic Development." The future of Minnesota's economic vitality hinges on statewide business and residential access to affordable cable and telecommunications services that facilitate economic development and keep everyone in the State "connected." It is competition, not regulation, that will in the end assure lower rates for consumers, higher quality service, and the accelerated deployment of advanced and competitive telecommunications services.

B. Current State Goals for Telecommunications Regulation

It has become vogue to criticize regulation and regulators per se. And while the Ventura Administration fundamentally believes that reliance on the market, rather than on government intervention is the best way to achieve economic efficiency, the Ventura Administration also recognizes that, for the most part, the traditional goals of regulation have been pure.

Minnesota law currently sets forth the following goals for the State with respect to telecommunications:

1. Support universal service.
2. Maintain just and reasonable rates.
3. Encourage economically efficient deployment of infrastructure for higher speed telecommunication services and greater capacity for voice, video, and data transmission.
4. Encourage fair and reasonable competition for local exchange telephone service in a competitively neutral regulatory manner.
5. Maintain or improving quality of service.
6. Promote customer choice.
7. Ensure consumer protections are maintained in the transition to a competitive market for local telecommunications service.
8. Encourage voluntary resolution of issues between and among competing providers and discouraging litigation.

C. Ventura Administration Goals for Telecommunications

1. Competition Works!
 - a. Replace command-control style government regulation of rates and quality of service with mechanisms that rely on the free market to assure the reasonableness

- of rates, high quality of service, and the rapid deployment of advanced and competitive telecommunications services throughout the State.
- b. Streamline and simplify the regulatory environment in which service providers must operate to encourage investment and innovation.
 - c. The burden of performance in the marketplace must shift from regulators to competitive service providers, and the burden of regulatory cost must shift from captive ratepayers to shareholders.
2. A Level Playing Field
- a. Fully and irreversibly open the networks of incumbent local exchange carriers (ILECs) to allow the provision of telecommunications services by competitors.
 - b. Support the elimination of interLATA boundaries, which currently restrict U S WEST from providing in-region interLATA long distance service, once U S WEST has demonstrated that its local networks are fully and irreversibly open for competition.
 - c. Wait to deregulate other monopoly ILECs until, through an objective set of criteria, there is clear and convincing evidence that the incumbent's local exchanges are fully open for use by competitors.
 - d. Ensure that any State telecommunications reform legislation and administrative rules are competitively neutral and do not contradict federal law.
 - e. Eliminate the patchwork of cable service regulations resulting from local governmental regulation of cable services and standardize and incorporate cable regulations into law.
 - f. Provide uniform regulation, competitively neutral incentives for innovation, and strict, but even-handed enforcement of the rules of the marketplace.
3. Spur Telecommunications Investment in the State
- Establish telecommunications competition in rural Minnesota and create incentives for investment in competitive and advanced technologies throughout the State by:
- a. Developing and targeting infrastructure investment incentive programs at areas in Minnesota that are deficient in telecommunications infrastructure or services.
 - b. Ensuring that every community in Minnesota has a telecommunications infrastructure providing data transmission services of no less than 256 Kbps to residential customers.
4. Promote and Strengthen Universal Service
- a. Ensure that every Minnesotan has access to affordable basic local telephone service.
 - b. Ensure the price of providing services to rural or other high cost areas is reflective of the economic cost of providing that service.
 - c. Replace traditional implicit subsidies with explicit subsidies. To the greatest extent possible, ensure that the social costs of implementing universal service principles are no longer "buried" in the telephone ratepayer model, but rather funded through charges approved by the Legislature.

- d. Require that the State universal service program be compatible with a competitive rural telecommunications marketplace.
 - e. Ensure that the State universal service program is consistent with federal law and regulations.
5. Consumer Education and Outreach

Educate and protect consumers during and after the transition to a fully competitive marketplace by:

- a. Designing, developing and implementing a consumer education and outreach campaign aimed at educating consumers on their rights in a competitive marketplace, and on how to make intelligent choices in a competitive marketplace.
- b. Requiring telecommunications companies doing business in Minnesota to provide complete and accurate rate information to consumers. Tariffs and service policies affecting consumers shall be readily available in an easy-to-read and easy-to-understand format.

D. Desired Outcomes

By implementing this Plan, the Ventura Administration hopes to:

- 1. Establish no less than two local telephone providers in each market and no less than two competitors for data, video and high-speed transmission.
- 2. Maintain reasonable rates throughout the state.
- 3. Implement the nation's first "accountable" universal service plan for high cost service areas.
- 4. Encourage efficient deployment of higher speed telecommunications, voice, video and data transmission.
- 5. Encourage market forces to be incentive for improving quality of service.
- 6. Promote customer choice.

E. Roadmap for this Strategic Plan

This Plan sets out the Work Team's analysis and research findings regarding the state of the State's telecommunications infrastructure and regulatory framework. Based on this research, this Plan sets out the Governor's vision for Minnesota's future telecommunications infrastructure and regulatory environment. This vision, backed by the Work Team's research form the basis for specific legislative initiatives, that are also explained in this Plan. Overall, this Plan will form the foundation for a gubernatorial telecommunications regulatory reform bill that will be introduced to the public later this Fall and to the legislature in the 2000 session. As with all plans – the Governor's Strategic Plan is a working document. Persuasive argument and ideas from others, changes in law, technology, or within the industry may require that this Plan be amended or supplemented. The Governor is proud to introduce his Telecommunications 2000 initiative.

II. STATE OF THE STATE'S TELECOMMUNICATIONS INFRASTRUCTURE

A. Methodology

Immediately after taking office, Governor Ventura appointed an interagency work team to develop a strategic plan for telecommunications regulatory reform in Minnesota. The core agencies involved are the Department of Commerce (MDOC) (formerly the Department of Public Service), the Department of Administration, the Department of Planning, and the Department of Trade and Economic Development (the "Work Team"). The Work Team was charged with developing a work plan, researching telecommunications issues, and preparing a Strategic Plan (the "Plan") for the State regarding telecommunications issues. The first step in the strategic planning process was the development of a mission statement and strategic vision for the State.

Next, the Work Team began its research. The following research methodologies were utilized to gather information upon which the Work Team relied in constructing this Plan:

1. Telecommunications Infrastructure Inventory and Competitive Analysis

A telecommunications infrastructure inventory was completed, which provided the Work Team with a snapshot of private and government owned cable and telecommunications facilities within the State.

Every telephone company in the State was asked to complete a profile of each telephone exchange in the State. The inventory profile form used to collect telephone exchange data is included as Appendix A to this Plan. The telephone exchange inventory concentrated on facilities going into and services being provided out of the central office.¹ It was recognized by the Work Team that detailed information about the "last mile" facilities of telephone companies is regarded as proprietary and would likely not be produced by local telephone companies.

Every franchising authority in the State was also asked to complete a profile of the cable television system operating in their community. A copy of the inventory form used to obtain cable television system information is attached to this Plan as Appendix B.

All municipal electric utilities in the State were also asked to complete a profile of their telecommunications networks. A copy of the inventory form used to collect this data is included as Appendix C to this Plan.

The Work Team hopes to collect similar information from wireless carriers next year. However, because the State does not regulate wireless telecommunications services, information on wireless networks was not deemed as critical to the short-term goal of reforming the state's cable and telecommunications regulatory framework.

All of the data collected in this inventory process was entered onto a spreadsheet and transferred to the Department of Planning's Land Management Information Center's (LMIC) Geographic Information Center database. There, the data can be queried by any field, overlaid with other demographic data collected by the Department of Plan-

¹ The term "central office" generally refers to the telephone company building where subscriber lines are joined to switching equipment for connecting calls to their destination. See Newton's Telecom Dictionary, at 157 (13th ed. 1999).

ning, and used to generate digital maps of the State that visually communicate information about the State's telecommunications infrastructure.

2. Input from Stakeholders

Input was solicited from key legislators, MDOC staff, the telecommunications industry, business and residential consumer groups, educational institutions, trade organizations, regulatory associations, government institutions, and outside consultants to determine the status of competition within the Minnesota telecommunications marketplace, and to determine how best to achieve and implement the transition to a competitive marketplace.

3. Secondary Research

Secondary research was performed by the Work Team, utilizing academic publications and news sources. Policy and legal research regarding telecommunications regulation initiatives in other jurisdictions was also performed.

B. State of the State's Telecommunications Infrastructure

1. The Telephone Network

The Work Team developed a survey format to collect data on the existing telecommunications infrastructure from telephone companies. Information collected included: 1) whether the central office and the community was connected to the outside world digitally with fiber optic facilities; 2) availability of local number portability (LNP), CLASS services, ISDN services, DSL services, frame relay services (FRS), and ATM services; and 3) the extent of facilities-based competition in Minnesota. This survey was forward looking and responses were based on what the infrastructure would be as of January 1, 2000. The Executive Board of the Minnesota Telephone Association (MTA) and U S WEST supported this survey and effort. Without their support, this inventory of the State's telecommunications infrastructure would not have been possible. Through their efforts, responses were received from 78 telephone companies covering 697 (96%) exchange areas. However, there are 27 (4%) exchange areas of 11 telephone companies where no data was provided and therefore are not covered in this report.²

The following is a summary of the survey responses. The data provided, both raw numbers and percentages, represent the number of telephone companies responding to the survey (*percentages are based on the 697 exchanges covered in the responses*):

a. Central Offices Connected Digitally By Fiber to the World

This survey question determines whether the community has a high capacity digital connection to the outside world for high-speed data, internet access, and multi-media applications. It does not address the issue of the "last mile" and whether there is bandwidth capacity and facilities to the end users premises.

- 635 (91%) are connected digitally with fiber to the outside world.
- 62 (9%) are not connected with fiber.

² The following telephone companies did not respond to the Work Team's infrastructure survey: Clara City Telephone Company, Clements Telephone Company, Lonsdale Telephone Company, Northland, Redwood County Rural Telephone Company, Sacred Heart Telephone Company, and Starbuck Telephone Company.

Frontier Communications	23
GTE	15
Sprint	6
U S WEST	6*
Century Telephone	5
Northern Telephone Co.	2
Blackduck Telephone Co.	1
Ace Telephone Association	1
Paul Bunyan Rural Telephone Co.	1
Upsala Cooperative Telephone Co.	1

Table 1 - Central offices not digitally connected by fiber

(*NOTE: U S WEST is selling 5 of these central offices.)

Almost all of the smaller telephone companies and co-ops have installed fiber connections to their central offices. A vast majority (50/62 or 81%) of those central offices that are not connected digitally by fiber to the world belong to the four largest telephone companies. Map 1 provides a visual picture of this data. A possible explanation for this is that the future of the smaller independent telephone companies is directly dependent on the future and economic health of the community it serves. Thus, they see the need to invest in the telecommunications infrastructure to provide advanced services to that community. The largest telephone companies serve the larger cities as well as small rural communities. They do not have unlimited capital dollars to invest in all their exchanges. Their priority for this limited capital is to get the greatest return for their shareholders and provide advanced services in areas that are most vulnerable to competition. This primarily involves the metro area and the larger cities where they have large concentrations of customers.

b. Local Number Portability (LNP)

The availability of local number portability is an important factor impacting the development of competition for local service dial tone. Most customers, both business and residential, do not like to change their telephone numbers if they decide to use the local dial tone services of another provider. The following responses may not reflect a total picture since several indicated that the central office switch had the feature installed but it was not activated. They indicated it would be activated when there was a request for the service, which would take about six months. Once the feature is activated, the telephone company usually must start paying a right-to-use fee to the central office switch vendor.

249 (36%) Central offices with LNP available.

448 (64%) Central offices where LNP is not available.

Local number portability is widely available in the exchanges served by Sprint and U S WEST. This LNP data for the State is visually depicted in Map 2.

c. CLASS Services

CLASS services include items normally referred to as custom calling features. These include services such as Call Waiting, Call Forwarding, Three-way Calling, and Caller-ID. These features are part of the software of the central office switching system. They provide additional value and functionality to the end user for a fee. Central offices without CLASS services are usually the older types of switching systems.

646 (93%) Central offices with CLASS services.

51 (7%) Central offices without CLASS services.

This data is visually presented in Map 3.

In 1994, the MPUC ordered all ILECs to ubiquitously deploy SS7 trunk signaling by January 1, 2000.³ SS7 helps interexchange carriers set up calls more efficiently with out-of-band digital signaling. SS7 facilitates the provision of 800 database services and alternative billing services through line information databases. SS7 technology also allows CLASS services to work on interexchange calls. Consumers who pay for Caller-ID want it to work on as many calls as possible.

On September 30, 1999, GTE filed a petition to waive the January 1, 2000 deadline for 21 of its exchanges. Citizens Telecommunications, which recently entered into a purchase agreement to purchase all of GTE's telephone exchanges in Minnesota, filed comments with the MPUC in support of GTE's requested waiver.⁴ The MDOC has filed comments opposing GTE's petition.⁵

d. Integrated Services Digital Network (ISDN)

ISDN may be provided via two methods. These include adding the hardware/software to the central office locally to provide the ISDN service, or providing the service from a remote central office and including any costs for mileage in the rate. The method used for the deployment of ISDN is usually an economic decision. Below are the results of the data on ISDN. These results are visually depicted on Map 4.

Central offices equipped for ISDN	202	29%
Central offices available remotely with no mileage charge	50	7%
Central offices without ISDN service available	445	64%

Table 2 - Central Offices with ISDN

ISDN service is available in approximately 36% of the exchange areas throughout the state. It is more readily available in the metro area than in Greater Minnesota.

³ In re Commission Initiated Investigation to Establish Requirements for the Telecommunications Infrastructure in Minnesota, Order Approving Short-Term and Intermediate Infrastructure Recommendations as Modified in Establishing a Comment Period, MPUC Docket No. P999/CI-93-1176 (May 19, 1994).

⁴ The GTE sale to Citizens is pending and currently being reviewed by the MDOC to determine whether it should recommend that the MPUC approve the sale based on whether it furthers the public interest. See In re Joint Application of GTE Corp. and Citizens Telecommunications, Inc., MPUC Docket No. P5316,407/PA-99-1239 (filed August 27, 1999).

⁵ See Comments of MDOC, MPUC Docket No. P999/CI-93-1176 (filed October 25, 1999).

ISDN is frequently used for video as well as data applications. Its future for use to access the internet is doubtful and it will be overcome by other technologies such as xDSL and cable broadband modems which are faster and probably less expensive in most areas.

e. xDSL Services

xDSL service utilizes the existing telephone company copper facilities to the customer's premises. It provides high-speed data connectivity up to thirty times faster than on a dial up basis. A common use for this service is internet access. It allows the computer to be on-line at all times and does not tie-up the telephone line for local or long distance calls. xDSL technology is being rapidly deployed by the telephone companies to compete with the broadband modem technology being used by the cable companies for high-speed internet access. Several of the telephone companies indicated that they will begin deploying this technology in years 2000 and 2001 which is not reflected in the numbers below. xDSL is an important tool for both residential and business customers.

108 (15%) Central offices with xDSL.

589 (85%) Central offices without xDSL.

The data above is visually depicted in Map 5. The percentage of central offices with xDSL service is expected to rapidly increase over the next two years. This technology allows the telephone companies to meet the demand for lower cost, higher speed internet access and is a response to the competitive threat of the cable companies using broadband modem technology.

f. Frame Relay Service (FRS)

Frame Relay Service (FRS) is an economical method of providing high-speed data connectivity and internet access. It is primarily a service for business customers due to its cost. There is some work being done to use it for video and voice service also. It uses a private virtual network running over a shared infrastructure. It is most economical where the customer's serving wire center is in the frame relay "cloud" and access to the cloud is a single flat rate. If the customer's serving wire center is not in the "cloud" then there are usually mileage charges applicable which makes it less attractive to use. Once the customer has access into the "cloud," the private virtual circuit (PVC) can come out of the "cloud" in the frame relay service area provided by the telephone company without any mileage charges in between. The data below is visually represented in Map 6.

257 (37%) Central offices in FRS cloud.

440 (63%) Central offices not in FRS cloud.

xDSL service may replace frame relay service in certain applications by small business for access to the internet. This will depend on bandwidth requirements and cost.

g. Asynchronous Transfer Mode (ATM)

Asynchronous Transfer Mode (ATM) service is used to handle many different network requirements and applications for voice, data, and video over a single high capacity line. It is primarily used by large businesses and by telecommunications carriers. It can provide both fixed and variable bandwidth demand that al-

lows the efficient use of network capacity. Unlike frame relay service, ATM can provide the guaranteed bandwidth without delay needed for voice and video applications. This service is primarily for larger businesses and public sector customers. It is also used by telecommunications carriers for their own business purposes. This service is not widely deployed around the State at the present time. Most of the deployment has been primarily in the Twin Cities area.

174 (25%) Central offices in ATM cloud.

523 (75%) Central offices not in ATM cloud.

The above data is set out visually in Map 7.

h. Connecting Minnesota

Connecting Minnesota is a collaboration between the public and private sectors. It is a private sector project using private sector money. There is no taxpayer money involved. As a result of a formal bidding process, ICS/UCN, a Denver-based utility developer, is allowed a one-time access to lay fiber-optic cable along 950 freeway miles in exchange for installing the infrastructure along another 1,000 miles of trunk highway through smaller, less lucrative markets in rural Minnesota. Maps 8 and 9 depict the Connecting Minnesota route. The agreement also provides some telecommunications capacity for the public sector, including K-12 schools, libraries, colleges and universities.

Connecting Minnesota will benefit both public and private sectors, including local telephone companies, since the network will support more interLATA telecommunications service providers. It will reach to within 10 miles of about 80% of the state's population. The local infrastructure and connections must still be built and maintained by the local telephone and cable companies, electric utilities or other groups so that business and residential users can make full use of the advanced telecommunications services supported by the fiber-optic technology. The resulting competition will lead to better services and lower costs for everyone.

Some of the fiber routes that ICS/UCN will be installing in the Connecting Minnesota project will parallel existing fiber already in place by certain local telephone companies and Onvoy, a fiber-optic backbone carrier formerly known as MEANS Telecom. Nevertheless, the Connecting Minnesota installation is not redundant because it is designed to meet current demand throughout Minnesota for additional low-cost, high-speed network access. To date, the marketplace has determined there is not enough fiber along these routes to meet future bandwidth needs and private sector investors working with ICS/UCN are willing to risk millions of dollars on this project.

i. Municipally Owned Telecommunications Infrastructure

The Work Team, in cooperation with the Minnesota Municipal Utilities Association (MMUA), developed a survey to be completed by the 87 cities who own and operate municipal utilities. Information collected by the survey included the following:

- Does the municipal utility own and operate fiber facilities in their city?
- If not, does the municipal utility plan on placing fiber facilities in the future?
- How many miles of fiber infrastructure have they placed or plan on placing?

- Is this fiber infrastructure to be used only for the municipal utility's internal needs?
- Who are the entities, public and private, connected to this fiber infrastructure?
- What applications or uses are they running on the fiber?

The results indicate there are eleven municipal utility companies that have placed approximately 70 miles of fiber optic facilities in their cities located in Greater Minnesota. Ten of these fiber networks are connected to other public sector entities (city, county, K-12) in their cities. Six of these are connected to private entities in the city for internet access and private line transport. In addition to the above, nine municipal utility companies are considering placing their own fiber optic facilities in the future for their own use and possibly for public and private sector use also. The data regarding municipally owned facilities is visually depicted in Map 10.

The results of the survey indicate that municipal utility companies have not provided any significant competition to the incumbent telephone company in the past. The ten cities who are providing competitive transport only represent 11% of the total municipal utilities. Most have limited their connections to public sector entities only. Even if the additional nine cities install their own fiber, the number of municipal utilities providing competitive services would only be approximately 22% of the total who could. Therefore, even though municipal utilities may provide some competitive services such as private line transport and internet access in certain cities, this is not a significant statewide trend at the moment.

2. Cable Television Systems and Broadband

a. Surveys of Franchising Authorities

The Ventura Administration developed a survey to collect data on the existing cable systems from the municipalities that grant the franchises to their cable companies. Information to be collected included the following questions:

Name of Cable Company?

Upper operating bandwidth capacity?

Cable architecture?

Coaxial

Fiber-to-curb

Fiber-to-node

Number of video channels?

Number of Public, Educational, and Government (PEG) access channels?

Institutional network (INET) capacity?

Percentage of franchise fee?

Broadband modem service available and/or planned?

Plan to provide internet access?

Plan to provide local dial tone?

The survey was mailed to over 860 cities. The surveys were followed up by telephone calls by the Work Team. All or some of the desired survey information was

collected on cable operations in 855 cities. This information has not been verified by the Minnesota Cable Association.

b. Results of Cable Surveys

155 cities (18%) do not have a cable system. Map 11 presents this data. Residents who want entertainment services usually use a satellite dish to get the service. Most of these communities are very small towns or municipalities in Greater Minnesota.

- 700 cities (82%) are served by a cable system. (Map 12)
- 234 cities (27%) have or will have 750 MHz cable system capacity. (Map 13)
- 109 cities (13%) have broadband modem service available.
- 125 cities (15%) will have broadband modem service available.
- 106 cities (12%) plan on providing dial tone at some point in the future.

The following provides additional information regarding the cable industry in Minnesota and nationally.⁶ The National Cable Television Association (NCTA) reports the following about Minnesota's cable television picture:

- There are 364 cable systems in Minnesota.
- 1,480,433 homes are passed.
- There are 971,397 cable subscribers in Minnesota.
- There is 21,318 miles of cable plant in Minnesota.

There has been heavy news coverage of the AT&T merger with Tele-Communications, Inc. (TCI) and MediaOne. This primarily impacts the metro area and will provide direct competition to the incumbent telephone companies for internet access, long distance, and local dial tone services. In addition to this, there is merger activity in the cable industry in rural Minnesota. Bresnan Communications, ranked #34 in 1998, and serving approximately 63 cities in Minnesota, is merging with Charter Communications, ranked #8 in 1998, and serving 10 cities in Minnesota. The principal owner of Charter Communications is Paul Allen, co-founder of Microsoft Corp. Once all of his acquisitions are completed, the company will rank fourth in size among U.S. cable operators. Charter's cable systems will be used as a platform for such additional services as interactive television, high-speed internet access and voice communications. Other merger activity impacting rural Minnesota is that of Triax Telecommunications, ranked #24 nationally. Triax, the largest cable provider in rural Minnesota with approximately 105 cities, is merging into MediaCOM LLC, ranked #23 and who has a minimal Minnesota presence. Additional mergers among the cable companies in rural Minnesota can be expected in the future.

The above information indicates the cable industry is planning on being a significant player in providing telecommunication services. These include internet access, local dial tone, and long distance in addition to offering entertainment (cable/video) services. These services are currently being rolled out in the metro

⁶ See National Cable Television Association Web Site at www.ncta.com/glance.

area by MediaOne and Paragon Cable. In the next 2-3 years cable companies, particularly the larger ones, serving rural Minnesota may be offering these same services in competition with the local telephone companies and other telecommunications providers. The only exception to this may be those cable companies that are owned by the local telephone companies. For these communities, internet access as well as voice services are usually provided by the telephone company.

C. Status of Telecommunications Competition in Minnesota

1. Facilities-Based Competition

At the present time, facilities-based competition for local dial tone is minimal throughout the State. The Work Team surveyed telephone companies to determine the extent of facilities-based competition in the State. The results of the survey are visually depicted in Map 14. There are a few pockets where new competing fiber optic facilities are being overlaid in a geographical area served by an incumbent telephone company. Most planned overlays of competing facilities are to use fiber optic cable to the neighborhood that can be used for more than voice telephone service. Several smaller independent telephone companies, including North Star Access, owned by Sherburne Telephone, and Hutchinson Telephone, are reviewing the possibility of over-building facilities in adjoining areas currently served by the larger telephone companies such as U S WEST, GTE, and Sprint. They believe they can provide better service at a lower cost to the end user than the larger incumbent telephone company.

Facilities-based competition for telecommunications is rapidly being developed by the cable industry. The upgrading of the cable infrastructure will allow cable companies to provide entertainment (cable), high-speed internet access, local dial tone, and long distance over the same cable facility. This will be in direct competition with the incumbent telephone company. Most of this activity is in the Twin Cities area and a few cities in Greater Minnesota. Several of the cable companies in Greater Minnesota (except those owned by the incumbent telephone company) are developing plans to do the same thing in their franchise areas over the next 2-3 years.

The Work Team's research results and conclusions regarding the extent of facilities-based competition are consistent with the Federal Communications Commission's (FCC) latest statistics on the number of lines provided by large ILECs to CLECs as UNE loops as of December 31, 1998.⁷

⁷ FCC's Local Competition Report Table 3.3 (August 1999)

	<i>Total Lines</i>	<i># of UNE Loops</i>	<i>% of total lines</i>
<i>United States</i>	<i>172,452,000</i>	<i>361,000</i>	<i>.2%</i>
<i>Minnesota</i>	<i>2,878,000</i>	<i>2,000</i>	<i>.1%</i>
<i>U S WEST Regionwide</i>	<i>16,695,000</i>	<i>8,000</i>	<i>0</i>
<i>Ameritech Regionwide</i>	<i>2,1054,000</i>	<i>100,000</i>	<i>.5%</i>
<i>Bell Atlantic Regionwide</i>	<i>41,429,000</i>	<i>91,000</i>	<i>.2%</i>
<i>Bell South Regionwide</i>	<i>24,101,000</i>	<i>41,000</i>	<i>.2%</i>
<i>GTE Regionwide</i>	<i>17,008,000</i>	<i>23,000</i>	<i>.1%</i>
<i>SBC Regionwide</i>	<i>36,778,000</i>	<i>67,000</i>	<i>.2%</i>
<i>Sprint Regionwide</i>	<i>7,545,000</i>	<i>30,000</i>	<i>.4%</i>

Table 3 - Lines Provided By Large ILECs to CLECs as UNE Loops

2. Wireless Local Service Dial Tone Competition

Several telephone companies responded that they believe they face competition by wireless companies for local service dial tone. This is based on perception. There was no data available to the Work Team to confirm this. The data visually depicting where telephone companies believe they face competition from wireless carriers is set out visually in Map 15. The growth of wireless no doubt has come at some expense to the growth of wireline services since customers, particularly mobile ones, may be using wireless for their additional lines or as their only line. Customers may use wireless as their only telephone line if this meets their needs in the most economical manner. Several wireless companies have developed calling packages of hundreds of minutes of usage with no long distance charges for a flat monthly rate. Some advertise this service as the “only phone you need!” Whether this is true depends solely on the end user’s telecommunications needs and calling patterns. It may fit some perfectly, others probably not.

In the future, wireless technology will be a major competitor to wireline telephone service for certain customers who are mobile. These customers will also likely have substantial long distance usage. As costs decrease, fixed-base wireless technology may also be an alternative and competition to wireline providers to homes and small businesses, especially in low density areas. Minnesota Cellular has publicly stated that they will use fixed-wireless technology to offer a competitive universal service offering in Greater Minnesota.

While the overall market for long distance services has shifted markedly over the past 15 years, there has been a less dramatic shift in the market for residential long distance services. In 1997, the market share of residential access lines in Minnesota was broken down among the following toll carriers: AT&T had 66.4%, MCI had 19.5%, Sprint had 3.6%, and all other carriers had 10.6%. Nationwide, AT&T had 67.2% share of all residential access lines in 1997. Also in 1997, the market share of residential toll revenue in Minnesota was broken down among the following toll carriers: AT&T had 60.2%, MCI had 22%, Sprint had 5.2%, and all other long distance carriers had 12.6%. Nationwide, AT&T had a 60.9% share of the total residential toll revenue during 1997. While the FCC study appears to indicate that alternative toll carriers have made fewer inroads into the market for residential toll services than they have made in the market for business services, it is important to point out that a significant proportion of residential customers make few, if any, toll calls. This type

of low usage residential customer has little incentive to consider switching long distance carriers and, therefore, is more likely to be pre-subscribed to AT&T. Also, long distance carriers tend to target customers with higher usage levels, so residential customers with relatively low usage levels are less likely to be the recipients of direct marketing programs from toll carriers.

D. Telecommunications and Economic Development

Infrastructure investment has been essential to Minnesota's economic and business development and moving products from the farm or factory to the market has always been the lifeblood of our economic growth. To facilitate these shipments, we have spent hundreds of millions of dollars each year expanding and improving our traditional transportation networks -- railroads, highways and bridges and airports.

Although many of Minnesota's businesses will continue to depend on these vital transportation trade links, telecommunications infrastructure is needed for the growing number of businesses that produce and transmit information. In fact, nearly all businesses are becoming information-technology companies through their use of or dependence on telecommunications products and services. This rapidly growing consumer and business demand for information helped data surpass voice in 1998 telecommunications transmissions.

From a business operations perspective, advanced telecommunications infrastructure is an increasingly important consideration in determining where to locate a business. Most research suggests that after workforce availability, the quality of the telecommunications infrastructure is generally considered to be among the top site location criteria. This is especially true for companies that base site and operational decisions on global economic and business factors.

As companies face cost pressures, advanced telecommunications infrastructure offers an unparalleled degree of freedom to disperse operations to low-cost areas, sometimes to previously unimaginable locations. In a recent *Site Selection* survey, 58% of corporate real estate executives said technological advances are making their firms "less inclined to set up centralized locations and more inclined to establish smaller 'satellite' facilities located in relatively remote locales" (i.e. rural areas). Telecommunications helps these decentralized operations to have closer connections than today's centralized facilities. For example, private intranets for business communications are one way corporations are using electronic links and telecommunications to maintain close contact with worldwide operations and suppliers.

Although businesses in certain areas of Minnesota are served by an advanced telecommunications infrastructure, other areas are not equipped to effectively compete in the business expansion and location market. Numerous domestic and international competitors including Europe (especially Britain), Singapore, South Korea, Taiwan and Hong Kong are well positioned to offer high-quality telecommunications services to businesses which will spur economic growth. These competitors offer concentrated areas of high-quality services and also are devoting billions of dollars to implement the next generation of telecommunications. This is especially problematic as Minnesota businesses look to expand in non-metropolitan areas to reduce costs. Telecommunications is the new infrastructure foundation and an advanced system is essential for any economy (or company) to successfully compete in the modern global economy.

III. THE NEED FOR REGULATORY REFORM

A. Traditional Rationale for Government Regulation of Telecommunications Services

1. Review of Regulatory History and Principles

The United States economy is commonly thought to be based on principles of competition and private enterprise. However, American law and economic theory have also long recognized that effective competition does not exist in certain industries, raising the specter of evils such as extortionate monopoly pricing, manipulative restrictions on output, poor quality service, and invidious price discrimination. For those industries that are also “affected with a public interest,” extensive legislative and judicial regulatory frameworks have been developed to protect the public from such evils. These types of industries have become commonly known as “public utilities.”⁸

Public utilities have also enjoyed legal protections not afforded to most other businesses. Public utilities have enjoyed government approval of the reasonableness of utility prices. Through rate of return regulation, government assures that a public utility will receive a reasonable return on investment.

Another legal protection afforded to telephone companies is the “filed rate doctrine.” This doctrine holds a telecommunications service provider’s customers to any rates filed with the appropriate governing authority.⁹ It does not matter whether the customer knows about the tariff. Even if a carrier has made promises to a customer contrary to the tariff, the doctrine serves to shield carriers from all contract claims brought by customers against a telecommunications service provider.¹⁰ The purpose of the doctrine is to protect consumers from unreasonable prices and price discrimination.¹¹

In Minnesota, the filed rate doctrine exists by virtue of the MPUC’s procedural rules.¹² Once an initial rate or rate change is filed, MPUC rules set forth a strict time frame for comments and reply comments. Once a final order of the MPUC is issued, rates are presumed to be found reasonable by the MPUC, and not subject to challenge.

Public utilities are also granted a right of eminent domain in most states. This gives the utility the right to condemn private property for “public purposes” when necessary to the conduct of public utility business. Public utilities are required to pay a reasonable price for such private property.

Federal and state laws have also protected incumbent telephone companies from competitors. Laws have maintained rates at artificially low levels, preventing market forces from working to create incentives for competitive entry. If a telephone company’s rates could never rise too high, giving a consumer a reason to switch tele-

⁸ See generally, Charles F. Phillips, Jr., The Regulation of Public Utilities, 89-91 (3d ed. Public Utilities Reports, Inc. 1993).

⁹ See generally, Hank Brands and Evan Leo, The Law and Regulation of Telecommunications Carriers 150 (Artech House 1999).

¹⁰ Id.

¹¹ See AT&T v. Central Office Telephone, 118 S. Ct. 1956, 1962 (1998).

¹² See Minn. Rules 7827.0300, 7829.1400, .3000.

phone companies, the prospect of a competitor stealing away a customer was unlikely. State and local laws reinforce this implicit government sanctioned exclusivity by generally requiring competitors to obtain franchises and certificates of convenience and public necessity in order to provide service in a particular area. While not exclusive, these legal mechanisms protect public utilities from competition in their service area.

From its earliest modern origins, the telecommunications industry in the United States was viewed as being uniquely situated. First, it was deemed “in the public interest” to link the people through communications networks, wherever situated across the Nation, as quickly as possible. Second, it was recognized that significant incentives were required to encourage the massive investment in infrastructure required to bring this about. The regulatory framework constructed was designed to accomplish this, by tolerating and indeed nurturing a telecommunications monopoly.

The toleration of monopolies was deemed “in the public interest” because a duplication of effort associated with competition in telecommunications service would be unduly expensive and redundant, and would not assure that telecommunications service would be made available to the population at large (“universal service”). In particular, it was argued that the entry costs in fixed capital investment were economies of scope and scale such that a duplication of facilities would increase unit costs and hence prices to the consumer.

Once these premises were widely accepted, it became easy to condone the telecommunications monopoly, and to limit competition. At this point, it then was further deemed “in the public interest” to establish the regulatory framework that would assure that these monopolies worked to achieve the desired objectives of universal service and reasonable pricing.

In the telecommunications field, it became important to promote continued expansion and modernization of the network by assuring that carriers would realize a return on their investment in equipment. In the United States, and indeed throughout the world, the regulatory scheme established a revenue structure that provided the monopolies an established “rate of return,” representing profit in excess of investment in the network, less depreciation (the “Rate Base”), plus operating expense. Note that this “rate of return” regulation is tied to assets and investment. As telecommunications traffic increased over existing networks, the monopolies were compelled to invest further in modernizing and expanding the network. This increased investment then became the basis for an upward adjustment of revenue rates, with the monopolies always capturing a guaranteed profit, or rate of return, above the investment made. Increases in communications traffic and service demand required increases in investment, leading to increased tariffs and higher charges to customers. The tariff adjustment cycle was never-ending.

The system leaves much to be desired, since the monopolies essentially are rewarded with higher tariff rates for maximizing expenses, not for minimizing costs as in a competitive business. This is because the rate of return is firmly tied to expenses. This made some sense while universal service continued to be a significant objective. However, the system provides few incentives to hold the line on costs.

The agreement between AT&T and the United States District Court in 1984, commonly known as the Modified Final Judgment (the “MFJ”), transformed the telecommunications industry. It was the first significant effort to break up the old

monopolies, and the inefficient subsidies that had developed between local and long distance service and revenue generation.

The intent behind market segmentation under the MFJ between regulated local monopoly services and unregulated competitive services in long-distance was to stop AT&T from using its local service as a bottleneck to long distance competitors, which had found it difficult to gain access to the local network for purposes of placing and terminating calls. The Bell System breakup coincided with a fundamental overhauling of the long-established telephone industry pricing and cost-allocation schemes. Real effort went into reducing the cross-subsidy burdens previously placed on the users of long-distance services by shifting those burdens to local telephone subscribers.

The history of the telecommunications industry reminds us of the importance of viewing the public switched telephone network as a public trust. It was built on the backs of captive ratepayers, with little investment risk due to nearly guaranteed returns on investment and a system of regulation that perpetuated the monopoly. Since the divestiture of AT&T, the Regional Bell Operating Companies (e.g., U S WEST) have become increasingly proprietary in attitude about the networks they inherited. It is this attitude which has led to many of the difficulties in implementing the pro-competitive provisions of the Telecommunications Act of 1996 (1996 Act). It also provides the justification for singling out RBOCs for the regulatory purposes discussed below – at least until there is an objective determination that the residual effects of their historic monopoly status have been eliminated.

2. Market Failure as the Principle Justification for Regulation

The layperson thinks of “competition” much differently than the economist. For example, the layperson might believe that “competition” is effective when there are a large number of firms providing the same good. Under the layperson’s understanding, protecting competition might mean advocacy of laws that prefer a market structure of numerous, high-cost firms over an alternative of fewer, larger, yet more efficient firms charging lower prices.¹³

But economists measure effective competition in a much different way than a lay person. While a large number of competitors may be an indicator of a healthy market to a lay person, to the economist, a market is competitive when the market price is driven toward economic cost and producers are forced to adjust their production processes in order to produce at the lowest cost.¹⁴ In general, policy makers find that regulation of an industry is necessary when the competitive market fails or the public health, safety, or welfare is threatened.

For example, some businesses operate in an economic environment where competition cannot exist or survive for long, creating the need for government regulation. In this environment, unregulated competition will not produce competitive results (i.e. price competition, quality of service).

Non-competitive markets are determined by economies of scale. Economies of scale can ultimately create an inherently non-competitive market because a firm can, in

¹³ See generally Phillip Areeda & Herbert Hovenkamp, I Antitrust Law 3 (1997).

¹⁴ It is important to remember that the economist's concept of "cost" is "economic cost" which includes a reasonable return on investment necessary to attract new capital to the firm.

the long term, decrease its average costs by expanding its output capacity and its output. In this position, economies of scale allow the firm to underprice all other competitors if it can supply the entire market at a lower cost than any other firm can provide. The goal of the 1996 Act was to leverage economies of scale to benefit the public by requiring telephone companies to share their “public trust” with other carriers who can offer competition on price, innovation, and service quality. That is the reason it is important to view the 1996 Act as both pro-competitive and *regulatory*. Sometimes you have to regulate before you can deregulate.

Imperfect markets are also viewed as a market failure. The primary example of an imperfect market is an oligopoly (i.e., a few sellers) with implicit or explicit collusion. An imperfect market may be characterized by ruinous or cut-throat competition, resulting in weaker businesses being phased out, with only a monopoly or an oligopoly remaining. Imperfect markets may also be characterized by the presence of price discrimination. Price discrimination occurs when a seller establishes different rates for the same product or service that are not justified by differences in the cost of providing the product or service.

A competitive market is not a panacea to all social problems. In fact, competition sometimes worsens existing social problems. Competition does not remedy inequalities caused by disparate skills, bad luck, geography, terrain, or other forces external to the operation of the market.

Public utilities may operate in competitive markets; but, for public policy reasons, the legislature decides that regulation is warranted, even if it interferes with the efficient operation of the market. These “externalities” justifying regulation can be negative or positive. For example, without regulation, certain pollution or health effects from production are not internalized into the cost of the firm, but left as external costs to be borne by society as a whole. Regulations requiring internalization of these externalities is a typical economic regulatory response that utilizes the market to assist in remedying the social ill. Some external costs are so serious that the regulation has to be direct. An example of this is nuclear energy, which is regulated because of its potentially harmful effect on public health, safety, and environment.

An example of positive network externalities justifying regulation is illustrated by looking to the production of services using a network. The addition of person A to the telephone network creates benefits not only to person A, but also to other persons and firms that can then more easily contact person A. Internalizing this external benefit, by subsidizing the addition of A to the network, is an economic justification for universal service subsidies.¹⁵

3. A Brief History of Regulation in Minnesota

Minnesota’s telecommunications regulatory framework first developed from laws drafted by the Minnesota Legislature in 1915.¹⁶ At that time, several thousand local telephone companies operated throughout the state, with many city residents facing a choice of multiple telephone providers.¹⁷

¹⁵ See generally, Brands & Leo, *infra*, at 19-20.

¹⁶ The Minnette Bill introduced regulation of telephone companies. Connecting the North Star State, Minnesota Telephone Association, p. 143.

¹⁷ *Id.* at 225.

Many observers, in Minnesota and elsewhere, complained that an unfettered telephone market had generated inefficient and spotty service that was unaffordable to many citizens and was totally unavailable in some (mostly rural) locations. City residents observed several companies that erected telephone poles and wires on the same streets, yet could not provide a service that was interconnected to the point that a customer of Company 'A' could call a neighbor who was served by Company 'B.' Poorly capitalized companies began serving larger metropolitan areas first, because they believed that approach to the business was the most likely to generate a quick stream of cash. Some firms failed to survive under the circumstances, creating financial pain and inconvenience for those customers who had established service with them.

Ultimately, political leaders in the United States concluded that the telephone market held the same 'natural monopoly' characteristics as did the electric industry and the railroad industry.¹⁸ Persuasive advocates, such as the leaders of AT&T, convinced the public that better service would be provided at more reasonable rates if a single firm was granted a monopoly franchise to serve all credit-worthy consumers of any community. In order to prevent consumers from abusive pricing practices, poor service quality or discriminatory service provision, public agencies were created to oversee many detailed aspects of the monopolist's business. Regulatory oversight of telephone companies in Minnesota was first granted to the Railroad and Warehouse Commission (RWC), an agency that already had similar oversight responsibilities regarding the transportation and grain marketing industries.

After 1920, the era of rate based rate-of-return regulation began in earnest in Minnesota. The RWC's actions generally complemented federal telecommunications regulations that started with passage of the federal Communications Act of 1934. The RWC eventually embraced a role as a regulator of prices, of service quality, and of expansion of service to nearly every residence in the State.

Relatively little legislation concerning the regulation of telephone companies was passed by the Minnesota Legislature from 1920-1983. The RWC evolved into first the Minnesota Public Service Commission and then both the Department of Public Service and the MPUC during this time. The MPUC established more precise service territory maps in the 1960s; approved numerous mergers and sales of telephone exchanges; reviewed rate increase requests from time to time, and; gradually expanded toll-free calling areas in many parts of the State as suburbs were developed and the concept of the "Twin Cities" acting as a single metropolitan area became accepted.

Beginning in 1983, the Minnesota Legislature took a more active role in shaping regulatory practices in Minnesota. This coincided with the implementation of the MFJ. It also reflected the ongoing development of competition in the long-distance market, as facilities-based competitors began to attract significant market share from AT&T's long distance business.

Over the past 15 years, Minnesota's laws have been changed in an effort to: reduce regulatory time lags, particularly for requests to reduce prices; expedite the review of citizen requests to expand toll-free calling areas; provide local telephone companies

¹⁸ *Id.* at 227. Even the Minnesota Telephone Association became a supporter of this view, after years of opposition to government regulation of their industry.

with alternative methods of price regulation that do not “punish” telephone companies for becoming more efficient by forcing them to justify their profit levels in a formal legal proceeding; deregulate long distance (“toll”) rates; and encourage the development of competition in both toll markets and local markets.

Regulatory agencies throughout the United States are now attempting to cope with numerous challenges brought on by the passage of the 1996 Act, as well as the technological and financial developments that arise when cable services, internet services, wireless services and telecommunications services become integrated through mergers and other business alliances. The 1996 Act attempts to enhance the development of local telephone competition by providing incentives that would spur a certain amount of cooperation between ILECs and CLECs.

Section 271 of the 1996 Act describes the conditions under which a Regional Bell Operating Company (RBOC) may enter the interLATA long-distance business in any state where it now serves on the local level. Congress intended that each RBOC be allowed to compete in the long-distance market only after the RBOC established operating procedures that did not prevent local competitors from entering the RBOC’s market. The expectation was that this *quid pro quo* would establish new competition in both markets, to the benefit of consumers. The procedures adopted under this law direct an RBOC to file a petition with the appropriate state public utilities commission. In its filing with state regulators, the RBOC must prove that the company has opened its network to its competitors to the extent necessary for local competition to flourish. If state regulators agree, the RBOC may then file for final approval from the Federal Communications Commission (FCC). The Department of Justice then reviews these filings, and reports its recommendations to the FCC. To date, no RBOC has been granted approval to enter the long-distance market, although in a few cases the state PUCs have recommended approval. U S WEST Communications has not requested a state review of its section 271 eligibility in Minnesota.

The 1996 Act imposed different obligations on the RBOCs than it did on smaller independent telephone companies. This was a reaction to concerns that competitive entry in rural locations would create extreme financial hardships for small incumbents, and might cause the discontinuation of all service to many isolated farms and ranches. Because RBOCs tend to serve most of America’s larger municipalities, the development of local competition was expected to develop more slowly in rural communities. However, in Minnesota, wireline and wireless local competition has blossomed in many small rural communities previously served by U S WEST. Other competitors, most of whom cater to business customers, serve parts of the Twin Cities, Rochester, St. Cloud and Duluth. One surprising development has been the fact that certain residential consumers in smaller towns, such as Marshall, have been presented with a choice of multiple local service providers at a quicker rate than residential customers in Minneapolis and St. Paul. It is also interesting to note that these competitors have used overbuild strategies rather than purchasing unbundled network elements (UNEs) from the ILEC.¹⁹

In general, consumers have benefited greatly from changes in regulatory policies, improved technology and reduced prices for telephone services in the past twenty years. The prices of pagers, cellular services, fax machines, and computers have

¹⁹ See discussion of UNEs at pp. 72, 75, 77-78, 81 and 93 of this Plan.

fallen to the point that they are well within the reach of most of the households in Minnesota. Minnesota is continually among the top fifteen states in terms of the proportion of households that have at least one operating telephone.²⁰ Competition in the long distance market, along with other factors, has reduced the price to as little as five cents per minute for consumers who make frequent toll calls. And federal programs that provide internet access to our nations' schools have expanded the learning experiences for many students, no matter what their economic circumstances may be. However, the welfare of certain consumers has not improved as a result of these developments, and in fact may have been hurt by them. Citizens who subscribe to flat-rated local service but make no toll calls have been alarmed by increased fees on their monthly bills. These increases are likely to continue, and may even escalate, as competition drives prices closer to true economic costs. A successful transition to local telephone competition will ultimately be judged on the basis of whether consumers realize savings, obtain better quality service than they had under the old regulatory framework, and have access to competitive and advanced telecommunications services.

B. Technology's Impact on Telecommunications Regulation

Minnesota's current telecommunications laws represent a collage of legislation overlaid on the original laws enacted in 1915. To put this in perspective, the invention and commercialization of the telephone occurred in the 1870's, and Minnesota's current telecommunications statutory framework was established only 40 years after the invention of the telephone. It is a gross understatement to say that much has changed since 1915.

1. The Evolution of the Telephone Network

The telephone network most Americans use today works on the same fundamental concept it always has – circuit switched technology. Today, switching technology is fully digital.

The local loop, being that area of physical connection between a user's premises and the telecommunications network, represents a bottleneck in the evolution towards advanced broadband services. The loop is largely comprised of twisted copper pairs, with electronics designed to transmit narrowband signals -- voice and low-speed data -- from users through the central office (CO) switch. With increasing demand for higher speed data transmission, service providers are faced with the task of finding economic means to leverage their costly installed base of copper in the local loop. Upgrade investment in the local loop represents the most significant expenditure of any network segment, given that the local loop represents the most mileage in the network and is often the oldest segment. Thus, service providers have sought out technologies that will prolong the life of the legacy copper plant, while still engaging in higher levels of services.

Although technologies such as certain forms of DLC, xDSL and HFC are being deployed currently for the purpose of extending the life and capabilities of the existing local loop infrastructure, it is clear that deployment is not occurring in a timely fashion. This is due in part to continued resistance among ILECs to freeing access to their local loop infrastructure on an unbundled basis. This resistance is not entirely surprising. There is significant risk associated with the unbundling requirements of the

²⁰ Bureau of the Census, Current Population Survey Branch, February 22, 1999. See Appendix H.

1996 Act. The economic reality is that an ILEC may find it easier and less expensive to explore long distance markets for new revenue sources than to assist competitive growth in local markets by unbundling its copper plant. The long distance business is less capital intensive, and its financial rewards may be more immediate, than upgrades to the local loop. By entering long distance before local upgrading, therefore, local service providers which already have a substantial local infrastructure investment see opportunities to secure new revenue before being required to further invest.

With these principles at issue, strategies frequently are employed by ILECs to limit local loop development. These strategies are varied, but typically include the following: dramatically lowering prices on interconnection agreements for T1 service (1.544 Mbps) as a means to avoid having to unbundle local copper; imposing limits on construction of capacity in “popular” COs so that there is limited co-location space for unbundling; demanding that all co-location equipment be certified through a needlessly lengthy and complicated process; and demanding “spectral-compatibility” among component parts of the network, when there are no compatibility specifications. The use of such strategies, irrespective of whether or not they are warranted, has had a dampening effect on the growth of competition in the local loop, and on the expedient deployment of technologies with advanced telecommunications capability.

Today, there are really only four ways in which new service competitors may gain access to customers in the local loop. First, they may resell services purchased from incumbent service providers, which can be prohibitively costly and limited to resale services offered by the ILEC. Second, they may build wholly new facilities, which again is economically unsettling, particularly in geographically dispersed markets for small businesses and residential customers typically targeted by new competitors. Third, they may lease T1 lines from the ILECs, which is now the preferred method for gaining local access. Fourth, they may secure access to unbundled segments of the local loop, which is clearly the most economical access strategy, except that it is extremely difficult to obtain access from ILECs.

2. The Digital Era

Perhaps the most important technological change to occur this century is the development of digital technology and the internet. Data, voice, and video signals can all be transported digitally. Digital transmission is extremely flexible and dynamic. It can be used asynchronously – that is, data may be transmitted at irregular timing intervals. Digital data can be delivered ubiquitously with “packet-switched technology.” Digital signals can be tagged with differing levels of priority to take different delivery paths. For example, digital signals for a video conference can be tagged as “high priority” to ensure that video signals are not degraded. Digital signals can also be directed to follow a certain transmission path. Digital signals can be converted to analog and back to digital again to allow information to originate and terminate between a wide variety of end user equipment.²¹ Digital information can be easily indexed, categorized, and searched.

The internet can best be described as the world’s largest computer network. The topology consists of three discrete layers: (i) the application layer; (ii) the network layer; and (iii) the physical layer. The application layer consists of software on both

²¹ For example, a fax machine works with analog technologies on both ends and digital technology in the middle.

ends of an internet communication. At the end user's premises, there is a "client" server. The client server essentially sends out a request for information ("I want to access Yahoo's web page."). At the click of a mouse, that request is sent out in the form of "packets" over the "physical layer" of infrastructure – the local exchange system, or cable system, which delivers the request to a central office, in the case of a telephone system, or a head end or hub, in the case of a cable system. In the case of a high-speed service provider, the high-speed service boosts speed of delivery to the head end or central office, it does nothing to improve the speed of a signal once it is relayed out of the head end or central office to the network layer. At the head end or central office, the Internet Service Provider (ISP) has installed a router. The router relays the packets ubiquitously to an interconnected network of other routers, each of which is capable of determining where to send the data packet in order to reach its destination. To travel interstate or internationally, the packets are routed over one of several national backbone networks. The backbone network delivers the request through regional and local networks, ultimately to a server on the receiving end, which reassembles the data packets and submits the request. The server completes the request ("Here is the Yahoo! home page.") and sends it back over the same network to its origination point.

The technology of long haul transport has also changed. Prior to 1960, transport was accomplished with the use of large copper trunks and microwave analog toll circuits. These technologies had severe limitations of capacity and were very expensive to use. Fiber optics changed the technology of long haul transport forever. Unlike microwave technology, fiber optic lines have much more capacity than microwave and copper circuits, and carry signals at a fraction of the cost of microwave and copper.

3. Cable Television Technology

Compared to the telephone network, cable television technology is an adolescent. Cable television technology began after WWII and the emergence and popularity of television. For many television lovers, reception over the air was poor. Broadcast towers were not powerful enough to provide clean signals to television watchers throughout the country.

Cable television started as a system of community antennas. Line-of-sight antennas were built in communities unreachable by over-the-air broadcast signals. Coaxial cable brought the broadcast signals to homes. Cascades of line amplifiers provided the power to get the signal from the antenna to the home. The early cable systems carried only 5 VHF channels.

Television sets spurred the use of the UHF spectrum. Cable technology research had identified a spot between VHF channels 6 and 7 where up to nine standard 6 MHz channels could be located. The only problem was that a standard television set could not tune these channels. This led to the development of the set top converter box.

Channel capacity continued to expand due to improvements in the quality of cable and amplifier technology. The first major "standard" for the cable industry was the 300 MHz cable system, capable of providing 36 standard analog channels.

Cable television system capacity has continued to expand. Improvements in cable system architecture have driven these improvements. Coaxial cable architectures are being upgraded to fiber optic coaxial systems (HFCs) that increase capacity. HFCs can also carry signals farther than coaxial cable systems could, eliminating the need

for long amplifier cascades and microwave relays, that tended to degrade audio and visual quality. With fiber optics, most cable operators are building cable systems with an upper operating bandwidth capacity of 750 MHz, the equivalent of 110 analog channels.

Most early cable systems were one-way systems, which did not send signals “upstream” (back to the head end facility). When upstream capability was developed, local government and educational authorities often requested the ability to utilize the upstream capability to insert and distribute local “access” programming to their community.

There are three major milestones on the horizon for the cable industry. First, digital technology will allow cable operators to expand bandwidth and provide high resolution video programming to consumers. Current digital compression technology allows 12 analog channels to be transmitted over the same 6 MHz spectrum allotment as one analog channel is today. Theoretically, that multiple of 12 would increase the channel capacity of a 750 MHz cable system from 110 channels to 1320 channels. Second, cable system interconnection and improvements in the efficient use of bandwidth spectrum are allowing cable operators to provide voice service over cable systems. Third, advances in cable modem technology along with the efficient use of bandwidth are allowing cable operators to position themselves as providers of high-speed data services.

4. How Technology Has Surpassed the Law

- a. Chapter 237. Well crafted definitions are the building blocks of any effective legislation. It is here that fundamental regulatory distinctions are established, which carry over into every other aspect of the regulatory framework. The Ventura Administration believes that these definitional building blocks should be service based to ensure that identical services are regulated in the same fashion. Regulatory distinctions should not be based on the technological platform used to provide a service.

Section 237.01 does not contain a single definition of a service. The absence of service based definitions coupled with advances in technology, and the phenomenon known as “convergence,” create unnecessary, yet fundamental regulatory issues, which could be easily eliminated with service based regulatory definitions. For example, it would be very difficult to determine today how high-speed data services provided over a cable modem platform should be regulated under Minnesota law.²²

- b. Chapter 238. Like Chapter 237, Chapter 238 does not contain a single definition of a service. Local franchising authority jurisdiction attaches to any “cable communications system.” Section 238.02, Subd. 2 could be interpreted to mean that any service provided over a “cable communications system” is subject to local franchising authority (LFA) jurisdiction. Again, these definitions are extremely

²² See pp. 31-35 for a more detailed discussion of this issue. It should be noted that section 237.01 also contains important definitional distinctions between local and long distance carriers.

important and carry over to every other aspect of the cable regulatory framework.²³

Other provisions under the Minnesota Cable Act refer to technologies that are obsolete. For example, there is little use for the term “master antenna television system,” defined in section 238.02, Subd. 7. Another example is the minimum operating bandwidth standard set forth in section 238.084, Subd. 1(m). 72 MHz, or 12 channels, is an unacceptable standard for any cable television system operating within the State, given the availability of digital compression technology, and other equipment that should allow even the smallest community to have a franchised cable system with an upper operating bandwidth of at least 300 MHz.

This is not an exhaustive list of the provisions under Minnesota law which need to be revised or rewritten due to advances in technology. However, these provisions indicate how definitions and other technological distinctions in the law can result in mines on the playing field around which regulators and the industry must delicately navigate. As explained further below, these problems can be eliminated.

C. Federal Regulatory Reform Has Changed the Role of States

In 1996, federal law underwent a fundamental and dramatic overhaul. The stated purpose of the 1996 Act was to stimulate the development of competitive and advanced telecommunications services, assure the development of telecommunications systems with optimum technology, and achieve maximum penetration of these services throughout America as rapidly as possible. The spirit of the 1996 Act was deregulatory and pro-competitive. The 1996 Act redrew the lines of state and local governmental regulatory authority over cable and telecommunications service providers.

Federal, state and local laws implementing the 1996 Act will be tested in the courts, at the FCC, and in Congress, and the law will not stabilize in the foreseeable future. The State faces the challenge of developing a flexible regulatory structure in the midst of constantly changing law and technology without discouraging development of telecommunications infrastructure.

While the telecommunications industry must be subject to some form of governmental regulation, it must also be protected from unreasonable regulation. The State must develop a telecommunications policy designed to promote the rapid but stable development of the local telecommunications infrastructure in a manner that protects the public interest. The State must also assure the availability of high quality plain old telephone service (POTS) to all consumers throughout the State, while also assuring the deployment of technologies with advanced telecommunications capabilities in a reasonable and timely fashion.

²³ Section 237.79 provides that “a telephone company providing cable television services shall, with respect to provisioning of those services in Minnesota, be subject to the same franchise requirements, procedures . . . as a cable communications company under Chapter 238.” Minnesota law does not define “cable television services.” The franchising requirement under Chapter 238 only applies to “cable communication systems,” not to any person providing “cable television services.” Although these may seem like “technicalities” and the spirit of the law may be clear, these two sections provide an example of how the “convergence” of the cable and telecommunications industries could provide great fodder for lawyers if the definitional sections under these two chapters are not cleaned up.

D. What Other States Are Doing

States have adopted a variety of models for implementing telecommunications regulatory reform since the passage of the 1996 Act. All post-1996 Act state regulatory frameworks have been developed with common purposes. Every state wants to: promote competition, keep rates low, ensure high quality service, protect consumers, promote universal service, and promote universal deployment of infrastructure and advanced services. The difference is in the paths different states have taken to reach these goals. The Work Team studied the telecommunications regulatory frameworks in Nebraska, Texas and New York. A comparative analysis of these states' regulatory frameworks is included in Appendix D to this Plan. The Work Team also studied the cable regulatory framework of Connecticut. This discussion is included in Appendix E to this Plan.

IV. BUILDING A NEW FRAMEWORK FOR TELECOMMUNICATIONS REGULATION IN MINNESOTA

A. Focus on Essential Services and Competitive Markets

The Ventura Administration asserts that the level of regulation placed on telecommunications services should correlate to two primary factors: (I) the extent to which the market for the service is competitive; and (II) the degree to which a service is “essential.” These two criteria form the foundation for the Ventura Administration’s local competition regulatory framework discussed in detail in Section VIII of this Plan.

<i>Essential/ Non-Competitive = Non-Qualified Companies</i>	<i>Essential/ Competitive = Qualified Companies</i>
<i>Non-essential/ Non-competitive = Light Regulation</i>	<i>Non-essential/ Competitive = Deregulated</i>

Table 4 - Local Regulatory Framework

1. Competitive Markets²⁴

To demonstrate that a market for a particular service is competitive a two part test should apply. First, the petitioner should have to prove that “actual competition” exists in that market. The Ventura Administration asserts that “actual competition” exists when one or more competitors are offering some quantifiable degree of competitive services to the customer base in the relevant service area. Under this test, the Ventura Administration recommends that the FCC’s definition of “offered” be applied. That is that a competitive service is deemed “offered” when the incumbent proves that a competitor is: (I) Physically able to deliver service to potential customers, with the addition of no or only minimal additional investment by the competitor, in order for an individual subscriber to receive service; and (II) When no regulatory, technical or other impediments to customers taking service exist, and potential customers in the service area are reasonably aware that they may purchase the services of the competing service provider.²⁵

The second element of the test should require an incumbent monopolist to demonstrate that its network is completely and irreversibly open to competition, applying a test akin to the 14-point checklist set forth in the 1996 Act.²⁶ This showing would as-

²⁴ The Ventura Administration uses the term “competitive” here merely as a label for convenience in referring to a category of services under its proposed local competition framework. The label is not meant to indicate anything about the degree of competition in a particular market.

²⁵ See 47 C.F.R. § 76.905.

²⁶ 47 U.S.C. § 271 (1998). Section 271 sets out the following competitive checklist requirements: (i) Interconnection; (ii) nondiscriminatory access to network elements; (iii) nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates; (iv) local loop transmission from the central office to the customer’s premises, unbundled from local switching or other services; (v) local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services; (vi) local switching unbundled from transport, local loop transmission, or other services; (vii) nondiscriminatory access to 911 and E911 services, directory assistance services, and operator call completion services; (viii) white pages directory listing for customers of other carriers’ telephone exchange service; (ix) nondiscriminatory access to telephone numbers for assignment to the other carrier’s telephone exchange service customers; (x) nondiscriminatory access to databases and associated signaling necessary for call routing and completion; (xi) interim telecommunications number portability through remote call for-

sure regulators that an incumbent monopolist's behavior would always be checked by "actual competition" *and* the threat of easy competitive entry.

2. "Essential" Services

The Ventura Administration believes that "essential services" are those which are "affected with the public interest."²⁷ The Ventura Administration asserts that services meeting this test are those which have become vital to the public health, safety, or welfare. These are services upon which the consumer, whether a business or a resident, is dependent upon for personal or economic security, and survival – either in the marketplace or in the home. These are services which the consumer would become desperately willing to obtain in a supply shortage.

A corollary concept is the anti-trust doctrine of "essential facilities." Federal law defines "essential facilities" for anti-trust purposes as "those facilities that competitors cannot practically duplicate and that are otherwise unavailable."²⁸ While the law does not provide that a facility need be indispensable to be essential,²⁹ it is usually a new technology that creates an initial demand for a new service. In some cases, the new technology is so useful and important, that a collective, gradual societal commitment to incorporate the new technology into the fundamental infrastructures of society occurs. This collective societal commitment creates consumer dependence on the providers of the service. This collective decision means substantial investment by consumers in equipment and facilities, allowing the consumer to use the service to its optimum efficiency. The public interest is at a great risk when the presence or prospect of a monopoly provider of an essential facility is introduced into this scenario. Society is at the mercy of the monopoly provider because it is a bottleneck facility. The old infrastructure may no longer be available for use, new infrastructure and investments run the risk of becoming stranded, and society becomes desperately willing to purchase at any cost because it has no other choice. This gives the monopoly owner of an essential facility the ability to manipulate output and exact unreasonable prices for services provided over that essential facility.

The Ventura Administration asserts that basic local telephone service is an essential service and the telephone network is an essential facility. Our society has become dependent on the need for access to basic telephone service. The telephone network has become the single most important communication tool in American society. The public relies on the telephone network for transmitting emergency telephone calls and daily business. A national infrastructure has been built to facilitate communications over the telephone network. Businesses have invested heavily in telephone related technology, including the fax machine and the modem. Access to basic telephone service is essential to the public's health, safety, and welfare.

The Ventura Administration also recognizes, however, that data transport services are necessary in Minnesota today. Key issues of economic development and the need

warding, direct inward dialing trunks, or other comparable arrangements; (xii) nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity; (xiii) reciprocal compensation arrangements; and (xiv) telecommunications services available for resale.

²⁷ See discussion at pp. 26-28.

²⁸ See AT&T v. City of Portland, CV 99-65-PA (D. Ore. June 3, 1999). (The court referred to the term "essential facility" as a "term of art" for the purposes of anti-trust law.)

²⁹ See generally, David Hjelmfelt, Antitrust and Regulated Industries 140-148 (Wiley Law Publications 1985).

for data communications dictate that data communications capability be recognized as essential. The Ventura Administration will strive to assure that to every reasonable and prudent extent advanced telecommunications will be made available to communities throughout the State.

The Ventura Administration proposes that the Legislature direct the MPUC to complete a rulemaking within six months after the effective date of any telecommunications regulatory reform legislation for the purpose of determining which telecommunications services offered within the State are essential. This approach recognizes the changing nature of telecommunications services, as described above. Services that are essential today may not be essential tomorrow. Services that are not even known about today may be essential to our children tomorrow. Further, a rulemaking approach for determining whether services are essential or not recognizes that there are many flavors of telecommunications services being offered today. Administrative efficiency dictates that these decisions be delegated to the MPUC for rulemaking.

B. A Need to Update Legal Definitions

1. Service Based Definitions

The Ventura Administration's principles of technology and competitive neutrality require that similar services be regulated in the same manner, regardless of what technological platform is used to provide the service. To develop a regulatory framework that adheres to this principle, it is necessary to examine the nature of the service provided by the cable and telecommunications industries, ascertain technical distinctions between services, identify distinctions in services and providers created by federal law, and categorize services based on these distinctions. The Work Team has developed a comparative analysis of current federal and state definitions of services, which is attached as Appendix F to this Plan. Services should be categorized taking into account their immutable technical and legal characteristics before deciding how they should be regulated. The Ventura Administration posits that there are essentially two types of services currently provided by the cable/telecommunications industry: (I) Programmed services and (II) Common carrier services.

a. Programmed Services

The important technical characteristic that distinguishes programmed services from common carrier services is that the provider of a programming service *controls the content* of the information delivered to the consumer. For example, historically a customer has not had the ability to choose video programming channels provided by a cable operator on an a la carte basis. A consumer cannot purchase The Golf Channel if his or her cable operator does not offer that program over its cable system. A consumer cannot pick CNN and reject ESPN if the cable operator chooses to offer those channels as a bundled package.

Another test for determining whether a service is a programmed service or a common carrier service is whether the service provider enjoys First Amendment protection with respect to the content of the message being delivered. A cable operator has First Amendment rights over the content of its programming. A common carrier enjoys no such protection.

The Ventura Administration believes the federal definition of "telecommunications services" should be incorporated into Minnesota statute. Congress's defini-

tion of “cable service” incorporates the “programmed service” concept described above, which is easily distinguished from common carrier services. Moreover, the Ventura Administration believes federal and state law should be consistent with respect to these fundamental definitional issues.

b. Common Carrier Services

Common carriers services have a quasi-public character.³⁰ A service has historically been referred to as a common carrier service if there is an undertaking by the service provider to carry a tangible or intangible good for all people indifferently.³¹ The second traditional element of a common carrier is that the good being carried is of the customer’s own design and choosing.³²

In contrast with programmed services, the provider of a common carrier service does not control the content of the information it delivers for customers. The content delivered by a common carrier will always be specified by the user of the service. A common carrier merely provides transport. The Ventura Administration believes the federal definition of “telecommunications services” should be incorporated into Minnesota statute. Congress’s definition of “telecommunications service” incorporates the common carrier concept of content specified by a user being delivered between two points specified by the user. This definition can easily be distinguished from programmed services. Moreover, the Ventura Administration believes federal and state law should be consistent with respect to these fundamental definitional issues.

Within each of the above broad categories of service there are several subcategories of service (i.e. long distance service versus local exchange service). These must be distinguished from one another to create a workable definitional framework for the State.

2. Telecommunications Services

a. Long Distance Services Distinguished From Local Telephone Services

To achieve competitive neutrality, the law must recognize the obvious distinction between local and long distance telecommunications services. Currently, under Minnesota law the term “telecommunications carrier” includes long distance carriers as well as CLECs.³³ The Ventura Administration asserts that there should be a stand alone definition for long distance providers. As discussed in section XII of this Plan, the long distance industry has become competitive. As long as this sector of the industry remains competitive, the Ventura Administration believes it should be subject to less stringent regulatory treatment than local telephone services. For that reason, it makes sense to define long distance telecommunications services separately.

b. Unbundled Network Elements (UNEs)

The 1996 Act directed the FCC to develop a list of the network elements that RBOCs would be required to make available to competitors on a wholesale basis

³⁰ Southwestern Bell Telephone v. FCC, 533 F.2d 601, 608-09 (D.C. Cir. 1976).

³¹ Id.

³² Id.

³³ See Minn. Stat. §237.01, Subd. 6.

(“unbundling”). In determining which elements the RBOCs must unbundle, Congress directed the FCC to consider the following factors:

- i. Whether access to proprietary network elements is necessary; and
- ii. Whether the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer.³⁴

The FCC’s first attempt at establishing this list resulted in litigation that was appealed to the United States Supreme Court.³⁵ The Court found that the FCC had not properly applied the section 251(d)(2) standard (which is known in telecommunications regulatory circles as the “necessary and impair” standard). The FCC’s revision of its UNE list was released on September 15, 1999.³⁶

The 1996 Act preserves the right of the State to add to the list of UNEs established by the FCC, as long as the network element meets the “necessary and impair standard.” The Ventura Administration believes that the State’s regulatory framework should incorporate the FCC’s list of UNEs by reference. Moreover, the MPUC should be given explicit authority to add UNEs to the list applying the federal “necessary and impair standard.” In developing these provisions, the Ventura Administration believes that the definition of “network element” should be incorporated into Minnesota’s telecommunications regulatory framework. Access to UNEs is discussed further below in section VIII of this Plan.

c. Carrier Based Distinctions

For the reasons set out in section VIII of this Plan, the Ventura Administration believes wholesale telecommunications service providers, such as U S WEST, should be distinguished from other telecommunications service providers in the State under Minnesota’s telecommunications regulatory framework.³⁷ The special duties that go along with this distinction will be set out in greater detail in section VIII of this Plan.

With respect to regulatory distinctions for rural telephone companies, Minnesota must live with the policy judgment of Congress to protect rural telephone companies from the forces of competition. Currently, the statutory definition of “independent telephone company” and the federal definition of “rural telephone company” are different.

However, the Ventura Administration does not believe rural telephone companies should continue to receive special protection from competition, and will work to eliminate these distinctions. The Ventura Administration will continue, as it advocated in Minnesota Cellular Corporation’s petition to become an eligible telecommunications carrier (ETC), to promote telecommunications competition in Greater Minnesota.³⁸ The policy of protectionism has resulted in reinforcement

³⁴ 47 U.S.C. §251(d)(2).

³⁵ AT&T v. Iowa Utilities Board, U.S. Sup. Ct. No. 97-826 (1999).

³⁶ See FCC News, *FCC Promotes Local Telecommunications Competition*, Adopts Rules on Unbundling of Network Elements (September 15, 1999).

³⁷ See section VIII of this Plan, at pp. 101-102 and 112.

³⁸ See Initial Brief of the MDOC, In re Petition of Minnesota Cellular Corporation for Designation as an Eligible Telecommunications Carrier, Docket No. P5695/M-98-1285 (MPUC July 19, 1999) (herein “MCC Petition”).

of the assumption that wireline technology is the most efficient and cost effective way to provide telecommunications service to Greater Minnesota. Universal service funding mechanisms and “forward looking” economic cost models are all based on this presumption. However, it is possible that telecommunications capability based on advanced technologies or wireless telecommunications systems or some other future technology might be or become the most efficient “forward looking network.” The Ventura Administration believes this creates the possibility that telecommunications services to rural communities are or will be over-subsidized. The wireline superiority assumption should be challenged. One way this can occur is by eliminating the monopoly protections currently enjoyed by small incumbent telephone companies. These monopolies can be eliminated by encouraging the deployment of more efficient and open local exchange networks in Greater Minnesota, rethinking the traditional wireline model for Greater Minnesota, and encouraging public/private partnerships to create true open access networks in Greater Minnesota that would allow any competitor to access customers throughout the State.

3. Cable Services

Like Minnesota’s telephone statutes, Minnesota’s current cable laws do not contain service-based definitions. Minnesota’s cable laws should apply based on the nature of the services provided, not the technological platform over which such services are provided. The lines of regulatory authority over cable services should be clearly drawn. Currently, they are not. Minnesota law should clearly hold that “cable services” are programmed services in which content is controlled by the service provider. Moreover, the definitions in Minnesota’s cable law should be revised to be consistent with federal cable laws. Making state and federal regulatory definitions consistent, reduces conflicts between state and federal law, and works to harmonize state and federal regulatory structures that should ideally work in tandem.

4. The Battle Over Data Services

a. High-speed Data Services Are Telecommunications Services

The emergence of the internet has created a major regulatory definitional issue. For example, the 9th Circuit Court of Appeals is currently considering a case in which the City of Portland issued an order requiring TCI to allow unaffiliated internet service providers (ISPs) to access TCI’s high-speed data cable modem platform.³⁹ The FCC has filed a “friend of the court” brief with the 9th Circuit raising the question of whether the Oregon federal district court, and the parties in the case, “relied on a faulty premise by assuming that internet access via cable is a “cable service,” an issue that the [FCC] has yet to resolve.”⁴⁰

Local telephone companies recently presented arguments to the FCC that xDSL services are not subject to interconnection obligations under sections 251(b) and (c) of the 1996 Act. Interconnection obligations apply to “local exchange carriers” under section 251(b) and (c). The telephone companies argue that DSL services are “information access” services, not “exchange access” or “telephone exchange

³⁹ See *AT&T Corp. v. City of Portland*, CV 99-65-PA (D. Ore. June 3, 1999).

⁴⁰ *Amicus Curiae* Brief of the FCC, *AT&T v. City of Portland*, CV 99-65-PA (D. Ore. June 3, 1999), Appeal Docketed, No. 99-357609 (9th Cir., June 14, 18, 1999).

services.” Therefore, the argument goes, such services are not provided by a “local exchange carrier” and are not subject to the interconnection obligations. In 1998, however, the FCC held that DSL services are either “telephone exchange services” or “exchange access services” subject to section 251’s interconnection requirements.⁴¹

The Ventura Administration asserts that high-speed data delivery services, like DSL and cable modem services, fall clearly within the definition of a “telecommunications service.” Whether high-speed data signals are delivered over a cable television system, telephone network, or over a wireless network is an irrelevant consideration for the purpose of determining which regulatory framework governs. A user of a high-speed data service specifies the content of his or her message, not the high-speed data service provider. The user dictates the content of his or her e-mail messages. The user specifies which web sites he or she wants to view, and chooses which content to absorb. The high-speed data service provider’s First Amendment rights are not implicated when a customer surfs the web using its service. Even if the high-speed data service provider also acts as an ISP, the user remains free to bypass the service provider’s content and move on to the other web sites of its choosing.

High-speed data services do not meet the federal definition of “cable service.” They are not “one-way services” as contemplated in the federal definition of “cable service.”⁴² To the contrary the appeal of high-speed data service is its two-way interactive capability. High-speed data services also do not meet the definition of a “video programming service” which is another one of the elements of the federal definition of “cable service.”⁴³ While some of the entertainment products available for delivery over a high-speed line may consist of video programming, these services have nothing to do with the nature of the high-speed service over which such products are delivered.

High-speed data service is a common carrier service. The high-speed data provider carries messages, specified by the user, between points which are also specified by the user. In other words, when a user enters the world wide web using a high-speed data provider’s service, the service provider merely carries messages from one place to another, as directed by the user. Moreover, a high-speed service provider will provide service to any credit-worthy customer. All of these arguments point toward the conclusion that high-speed data services are “common carrier services” and therefore a “telecommunications service” under federal law.

The definition of “advanced telecommunications capabilities” under section 706 of the Act does not impact the conclusion that high-speed data services are “telecommunications services.” Section 706 uses the term “advanced services” and “telecommunications service” interchangeably, indicating that Congress believed the terms to be synonymous. Advanced services capabilities are defined to include high-speed data services, indicating that Congress believed that high-speed data services should be classified as telecommunications services.

⁴¹ Notice of Proposed Rulemaking, “Advanced Service Order” (FCC August 7, 1998).

⁴² See 47 U.S.C. §522(46).

⁴³ *Id.* §522(20).

The Ventura Administration asserts that the term “internet service,” as that term is used in everyday parlance, is comprised of two very different service elements: (I) transport and (II) content. The transport component is “telecommunications service.” Content, the Ventura Administration asserts, is what Congress was contemplating when it created the term “information service,” and what the FCC intended when it defined the term “enhanced service.” High-speed data transport should not be confused with “information service” or “enhanced services.”

This discussion illustrates the danger in commingling the concepts of high-speed data service and internet service. High-speed data service, as we have discussed above, is nothing more than a common carrier telecommunications service. Internet service, on the other hand, is an entirely different kind of service. Prohibiting government from regulating “the internet” sounds like good public policy. However, a law worded in such a way could have severe consequences for local telecommunications competition in Minnesota. It could unintentionally bar the state from stepping in to quash anti-competitive activity in the delivery of high-speed data service.

b. High-speed Data Service Is An Intrastate Telecommunications Service for the Purposes of Determining Jurisdiction.

The Ventura Administration asserts that high-speed data telecommunications services are intrastate in nature. This is a controversial and extremely important issue because its resolution determines whether the State or the FCC has regulatory authority over these services. This issue also has been muddled by the Oregon federal district court’s decision in *AT&T v. City of Portland*.⁴⁴ Because the court in Portland decided the case on the assumption that high-speed data services provided over a cable platform are “cable services,” the court also never reached the issue of whether the services are interstate or intrastate in nature.⁴⁵ The issue has been further muddled by two FCC rulings.

The FCC recently issued a declaratory ruling regarding the issue of whether local exchange carriers are entitled to receive reciprocal compensation for termination of traffic delivered to an ISP.⁴⁶ The issue required the FCC to determine whether internet traffic is interstate or intrastate in nature. The FCC’s Reciprocal Comp Order first discussed how the agency had historically treated “enhanced service providers” (ESPs). ESPs are a class of service created by FCC rules that the FCC believes includes internet service providers.⁴⁷ The FCC reviewed its earlier holding that while ESPs use interstate access services, since 1983 the FCC had “exempted” ESPs from the payment of certain interstate access charges. Instead, the FCC has chosen to treat ESPs as “end users for the purposes of assessing access

⁴⁴ Id.

⁴⁵ Id. It may be argued that the Portland court’s decision supports the conclusion that high-speed data services are intrastate in nature. Congress has always recognized that “cable services” are subject to concurrent state and federal regulatory jurisdiction. The Cable Act is replete with examples of this policy. Thus, if the Portland court determined that high-speed data services provided over a cable system are “cable services,” the court must have accepted local and therefore state jurisdiction over such services.

⁴⁶ In the Matter of the Local Competition Provisions in the Telecommunications Act of 1996 Inter-Carrier Compensation for ISP-Bound Traffic, CC Docket No. 96-98 (FCC Feb. 26, 1999)(herein the “Reciprocal Comp Order”).

⁴⁷ Id. at ¶1, n.1. The FCC noted that it believed the term ‘enhanced service’ is quite similar to ‘information services’” The term “information services” is discussed in Appendix F of this Plan.

charges, and the FCC permits ESPs to purchase their links to the public switched telephone network (PTSN) through interstate business tariffs rather than through interstate access tariffs.”⁴⁸

Three pages later, in the same opinion, the FCC declared “the Commission has traditionally determined the jurisdictional nature of communications by the end points of the communications and has consistently rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers.”⁴⁹ Based on this “one call” jurisdictional analysis, the FCC concluded that

the communications at issue here do not terminate at the ISP’s local server, as CLECs and ISPs contend, but continue to the ultimate destination or destinations, specifically at a (sic) Internet website that is often located at another state. The fact that the facilities and apparatus used to deliver traffic to the ISP’s local servers may be located within a single state does not affect our jurisdiction.⁵⁰

The FCC then stated that the “jurisdictional analysis is less straightforward for the packet-switched network environment of the Internet.”⁵¹ According to the FCC, the internet user typically communicates with international, interstate and intrastate servers in a single session. Based on this fact, the FCC declared, “although some Internet traffic is intrastate, a substantial portion of internet traffic involves accessing interstate or foreign web sites.”⁵² Indeed, the FCC concluded that internet traffic is “jurisdictionally mixed.”⁵³ Recognizing that States probably relied on the FCC’s exemption of ESP traffic from interstate tariff requirements, the FCC decided to continue to allow states to enforce state approved interconnection agreements requiring payment of reciprocal compensation for internet traffic.⁵⁴

Four months prior to the Reciprocal Comp Order, the FCC issued an order addressing the propriety of GTE’s interstate tariff for its DSL service.⁵⁵ Much of the analysis in the Reciprocal Comp Order was borrowed from the GTE DSL Order. However, in this case the FCC definitively concluded that GTE’s DSL service was an interstate service, using the “one call” analysis, *and* the “mixed facility doctrine.” The mixed facility doctrine derives from a 1989 FCC decision regarding the FCC’s jurisdiction over access lines used for both interstate and intrastate

⁴⁸ *Id.* ¶5.

⁴⁹ *Id.* ¶ 10 (citing *Bell South Memory Call*, 7 FCC Rcd 1619 (1992); *Teleconnect Co. v. Bell Telephone of Penn.*, E-88-83, 10 FCC Rcd 1626 (1995); and *In the Matter of Southwestern Bell Tel. Co.*, CC Docket No. 88-180, 3 FCC Rcd. 2339, 2341 (1988).

⁵⁰ *Id.* ¶12.

⁵¹ *Id.* ¶ 18.

⁵² *Id.*

⁵³ *Id.* ¶ 19.

⁵⁴ *Id.* ¶ 24. The FCC also issued a Notice of Proposed Rulemaking to further address this “tentative conclusion.” *See id.* at ¶28.

⁵⁵ *In the Matter of GTE Telephone Operating Cos.*, FCC 98-292, CC Docket No. 98-79 (October 30, 1998)(herein “GTE DSL Order”).

non-switched traffic.⁵⁶ The “mixed facilities doctrine” states that lines carrying more than a *de minimus* amount of interstate traffic should be assigned to the interstate (FCC) jurisdiction.⁵⁷ The FCC has set this amount at 10% (the 10% standard). Without citing any evidence in the record to support its conclusion, the FCC determined that GTE’s DSL access lines carry more than 10% interstate traffic. Therefore, the FCC concluded, there was federal jurisdiction.

These two FCC decisions create more questions than answers about jurisdiction over high-speed data services. First, the FCC fails to distinguish between the “telecommunications service” element of the high-speed data service provided to customers and the “enhanced service” or “information service” provided to consumers. High-speed data service, as discussed in the previous section, is fundamentally a telecommunications service. It can also be argued that providing access to the internet is a “telecommunications service” – a router is nothing more than a switch. Functions like e-mail, voice mail, and a web page better fit into the category of “enhanced services” or “information services.” The Ventura Administration does not believe “information services” should be regulated, other than by those laws that typically apply to any business (i.e. securities regulation, contract law, and consumer protection laws).

Furthermore, in the Reciprocal Comp Order, as with the ESP ruling, the FCC allowed states to exercise jurisdiction over internet traffic, despite the premise that the traffic is predominantly interstate in nature. Both the result, and the conclusion that internet traffic is “jurisdictionally mixed” suggest that the states have concurrent or shared authority over these services with the FCC. Moreover, with respect to the 10% standard, the FCC’s Order in GTE fails to cite to any evidence in the record indicating that internet traffic over the DSL lines in question in that case carried more than 10% interstate traffic.

Finally, the merits of the “one call” analysis should be reconsidered from a policy perspective. The Ventura Administration submits that much of the reason the FCC’s decisions do not follow from its “one call” analysis is because of the “jurisdictionally mixed” nature of the internet. Whether regulation is necessary to break up anti-competitive conduct in Minnesota or other communities should be a state or local decision, not a national one. Just as states are willing to provide regulatory incentives to entice businesses to locate in a state or to regulate bad behavior, so should a state be able to provide those incentives or disincentives to encourage competition and discourage anti-competitive behavior in the local telecommunications marketplace. These key economic development decisions should not be dictated from Washington, D.C.

The determination of whether high-speed data service is intrastate or interstate in nature is an issue that will ultimately be decided in the courts. Until there is a definitive court ruling applicable to Minnesota, the Ventura Administration will analyze in all cases involving jurisdiction over high-speed data services (or any other telecommunications service) focusing on the true jurisdictional nature of the service, not through the use of arbitrary rules-of-thumb. The Ventura Administration’s advocacy position will follow each determination on the merits of its

⁵⁶ Id. at ¶ 23 (citing MTS and WATS Market Structure Separations Order, 4 FCC Rcd. 5660 (1989)).

⁵⁷ Id.

jurisdictional analysis. Given the uncertain outcome of this issue and the potential for federal preemption, the Ventura Administration does not recommend that any legislative action be taken to expressly classify high-speed data services as intrastate in nature.

C. Recommendations

1. Abolish Minnesota Statutes sections 237.01 and 238.02.
2. Draft new definitions which base regulatory distinctions on the nature of the service being provided, rather than the technological platform over which the service is provided, or who is providing the service.
3. The degree of regulation over a service should correlate to whether the service is essential and the extent to which the market for the service is competitive.
4. The Legislature should direct the MPUC to complete a rulemaking to determine which telecommunications services offered within the State are essential.
5. New statutory definitions should track federal service based definitions for “telecommunications service,” “cable service,” and “information service” as closely as possible. However, high-speed data transport should be expressly categorized for what it is – a telecommunications service.
6. The term “telecommunications service” should reflect the fundamental “common carrier” nature of a telecommunications service. The term “cable service” should reflect the reality that cable services are programmed services – the content is controlled by the service provider.
7. Separate definitions for “local long distance” providers and “competitive local exchange carriers” should be established rather than covering them under one definition.
8. Owners of telecommunications facilities capable of providing wholesale telecommunications services should be defined separately, and given unique duties placed upon them under section 251 of the 1996 Act.
9. Terms such as “small telephone company,” “independent telephone company,” or “rural telephone company” designed to create exemptions from requirements applicable to larger carriers should be consolidated into a single definition. This definition should track with the definition of “rural telephone company” under 47 U.S.C. section 153(37).
10. Eliminate the presumption of wireline system superiority.
11. Define by statute the term and standards for establishing a “network element” for purposes of unbundling.
12. State law should recognize the two components of “internet service”: (I) transport and (II) content. Preserve regulatory authority over transport. Prohibit regulation of content.

V. UNIVERSAL SERVICE

A. Background

Universal service refers to establishing an affordable basic telephone communications service package accessible to as many households as possible. Traditionally, the “universal service” goals fell into two primary categories: (I) ensuring the availability of basic telephone service in high cost areas; and (II) providing support to low-income individuals. Minnesota has consistently been among the top five states in the nation with respect to the number of Minnesota’s households with telephones. The latest Census Bureau report indicated that 97.5% of all Minnesota households had a telephone.⁵⁸

The 1996 Act provided for the restructuring of the telecommunications markets in the United States and reinforced the federal commitment to universal service. The 1996 Act provides for (1) increased competition in all markets (including local telephone service), (2) the movement of prices toward cost by eliminating certain implicit subsidies; and (3) the design of “specific, predictable and sufficient” universal service support programs. The 1996 Act also requires that the universal service programs accommodate and encourage competition. The 1996 Act contemplates both federal and state universal service programs. The 1996 Act permits states to adopt universal service regulations that are “not inconsistent with the FCC’s rules to preserve and advance universal service.”⁵⁹ States may adopt universal service regulations “to provide for additional definitions and standards to preserve and advance universal service . . . only to the extent that such regulations adopt specific, predictable, and sufficient mechanisms . . . that do not rely on or burden federal universal service support mechanisms.”⁶⁰ In determining whether state universal standards adhere to this principal, legal commentators generally agree that a traditional federal preemption doctrine analysis applies.⁶¹

Federal universal service programs are to be based on the following five principles, found in sections 254(b)(1) to (5) of the 1996 Act:

1. Quality services should be available at just, reasonable, and affordable rates.
2. Access to advanced telecommunications and information services should be provided in all regions of the Nation.
3. Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.
4. All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.

⁵⁸ Estimates of Telephone Subscriber Rates for the United States, Minnesota, and Selected States (Bureau of the Census, Current Population Survey Branch July 1999). See Appendix H.

⁵⁹ 47 U.S.C. §254(f).

⁶⁰ *Id.*

⁶¹ See generally, M. Trincherro and H. Smith, "Federal Preemption of State Universal Service Regulations Under the Telecommunications Act of 1996," 51 Fed. Comm. L. J. 303 (1999).

5. There should be specific, predictable and sufficient federal and state mechanisms to preserve and advance universal service.

The 1996 Act also provides that “[u]niversal service [is] an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services.”⁶² Congress has given the FCC the discretion to adjust its universal service policy to account for changes in technology or the marketplace.

The FCC has issued a number of rules to guide the transition from implicit to explicit universal service subsidies. Some of the pieces of the FCC’s universal service program are in place, such as subsidy programs for hospitals, schools and libraries (the “E-rate Program”). The FCC’s Lifeline program provides subsidies to low-income consumers, including an incentive for a coordinated state program by offering a higher subsidy in those states with a program that meets certain characteristics.⁶³ But the most complex and expensive component of the 1996 Act’s universal service package, dealing with subsidies to high-cost areas, is still under development. The FCC’s high cost plan is expected to be released in January 2000.

1. High Cost Support

High cost support has traditionally taken the form of two regulatory schemes embedded with implicit subsidies: (I) Rate Averaging; and (II) Access Charges.

- a. Rate Averaging

Rate averaging results in two forms of cross subsidy: (I) an urban to rural subsidy; and (II) a business to residential subsidy. Regulators have required (or “permitted”) local telephone companies to average rates for local telephone service across the state. It does not cost local telephone companies more to provide telephone service to business customers than it does to provide it to residential services. Yet averaged business rates are generally higher than averaged residential rates for local telephone service. It costs local telephone companies less to provide telephone service to urban customers than it does to provide it to rural customers; yet due to rate averaging, rural customers pay roughly the same rate as urban customers for local telephone service. In other words, the higher cost of providing telephone services to rural customers has been accomplished through government sanctioned price discrimination.

The system of implicit cross subsidies through rate averaging worked hand in hand with a monopoly market structure. In a competitive market, businesses and urban customers would not pay prices above economic cost. But in a monopoly market, customers have no choice of provider. They must pay the artificially inflated price.

It is important to distinguish the difference between wholesale and retail rates when discussing rate averaging. Both wholesale rates (rates for UNEs) and retail rates are averaged in Minnesota. When addressing the need for rate deaveraging, a plan for both wholesale and retail deaveraging must be discussed contemporaneously to avoid the possibility of a price squeeze imposed on CLECs by ILECs. To

⁶² 47 U.S.C. §254(c)(1).

⁶³ FCC, Report and Order, released May 8, 1997, CC Docket No. 96-45.

illustrate, presume the average wholesale rate for the ILEC's unbundled loop in Community A equals \$10. Presume the average retail rate equals \$15. Next, assume the ILEC retail rate is deaveraged, and the retail rate drops to \$9. If the wholesale rate is not deaveraged also, ILEC A has been provided a competitive advantage because it can sell local service for \$9 per month, while competitors would be forced to purchase a loop wholesale for \$10. No rational competitor would enter this market.

The 1996 Act mandates that rates for interconnection and unbundled elements be "based on the cost . . . of providing the interconnection of network elements."⁶⁴ The FCC has determined that this statutory requirement means that wholesale rates for interconnection and UNEs must be offered on a geographically deaveraged basis.⁶⁵ The FCC mandated that states accomplish geographic deaveraging of wholesale rates by creating a minimum of three "cost-related" zones within the state. A state may establish more than three zones where cost differences in geographic regions are such that it finds that additional zones are needed to adequately reflect the costs of interconnection and access to unbundled elements.⁶⁶ The FCC stayed the effective date of this requirement until six months after it issued its order reforming the high cost support framework for non-rural carriers. As discussed below, the FCC issued a press release summarizing this order on October 21, 1999. Presumably, the six month stay would be lifted by April 21, 2000.⁶⁷

Minnesota law provides that "no telephone company shall offer telecommunications service within the state upon terms or rates that are unreasonably discriminatory."⁶⁸ Minnesota law also provides that "the rates of a telephone company must be the same in all geographic locations of the state unless for good cause the MPUC approves different rates."⁶⁹

During its 1997 session, the State legislature directed the then Department of Public Service to convene a work group to examine the policy implications of both wholesale and retail geographic rate deaveraging.⁷⁰ In its report to the Legislature, the MDOC noted that in Greater Minnesota, subscribers pay \$1 less per month for local service than consumers in the Twin Cities, despite the fact that it costs less to provide telephone service to Twin Cities customers.⁷¹ In that Report, the DPS recommended that any deaveraging of rates must be done in concert with the establishment of a high cost universal service fund. The MDOC echoed this recommendation in comments to the MPUC regarding the deaveraging of wholesale

⁶⁴ 47 U.S.C. § 252(d)(1)(a)(i).

⁶⁵ First Report and Order, In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, FCC 96-325 ¶ 764 (August 8, 1996).

⁶⁶ Id.

⁶⁷ The FCC has only issued a press release regarding its long awaited decision on reforming the high cost support model for non-rural carriers. The actual text of the order had not been released in time to incorporate that information into this Plan. The date the stay is lifted could be different than the date of the press release (October 21, 1999).

⁶⁸ Minn. Stat. § 237.60, Subd. 3 (1999).

⁶⁹ Id.

⁷⁰ 1997 Minn. Laws, Chapter 223 § 19.

⁷¹ *A Report to the Legislature Implications of Geographical Deaveraging of Local Telephone Rates in Minnesota*, Minnesota Department of Public Service (February 8, 1998).

rates.⁷² If geographic rate deaveraging were to take place without a high cost universal funding mechanism in place, rates in low density areas would increase substantially. Deaveraging removes the urban to rural subsidy. The report recommended that a state universal service fund must be in place and operating to replace the implicit subsidy with an explicit one before rates are deaveraged.

The Report also included a study which demonstrated the differences in the cost of providing services based on population density (measured by the number of telephone access lines per square mile). Attached to this Plan is a chart that demonstrates how the cost of service increases as density per square mile decreases.⁷³

b. Access Charges

Local telephone companies are also implicitly subsidized through the federal and state system of access charges. Access charges can generally be defined as charges that long distance carriers pay to local telephone companies for interconnection to the local telephone network and access to the end customer. To truly understand the access charge scheme as it exists today, it is necessary to understand the historical evolution of access charges, and their integral relation to universal service policy.

Under the Communications Act of 1934, the FCC was placed in charge of allocating the costs of providing interstate telephone service and intrastate telephone service for the purposes of establishing a rate base for regulating rates. The farcical nature of this exercise led the FCC to use this allocation process to further universal service goals.⁷⁴ Under a monopoly market structure, the FCC could allocate a disproportionate amount of costs to the interstate side of the equation. Under rate of return regulation, this resulted in higher rates for long distance service (because that is where most of the costs were purposefully allocated) and lower local telephone rates.⁷⁵ In other words, high volume long distance customers (primarily businesses prior to residential long distance competition) subsidized the costs of providing residential local telephone service. Costs were allocated using a “settlements process.” All long distance revenues were collected in a pool administered by AT&T, and allocated based on toll access cost schedules filed by all local exchange carriers, including independent local exchange carriers.

As MCI emerged as a competitor, it became evident that this settlements process could not last. MCI, having no local telephone operations, had no reason to subsidize local telephone services with higher long distance rates. Nor were they required to do so. The inherent unfairness of this arrangement became evident to AT&T’s Bell System, and the FCC began looking for a solution.⁷⁶ In 1983, the FCC established an interstate access charge plan to replace the settlements process.⁷⁷

⁷² *Comments of the Minnesota DPS in the Matter of the Investigation Into Geographic Deaveraging Requirements of 47 C.F.R. § 51.507(f)* MPUC Docket No. P999/CI-99-465 (July 2, 1999) (herein “Minnesota Geographic Deaveraging Docket”).

⁷³ See Appendix H.

⁷⁴ See Brands and Leo, at 201.

⁷⁵ *Id.*

⁷⁶ The MFJ also prohibited the continuance of the Bell System settlements process.

⁷⁷ *Third Report and Order*, 93 FCC 2d 241, 48 F.R. 10319 (March 11, 1983).

The FCC devised a scheme in which all long distance providers would pay local telephone companies the same per minute “access charge” for origination and termination of traffic using the local telephone company’s facilities. The access charges were tariffed rates, both at the federal and state level. At the federal level, access charges were set high enough to cover the costs that had been historically overloaded in the federal rate base. The cross subsidy remained, just in a different form.

The FCC’s access charge rules also forced the State to replace its settlements process. In 1983, the MPUC established intrastate interLATA per minute access charges to compensate ILECs for the cost of providing access to local exchange networks.⁷⁸ In 1987, the MPUC established an access charge system for intrastate intraLATA services.⁷⁹

In determining the level of access compensation that ILECs would receive under an “access charge” system, the MPUC decided to mirror the FCC’s jurisdictional cost separations rules for the purpose of allocating costs between toll service, local service, and other services.⁸⁰ Thus, the cross subsidy embedded in the FCC’s cost separations rules carried over to the method used to set intrastate access charges.

While intrastate access rates have changed as the result of earnings investigations, commission decisions following complaints, Alternative Form of Regulation (AFOR) plans or company filings, the structure is essentially the same as that established by the MPUC in 1987. In the early ‘90s, all telephone companies were involved in a complaint by the long distance companies to reduce access rates. In that case the MPUC set rate targets to be achieved by all companies over a five year period that ended on January 1, 1998. U S WEST, Sprint, Frontier and GTE each had individual targets. Small telephone companies with low access rates were not required to make any access rate reductions. Small telephone companies with high access rates were to reduce rates. A formula was used to determine the reductions each year. Small companies with very high access rates did not reach the target. During 1997 there was to be an investigation on further access rate reductions, but that investigation did not materialize.

On January 1, 1999, U S WEST began operating under an AFOR Plan approved by the MPUC. A series of three access charge reductions are to occur during the first three years of the plan. The AFOR plan further provides that 30 months after the January 1, 1999 effective date (i.e., July 1, 2001), parties may file a complaint regarding U S WEST’s access charge levels. Any reduction ordered by the FCC may not become effective until after the third year of the plan.

There are three primary switched access components under the existing Minnesota structure. These components are:

- i. Carrier common line charge (CCLC)

⁷⁸ Order Approving Interim Plan Compliance Filing and Soliciting Comments, Docket No. P-999/CI-83-203 (MPUC February 7, 1984).

⁷⁹ In re Summary Investigation Into IntraLATA Toll Access Compensation for Local Exchange Carriers Providing Telephone Service Within the State of Minnesota, Docket No. P-999/CI-85-582 (MPUC Nov. 2, 1987) (herein referred to as the “582 Docket”).

⁸⁰ Id. at 21.

The stated purpose of the CCLC is to recover the costs associated with originating and terminating toll calls over the local loop facilities of an ILEC. Thus, the charge is designed to recover non-traffic sensitive (NTS) costs. Because the local loop facilities are required for access to the network, there is no additional loop cost to place long distance calls. Moreover, the CCLC is billed on the basis of switched minutes of use, the same as the local switching rate element, even though these are traffic sensitive (TS) costs. The CCLC has generally been the focus of access charge complaints since it does not have a cost basis, and because it is billed on a per minute of use basis, even though the loop facilities are NTS costs.

ii. Local Transport

The local transport rate element provides the transmission facilities between the customer's premises and the end office switch(es) where the customer's traffic is switched to originate or terminate the customer's communications. The local transport rate element consists of three primary components. The entrance facility is the connection between the point of presence of the long distance company and the serving wire center of the local exchange carrier. Tandem switching, the second component, is used to aggregate calls of long distance companies where there is not sufficient traffic to support the direct trunking of traffic between the serving wire center where the long distance company is interconnected and the end office serving the customer. The third component is the actual transport facility which may be either directly trunked or tandem switched. Some companies have separate rate elements for each of the components of local transport service while others have the components bundled for ratemaking purposes. Local transport is billed on a per-minute-of-use basis because the cost of providing service is related to the volume of use.

iii. Local Switching

The local switching rate category provides the local end office switching, end user line termination and intercept functions necessary to complete the transmission of switched access communications to and from the end users served by the local end office. The local switching rate category includes the local switching and information (i.e., directory assistance) rate elements. These rate elements generally are not bundled in the application of rates. Local switching is billed on a per-minute-of-use basis because costs are directly related to the volume of use.

Since the adoption of the 1996 Act, the FCC has taken moderate steps to eliminate the cross subsidy inherent in the access charge system. In 1997, the FCC issued companion orders implementing access charge and universal service reforms under the 1996 Act.⁸¹ Other than rate reductions achieved in U S WEST's AFOR, there has been little accomplished in Minnesota to eliminate the implicit subsidies that continue to exist in the State's access charge rate structure.

⁸¹ See First Report and Order Regarding Federal-State Joint Board on Universal Service, FCC 97-157 ¶ 750- 771 (May 8, 1997) (herein the "Universal Service Order"); First Report and Order in the Matter of Access Charge Reform, FCC 97-158 ¶ 28-35 (May 16, 1997).

c. Federal Implementation of High Cost Support Under the Telecommunications Act of 1996

The 1996 Act established an elaborate rule making process to implement its universal service provisions. First, the Act called for the establishment of a federal-state joint board on universal service (herein the “Joint Board”) to make recommendations to the FCC regarding the establishment of a federal universal service program. The federal-state joint report to the FCC was submitted on November 6, 1996.⁸² The FCC has relied heavily on the recommendations of the Joint Board in establishing universal service rules and policies. Establishing a working high cost support model is a complex task. There are many interrelated issues. Determining the total cost of the program and the proper funding mechanisms have proven to be problems with only inexact solutions. The FCC, however, has strived for as exact a solution as possible and this has resulted in delays in the implementation of a working high cost program. On October 21, 1999, the FCC announced that it had released its long awaited order on high cost support for non-rural carriers.⁸³ In the press release, the FCC states that the high cost framework for rural carriers “is not scheduled to be released until January 1, 2001 at the earliest.”

Below, the Ventura Administration identifies the key issues related to high cost support, and reviews what the FCC has done to date to resolve those issues.

i. What Telecommunications Services Should Be Supported By the High Cost Fund?

In determining what services to support with federal universal service funds, Congress directed the FCC to consider the extent to which telecommunications services:

- (a) are essential to education, public health, or public safety;
- (b) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;
- (c) are being deployed in public telecommunications networks by telecommunications carriers; and
- (d) are consistent with the public interest, convenience and necessity.⁸⁴

ii. In applying these criteria, the FCC determined that federal universal service funds should support nine distinct services:

(a) Voice Grade Access to the Public Switched Network

The FCC concluded that voice grade access includes the ability to place calls, receive calls, and the ability to signal the network or receive a signal from the network through which or from which the call is routed. The FCC further determined that bandwidth for voice grade access should be, at minimum, 300 Mhz to 3000 Mhz. This minimum frequency range was drawn explicitly to recognize that access to high-speed data transport serv-

⁸² Recommended Decision of the Federal-State Joint Board on Universal Service (November 6, 1996).

⁸³ *FCC Reforms High Cost Support to Ensure the Preservation and Advancement of Universal Service*, FCC News (October 21, 1999).

⁸⁴ 47 U.S.C. § 254(c)(1)(A)-(D).

ices should not be included in the list of supported services at the present time.

(b) Local Usage

The FCC ruled that ETCs must provide some minimal amount of local usage as part of a universal service package, but has not finally determined what minimum amount should be required.

(c) Dual-tone multi-frequency (DTMF) signaling or its functional equivalent

DTMF means touch tone dialing capability. The FCC found that this technology helps speed access to emergency services, such as 911. On the network side, the technology also allows more rapid call set-up, which increases the speed and efficiency of the network.

(d) Single Party Service or its Functional Equivalent

Single-party service means that only one customer is served by each subscriber loop or access line. Previously, customers often had to share a line. Customers would distinguish which calls were theirs (versus their neighbor's) by a unique cadence on the ring.

(e) Access to Emergency Services

The FCC determined that every ETC must offer customers the ability to reach an emergency services provider. This includes access to both 911 and enhanced 911 (E911) services. E911 includes three services: Automatic Numbering Information (ANI), Automatic Location Information (ALI), and Selective Routing (SR). ANI can provide the 911 operator the billed number from which the call is received. ALI can provide the name, phone number, address, and a description of any special conditions that emergency personnel should know about (i.e. the caller works for a plant that deals with hazardous substances). This technology can save a 911 operator up to 30 seconds per call by not having to obtain this information from the caller over the telephone. ALI allows the 911 operator to trace the location of the caller, a technology which is being developed particularly for the mobile telephone industry.⁸⁵ SR provides for routing of a 911 call based on the ALI, and default routing if the ALI fails.

(f) Access to Operator Services

The FCC required that ETCs provide access to any automated or live operator assistance. This includes the ability to arrange for billing and completion of a call.

(g) Access to Interexchange Service

⁸⁵ Wireless carriers are not required to implement E911 technology until October 1, 2001, and even then only if the relevant locality has implemented E911 and established a cost recovery mechanism. *Universal Service Order* at ¶¶72-73.

The FCC required that all ETCs provide customers the ability to make or receive long distance calls. The FCC did not require ETCs to provide customers equal access to long distance carriers.⁸⁶

(h) Access to Directory Assistance

The FCC required ETCs to provide customers directory assistance service, which allows a customer the ability to call “411” or “(651) 555-1212” to obtain a telephone number.

(i) Toll Limitation for Qualifying Low-income Consumers

The FCC required ETCs to provide low-income customers the ability to block outgoing toll calls from their line (toll control) or to limit in advance their toll usage per month or per billing cycle (toll limitation).

The FCC has deferred the question of whether the universal service fund should support anything more than primary lines to residential services. Some lobbying groups have advocated that universal service should also support second lines to residences, as well as business lines, internet access, and even cable service.

iii. Determining Affordability

The 1996 Act requires that services supported with universal service funds be affordable.⁸⁷ The FCC has determined that the definition of affordability should contain an “absolute component” which takes into account an individual’s means to subscribe to a universal service package, and a “relative component”, which takes into account whether consumers are spending a disproportionate amount of their income on telephone service.⁸⁸

The FCC has set forth a number of specific factors that must be considered in determining whether rates are affordable or not, including: telephone subscribership levels, size of the local calling area, consumer income levels, cost of living, population density, and rate design cost factors (in a rate of return environment).⁸⁹ The FCC also held that given the local nature of the characteristics listed, states possess the greater expertise to determine levels of affordability. Therefore, states have “primary responsibility for determining affordability.”⁹⁰ The FCC also concluded that current rates for local telephone service are affordable.⁹¹

The FCC also has addressed the issue of how to carry out Congress’s mandate that rates in high cost areas be “reasonably comparable” to rates in urban areas. The FCC has held that the “reasonably comparable” standard does not contain any implied meaning that consumers in rural and high cost areas

⁸⁶ Equal access allows a customer to reach the long distance carrier of choice using “1+” dialing as opposed to having to dial an access code, such as (“10-10-xxx”).

⁸⁷ 47 U.S.C. §§ 254(b)(1).

⁸⁸ *Universal Service Order*, ¶110.

⁸⁹ *Seventh Report and Order on Universal Service*, FCC 99-119 ¶ 36 (May 28, 1999).

⁹⁰ *Id.*

⁹¹ *Id.* at ¶38.

should be subject to means-testing to receive high cost support.⁹² The FCC distinguished this statement from its view of how low-income support should be implemented. Low-income support relies on means testing to determine eligibility. However, consumers cannot be required to meet a means test in order to obtain high cost relief. Nonetheless, the FCC held that if states wish to employ means testing in their analysis of whether to provide explicit high cost relief under a state universal service program, states have the discretion to do so.⁹³

iv. Who Gets The Subsidy?

The 1996 Act provides that only “eligible telecommunications carriers” (ETCs) designated by the state receive federal universal service support.⁹⁴ The FCC has clearly stated that any telecommunications carrier may become an ETC, regardless of what technology platform is used to provide the service, as long as they meet the ETC criteria.⁹⁵ Moreover, federal universal service support must be portable among all ETCs. When a competitor acquires a subscriber line from an incumbent receiving support, the competitor will receive the incumbent’s support.

It is also important to note that an ETC does not receive universal service support merely by virtue of the ETC designation. Support only flows if and when the ETC actually provides a universal service offering to customers.

To be declared an ETC, a company must demonstrate that it is able and willing to provide the nine supported services described on pages 43-44 of this Plan. States may also impose additional criteria to that required by the FCC in determining whether ETC status should be designated.⁹⁶ States also have the ability to monitor and enforce continued compliance with eligibility criteria for as long as the carrier is providing a universal service offering to the public.⁹⁷ ETC status can be revoked if a carrier does not continue to meet the ETC criteria.

The federal law contemplates that the development of competition and universal service go hand in hand. In non-rural areas, the 1996 Act requires a state to grant ETC status to companies meeting the federal criteria. For rural companies, the 1996 Act provides that a state must determine that granting ETC status to a second company is in the public interest.

v. How Should Universal Service Be Funded?

Federal law requires that all telecommunications carriers providing interstate telecommunications services and certain other providers of interstate telecommunications must contribute to universal service support.⁹⁸ The FCC has ruled that this law be interpreted broadly to apply to all telecommunications

⁹² *Id.* ¶ 39.

⁹³ *Id.* ¶ 40.

⁹⁴ 47 U.S.C. § 254(e).

⁹⁵ *Seventh Report and Order on Universal Service*, at ¶ 72.

⁹⁶ *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421, 1999 WL 55461 (5th Cir. 1999).

⁹⁷ *Universal Service Order* at ¶ 138.

⁹⁸ 47 U.S.C. § 254(d); *Universal Service Order* at ¶ 772.

service providers on a technology neutral basis. Thus, states may require Commercial Mobile Radio System (CMRS) providers to contribute to the universal service fund.

The FCC has determined that federal high cost support should be funded through contributions from telecommunications service providers based on their interstate revenue derived from end users.⁹⁹ The FCC has decided that the federal government will oversee the assessments and recovery of the interstate share of the necessary universal service contributions, and that state governments will assess and provide recovery for the intrastate share of the necessary universal service contributions.¹⁰⁰ Under the federal program, carriers are permitted, but not required, to pass through their universal service contributions to their interstate access and interexchange service customers.¹⁰¹ The FCC also decided that administration of the federal universal service program would be accomplished through a neutral third party.

In its October 21, 1999 high cost order relating to non-rural carriers, the FCC determined that the federal high-cost support mechanism would provide support to non-rural carriers in states where the statewide average cost per line exceeds a national cost benchmark. The FCC has established a universal service cost model that will be used to ascertain the national cost benchmark. The cost benchmark will be based on the forward-looking costs incurred by non-rural carriers to provide supported services. The FCC decided that a forward-looking economic cost model best approximate the costs that would be incurred by an efficient carrier in the market.

The federal support mechanism will provide support for all forward-looking intrastate costs per line that exceed the national benchmark. The statewide average cost per line for all lines served by non-rural carriers in a given state will be compared to a national cost benchmark, set at 135% of the national average forward-looking cost per line. Based on the FCC's separations rules and the division of cost recovery between the state and federal jurisdictions, the FCC has calculated that the high cost fund mechanism will provide 76% of the portion of the forward-looking costs of providing the supported services.

Under the FCC's new high cost mechanism for non-rural carriers, seven states will receive high-cost support of approximately \$255 million. These seven states are: Alabama (\$67.5 million), Kentucky (\$18 million), Maine (\$6 million), Mississippi (\$113.5 million), Vermont (\$12 million), West Virginia (\$34.5 million), and Wyoming (\$3 million). For the year 2000, the total fund for the non-rural carriers, which includes both support from the new mechanism and the transitional hold-harmless support, will be approximately \$437 million. Minnesota receives no support under the FCC's new framework.

⁹⁹ *Universal Service Order* at ¶¶ 824, 843. In contrast, the FCC has determined that funding for the federal e-rate program, and support for rural libraries and hospitals should be funded through contributions based on interstate and intrastate revenue.

¹⁰⁰ *Id.* at 826.

¹⁰¹ *Id.* at 829.

Again, the FCC will not decide the amount of support that will be provided to rural carriers until at least January 2001.

vi. Transition for Rural Carriers

The FCC also concluded that it was prudent to gradually transition rural carriers to a forward-looking cost mechanism. The FCC concluded that conversion to a forward-looking cost methodology would significantly change a major source of revenue for rural carriers. The FCC wanted to ensure that no sharp changes in revenue flowing to rural ILECs occurred. Moreover, the FCC wanted to ensure that rural carrier incentives to invest in upgrades to plant and equipment were not removed arbitrarily. For these reasons, the FCC concluded that it would be best to modify the existing high cost support, take three years to study how to fund high cost support for rural carriers, and then replace the transitional high cost funding mechanism for rural carriers with a system based on a forward-looking methodology that the FCC believes will work for rural telephone companies. The FCC concluded that rural carriers should continue to receive high cost loop assistance, Dial Equipment Minute (DEM) weighting (local switching support), and Long Term Support (LTS) for all their working loops until they move to a forward-looking economic cost methodology.

Prior to the 1996 Act, FCC cost separation rules assigned 25% of an ILEC's loop costs to the interstate jurisdiction, which ILECs recovered, pursuant to FCC rules, through federal Subscriber Line Charge (SLC) and Carrier Common Line (CCL) charges. At one time, all ILECs had to pool their interstate loop costs to set a uniform, nationwide CCL charge. When individual ILECs were allowed to leave the pool in 1989, departing carriers were required to pay Long Term Support (LTS) to prevent the CCL charges of small, higher-cost ILECs that remained in the pool from rising significantly above the national average. The ILECs that make LTS payments (i.e., the larger, lower-cost ILECs that have left the pool since 1989) contribute to LTS and recover the revenue for their payments by increasing their own CCL charges.

The FCC concluded that the pre-1996 LTS program constituted an impermissible universal support program.¹⁰² However, the FCC also concluded that the payment of LTS to rural carriers furthered the public interest. The FCC ruled that LTS should continue in amounts comparable to what rural carriers had been receiving, but that LTS should be paid for out of the FCC's new universal service funding mechanism.

DEM weighting is designed to support local switching costs for small telephone companies. DEM weighting assistance is an implicit support mechanism recovered through switched access rates charged to interexchange carriers by those ILECs serving fewer than 50,000 lines. When the DEM weighting mechanism was created, it was assumed that smaller telephone companies have higher local switching costs than larger ILECs because the smaller companies cannot take advantage of certain economies of scale. DEM weighting allowed small telephone companies to shift what would otherwise

¹⁰² *Universal Service Order*, at ¶756.

be intrastate costs to the interstate jurisdiction, which took pressure off local telephone rates.

Rural carriers also have received a third form of subsidy from the federal government, high cost loop support. This support is based on a formula in which rural telephone companies receive a subsidy for those loops with costs higher than an FCC benchmark standard.

The FCC has ruled that all three of these high cost support elements were to be removed from the interstate access charge framework, and instead recovered from the federal universal service fund.¹⁰³ The FCC has stated that it does not believe support to small telephone companies should or will drop below current levels during the transition to and after the conversion to a rural high cost formula based on forward-looking costs.¹⁰⁴ Below is a table extracted from the Universal Service Administrative Company which provides projections on the amount of high cost support that will be paid to small telephone companies in Minnesota in 1999:

¹⁰³ *Fourth Order on Reconsideration in Re Federal State Joint Board on Universal Service*, 13 F.C.C.R. 5318 ¶26 (1997).

¹⁰⁴ *Universal Service Order* at ¶¶ 294, 296.

High Cost Loop Support	Long Term Support	Local Switching Support	Total Support
\$11,340,144	\$12,031,404	\$17,081,172	\$40,452,720

Table 5 - Current Federal High Cost Support to Small Telephone Companies¹⁰⁵

d. Current State Law Regarding High Cost Support

One of the policy goals listed at the beginning of Minnesota Statutes Chapter 237 is “supporting universal service.”¹⁰⁶ Minnesota law requires that the MPUC develop a universal service program designed to “preserve the availability of universal service throughout the state.”¹⁰⁷ Under current law, any Minnesota universal service plan should be consistent with the five principles from the 1996 Act that are listed above.

The rulemaking to satisfy this statutory requirement was commenced by the MPUC on May 19, 1997. However, the consensus among the parties has been to delay completion of a Minnesota Universal Service Fund (USF) plan until completion of the federal high cost USF plan. Nonetheless, there are some pertinent laws and rules on the books relating to a state universal service plan.

i. What Telecommunications Services Should Be Supported By the High Cost Fund?

In addition to the services required to be supported under the federal universal service plan, state law requires that any state universal service plan provide the following services: line quality capable of carrying facsimile and data transmissions, equal access, and statewide telecommunications relay service for the hearing-impaired.¹⁰⁸

ii. Who Gets the Subsidy?

Current MPUC rules require that eligibility for receiving USF subsidies is limited to those carriers designated as ETCs by the MPUC.¹⁰⁹ The MPUC automatically designated all ILECs operating in the state as both federal and state ETCs.¹¹⁰ CLECs must apply for and receive a grant of authority from the MPUC in order to attain ETC status.¹¹¹ The MPUC may also order a local service provider to provide service to unserved areas of Minnesota.¹¹² Additionally, the

¹⁰⁵ Universal Service Administrative Company Web Site, www.universalservice.org/hc/hcfund2q99.

¹⁰⁶ Minn. Stat. §237.011 (1).

¹⁰⁷ Minn. Stat. §237.16, Subd. 9.

¹⁰⁸ Id.

¹⁰⁹ Minn. Rule 7812.0100, subp. 15 defines an ETC as a carrier designated by the MPUC as eligible to receive federal USF support. 7812.1300, subp. 2 indicates that the designation of a federal ETC follows federal law and rules. However, 7812.1300, subp. 1 states that to be eligible for state USF support, a carrier must be an ETC (i.e., satisfy the federal requirements) and meet the requirements of 7812.0600. To avoid confusion here, reference will be made to “federal ETCs” and “state ETCs.”

¹¹⁰ Minn. Rule 7812.1400, Subp. 1.

¹¹¹ Id. at 7812.1400, Subp. 2.

¹¹² In re Petition for Assignment of an Eligible Telecommunications Carrier to Provide Service in Unassigned Territory in Northern Minnesota, Docket No. P999/CP-98-1193, Order Requiring GTE to Provide Service to Territory (July 28, 1999). Minn. Stat. §237.16, Subd. 9.

MPUC may revoke a company's ETC status upon finding that it no longer meets the state ETC criteria.

Local service providers are eligible to receive federal universal service support for the benefit of rural health care providers, educational institutions, and libraries as provided in section 254, subsection (h), paragraph (1), subparagraph (B)(ii), of the act and any applicable FCC regulations.

iii. How Should Universal Service Be Funded?

Under current state law, the fund must be administered and distributed in accordance with rules adopted by the MPUC and designed to preserve the availability of universal service throughout the state.

The MPUC is required to establish and require contributions to a universal service fund, to be supported by all providers of telephone services, whether or not they are telephone companies under section 237.01, including, but not limited to, local telephone companies, independent telephone companies, cooperative telephone companies, municipal telephone companies, telecommunications carriers, radio common carriers, personal communication service providers, and cellular carriers.

Thus, any telecommunications carrier, cellular, PCS, or cable company that provides telephone service must pay into the fund. This statute does not specify what financing method should be used, such as a per line charge or a per dollar of revenue assessment.

2. Low-income Support

While Minnesota is a national leader with respect to the number of households with telephones, studies suggest that there is a widening gap of "haves" and "have nots" when access to basic telecommunications is broken down by income level, geography, and race.¹¹³ Nationally, central cities lag behind suburban and rural areas with respect to households having phones. The gap becomes increasingly wide at income levels under \$15,000 per year.¹¹⁴

This technology gap is carrying over into the area of access to data services. Households earning more than \$75,000 per year are five times more likely to own computers than those households earning less than \$10,000 per year.¹¹⁵ Households at the \$75,000 level are seven times more likely to use the internet than households at the \$10,000 level. Most two parent households are twice as likely to use the internet at home than single parent households. Those earning less than \$35,000 are more likely to access the internet outside the home. Those earning more than \$35,000 are more likely to access the internet at home. Those with higher incomes are more likely to have internet access at work. Those with lower incomes are more likely to use schools, libraries, and other people's computers for access. Moreover, minority groups are more likely to use the internet for educational purposes and job searches than non-minority groups, who tend to use the internet more for work. Finally,

¹¹³ L. Irving, "Falling Through the Net: What States Should Know About America's Technology Gap," (United States Dept. Commerce – National Telecommunications and Information Administration July 20, 1999). See Appendix I for copy of full report.

¹¹⁴ Id.

¹¹⁵ Id.

16.8% of those households with a computer say they do not use the internet at home because internet service costs too much. For single parent households with computers, cost is the single biggest reason for not having internet access. Overall, Minnesota ranks 13th in the nation with respect to households with internet access. It is estimated that 542,000 households, or 29% of total households currently use the internet.¹¹⁶

There are explicit state and federal subsidy mechanisms that were intended to reduce the price that low-income consumers pay for basic local telephone service. These programs include the Lifeline fund (the federal program which provides a subsidy to low-income customers for local telephone service), the TAP program (the state analogue to the Lifeline program), and Link-Up America, which provides subsidies for telephone installation to low-income customers.

The federal and state low-income assistance plans are supposed to complement one another. The Lifeline Plan offers three forms of federal support.¹¹⁷ First, any person meeting the federal Lifeline qualifying criteria receives a \$3.50 reduction in the amount of their monthly telephone bill. Second, if the MPUC approves, the federal government will contribute another \$1.75 to low-income consumers qualifying for the federal program, for a total of \$5.25 in federal funds.¹¹⁸ No state match is required for consumers to receive this federal credit.¹¹⁹ Third, low-income consumers can receive additional federal support equal to one half of any support generated from the intrastate jurisdiction, up to a maximum of \$7.00 in federal support. Thus, if a state provides the minimum amount of matching support (\$3.50) to receive the full federal support amount, the total reduction in end user charges would increase from \$7.00 under the current system to \$10.50.

The federal Link-Up program reduces the cost of installing telephone service by 50% or \$30.00, whichever amount is less. To qualify for federal support, a person need only show that they currently participate in one of the following other federal programs: Medicaid, food stamps, Supplemental Security Income, public housing assistance, or the Low-income Energy Assistance Program.¹²⁰

Under the Minnesota TAP, a qualifying individual may obtain a credit of the total amount available under the federal matching plan.¹²¹ However, the credits available under the TAP may not exceed more than 50% of the customer's local telephone service rate.¹²² Further, the total amount of support provided in the program must be funded through a uniform recurring monthly surcharge on all subscribers, not to exceed ten cents per access line. Minnesota does not have any analogue to the federal Link-Up program. Minnesota's TAP law provides that the credit is available to any person who is disabled or 65 years of age or older; and whose household income is 150% or less of federal poverty guidelines, or is currently eligible for:

- (a) the Minnesota family investment program;

¹¹⁶"Percentage of Households with Internet Access," 65 Telecommunications Reports No. 28 at 17 (July 12, 1999).

¹¹⁷ See 47 C.F.R. § 54.403 (1998).

¹¹⁸ *Universal Service Order* at ¶351.

¹¹⁹ *Id.*

¹²⁰ *Id.* §54.409(b).

¹²¹ Minn. Stat. §237.70, Subd. 5 (1999).

¹²² *Id.*

- (b) medical assistance;
- (c) general assistance;
- (d) Minnesota supplemental aid;
- (e) food stamps;
- (f) refugee cash assistance or refugee medical assistance;
- (g) energy assistance; or
- (h) supplemental security income; and

who has been certified as eligible for telephone assistance plan credits by the Minnesota Department of Human Services. The table below sets out a comparative analysis of the federal and state low-income assistance programs.

	<i>Federal Contribution (Lifeline) Available</i>	<i>State Contribution (TAP) Customer Receives Federal Lifeline</i>	<i>State Contribution (TAP) Customer Does not Receive Lifeline</i>
Federal Baseline	\$3.50 <i>No match required</i>		
Additional federal contribution	\$1.75 <i>State approval required</i> <i>No match required</i>		State approval required
Current State contribution (TAP)	<i>N/A</i>	\$1.75	\$5.25
Maximum federal match.¹²³ Only available for state programs that support all low-income consumers	\$1.75¹²⁴		
Total Contributions¹²⁵	\$5.25	\$1.75	\$5.25

Table 6 – Low-income Support Under Current Formulas

Minnesota consumers are not currently eligible for the federal matching fund due to the State’s failure to bring its TAP qualification criteria into compliance with the FCC’s eligibility criteria. Federal matching funds cannot be received by residents in states where the telephone assistance program eligibility criteria do not focus solely on low-income factors.¹²⁶ The FCC has ruled that Minnesota’s TAP qualification cri-

¹²³ The maximum federal match would be the lesser of: The amount needed to reach the federal maximum contribution (\$1.75); or half of the state contribution from TAP (\$2.63).

¹²⁴ Minnesota low-income customers are not currently eligible to receive the \$1.75 in matching funds from the federal government due to the State's non-compliance with the FCC's qualification criteria discussed in the following paragraph. Minnesota low-income consumers are limited to \$5.25 in benefits unless and until state law is changed.

¹²⁵ While \$7.00 is the maximum available as a federal contribution, customers receiving federal assistance can receive a maximum of \$5.25 in federal funds. With the state contribution, under current Minnesota law customers receiving federal assistance receive a total credit of \$7.00 and those that do not receive \$5.25.

¹²⁶ *Universal Service Order* at ¶373; *Order in Response to Letter From MPUC and DPS*, CC Docket No. 96-45, DA-98-1709 (FCC August 27, 1998)(herein "FCC TAP Order").

teria do not comply with its Lifeline qualification criteria.¹²⁷ Therefore, the FCC ruled that “because TAP does not comply with section 54.409(a) of our rules . . . participants in that program will not be eligible to receive the additional \$1.75 in federal support that is available to states that comply with section 54.403(a) of the Commission’s rules.”¹²⁸

B. Analysis and Findings

The current system of implicit universal service subsidies contradicts just about every fundamental principle of the Ventura Administration. It is a system which is not accountable to the people and provides no incentives for desirable competitive behavior. It is a recipe created by government, cooked by the industry, and hardened by time. The huge dollar amounts at stake ensure that alteration of this recipe will be extremely controversial, costly to some, and beneficial to others -- a perfect recipe for controversy. The problems created by the current universal service program can be fixed. But the solution raises two fundamental “gut check” questions: Do we believe that competition works? Do we believe in doing the right thing and doing it well? The Ventura Administration says yes to both. Below, the Ventura Administration sets out its plan for ensuring that every Minnesotan has access to advanced and competitive telecommunications services, and that the historical system of implicit subsidies is replaced with a system of explicit subsidies that is developed in the sunshine, approved by elected representatives, and not unknowingly slipped by consumers in their telephone bills.

1. Geographic Deaveraging

a. Geographic Deaveraging of Retail and Wholesale Rates is Imperative to a Competitive Telecommunications Marketplace.

Geographic deaveraging of retail and wholesale rates for telecommunications services is imperative if the transition from a non-competitive marketplace to a competitive marketplace will be successful. Geographic deaveraging will get rid of the historical implicit cross subsidy caused by rate averaging that now constitutes a barrier to the development of fair competition. Under the current averaged rate structure, a potential competitor has no incentive to compete in communities where the local telephone rate is subsidized as a result of rate averaging. A competitor cannot compete against an incumbent price that is below a competitor’s cost of service. On the other hand, in a competitive environment, incumbents are at a disadvantage under an averaged rate structure in communities where the incumbent’s customers are subsidizing the cost of service of other communities because they are being charged prices above economic cost. A competitor can easily undercut an incumbent’s price if the incumbent is locked in at an averaged rate above economic cost. If competition is to work, the cross subsidy caused by rate averaging must be eliminated.

Rate averaging is not accountable to the people either. Most ratepayers have no idea they are subsidizing the cost of providing telephone services to other communities. Geographic deaveraging will allow for the worthy social goal of developing a working state universal service program that has been discussed and

¹²⁷ *Id.* at ¶¶4-5.

¹²⁸ *Id.* at ¶5.

decided in the sunshine, rather than being slipped into the telephone bills of unsuspecting ratepayers.

On the other hand, geographic deaveraging must also be accomplished in a manner which does not shock ratepayers in high cost areas. For that reason, geographic deaveraging should not occur unless and until there is a working state universal service plan in place. Finally, retail deaveraging should generally not be allowed unless underlying wholesale rates have been deaveraged. Generally, deaveraging retail rates without deaveraging wholesale rates can lead to anti-competitive price squeeze situations.

b. Deaveraged Rates Should be Established Based on Cost-Related Density Zones.

The FCC requires states to geographically deaverage wholesale rates by establishing a minimum of three cost related zones. Nothing prevents the state from establishing more than three zones. The Ventura Administration believes that deaveraged rates should be established using five zones – (i) Urban; (ii) Suburban; (iii) Town; (iv) Rural I; and (v) Rural II. These cost zones are based on a reasonable categorization of the cost/density information shown in Appendix G of this Plan. The Rural I Zone would include any area with an access line density of between 1 and 5 access lines per square mile.¹²⁹ The DPS 1998 study indicates that costs in these areas exceed the statewide average cost by 686%. The Rural II Zone would include areas with access line densities of between 6 and 100 access lines per square mile. The MDOC’s study indicates that costs in these areas exceed the statewide average by 268%. The Town Zone would include areas with access line densities of between 101 and 850 per square mile. The MDOC study indicates that costs in these areas fall between 75% and 112% of the statewide average. The Ventura Administration believes it is reasonable to group these areas together to constitute a Town Zone. The Suburban Zone would include areas with access line densities between 850 and 10,000. The Department’s 1998 study indicated that costs in these areas fall between 54% and 32% of the statewide average cost. The Ventura Administration believes it is reasonable to group these areas together to constitute a Suburban Zone. The Urban Zone would include areas with access line densities of between 10,001 or more. The MDOC’s 1998 study indicates that costs in these areas are 19% of the statewide average cost.

Cost Zone	Access Line Density	Cost Compared to Statewide Average
Rural I	1 to 5 per sq. mile	686%
Rural II	6 to 100 per sq. mile	268%
Town	101 to 850 per sq. mile	75%-112%
Suburban	851 to 10000 per sq. mile	32% to 54%
Urban	Over 10,000 per sq. mile	19%

Table 7 - Proposed Density/Cost Zones for Geographic Deaveraging

¹²⁹ Square mile units can be scoped by the Department of Planning within census blocks. Telephone companies have the information to directly calculate the access line density of every wire center. Diversity calculations for areas smaller than a wire center are a challenge.

Establishing the zones is just the first step of the deaveraging process. Once the zones are established, the cost of service for each wire center must be determined and pooled into the appropriate category based on the access line density of the wire center.¹³⁰ In Greater Minnesota, costs should be deaveraged below the wire center level, based on a town/country distinction.¹³¹ Then, the costs of these wire centers and rural areas should be averaged within each cost zone to achieve the deaveraged rate for all of the wire centers or rural areas within that zone. There is still a certain degree of rate averaging occurring, even under this proposed formula. But there will always be some degree of rate averaging because it is practically infeasible to attain absolute precision in matching price with cost. In a perfect world, the price of service would equal the cost of service on a per access line basis. However, determining the actual cost of service per access line would be a painstaking, time consuming effort. There are no cost models which can pinpoint costs to this level of accuracy. To deaverage at a level above the wire center, as some parties have suggested, would create unpalatable anomalies. For example, neighbors in an urban or suburban area may be served by different wire centers. If deaveraged rates were calculated at the wire center level, these two neighbors could easily end up paying two different rates for telephone service from the same company. The Ventura Administration approach achieves a reasonable degree of rate uniformity. More importantly, it achieves the goal of eliminating implicit urban to rural cross-subsidies in a manner which can be implemented by the MPUC and the MDOC with administrative efficiency. Finally, reasonable precision in deaveraging rates will result in further administrative efficiencies in the long run because universal service subsidies will be more easily calculable and portable in competitive areas.

- c. The MPUC Should Be Directed to Establish Deaveraged Wholesale Rates Upon the Effective Operation Date of the State Universal Service Program.

In order to expedite the elimination of competitive barriers caused by rate averaging, the Ventura Administration believes the MPUC should be directed to complete proceedings to deaverage the wholesale rates in Minnesota in accordance with the principles described above. This process should be implemented with as little rulemaking as possible.¹³² Deaveraged wholesale rates should become effective upon the effective operation date of the State Universal Service Program.

¹³⁰"Wire center" means "the location where the telephone company terminates subscriber outside cable plant (i.e. their local lines) with the necessary testing facilities to maintain them." A wire center may have one or more public exchanges or switches. A customer could get telephone service from one, several or all of these switches without paying additional costs. Newton's Telecom Dictionary at 884.

¹³¹ See In re Petition for Agreement With Designation of rural Company Eligible Telecommunications Carrier Service Areas and for Approval of the Use of Disaggregation of Study Areas for the Purpose of Distributing Portable Federal Universal Service Support, Memorandum Opinion and Order, CC Docket No. 96-45 (FCC Sept. 9, 1999); Minnesota Geographic Deaveraging Docket, Reply Comments of the MIC and Frontier (July 16, 1999).

¹³² There are several rule making dockets that have stagnated for a variety of reasons. For example, the MPUC, at the urging of the parties has chosen not to move ahead with geographic deaveraging or a state universal service plan until the FCC finishes its rulemaking process for universal service. As discussed previously, the FCC may not be done with its universal service rulemaking until 2001. The Ventura Administration believes this is too long to wait.

- d. The Deaveraged Rates/Costs Established Pursuant to the Legislature's Directive Should be Mandated for Other Applications.

Shortly after the adoption of the 1996 Act, the MPUC commenced a docket to determine the generic cost of unbundled network elements. The costs established in this docket are to be used as the basis for U S WEST's provisioning of unbundled network elements to competitors like MCIMetro, AT&T, and McLeod USA. The MDOC assessed nearly \$450,000 in expenses on this case, and over 8,000 hours of professional time, in addition to the time, effort, and cost that the OAG-RUD, CLEC community, and other stakeholders invested. Sadly, as of the date of this Plan, the generic cost docket has still not finally concluded.

One of the key elements at stake in this case is the wholesale cost of the local loop. The MDOC believes the expensive cost model developed for determining the costs of UNEs, including the local loop, should also be used for the purposes of establishing costs in other regulatory contexts, including geographic deaveraging. It only makes common sense that given the public resources that went into the establishment of this cost model, and the litigation costs of all parties, that as much utility as possible be made out of the results produced by that model. Presently, the MDOC is faced with the prospect of having to litigate the development or use of a cost model in the context of geographic deaveraging.

To avoid further prolonging of the arrival of competition throughout the State, the Ventura Administration believes that the costs established at the wire center which are pooled into cost zones for the purposes of calculating deaveraged wholesale rates, *must* be used in three other contexts: (i) establishing unbundled loop rates for each wire center; (ii) setting the price floor for retail deaveraging when requested by Qualified Companies;¹³³ and (iii) calculating a cost basis for universal service subsidies.

Telephone companies and regulators will have an incentive to estimate costs as objectively as possible under the Ventura Administration's proposed framework. The higher the cost, the greater the universal service support for the company. At the same time, the downward pressure on costs will promote local competition because CLECs will see lower prices for UNEs. Finally, a lower economic cost will allow ILECs increased pricing flexibility under the Ventura Administration's proposed local regulatory framework.¹³⁴

2. Access Charge Reform

- a. Implicit Cross-Subsidies Embedded in the Intrastate Access Charge Structure Must Be Eliminated.

Access rates have been used to provide an implicit subsidy to support the cost of providing other services. High access prices have resulted in higher toll rates. Thus, consumers have been paying too much for toll service, or have chosen not to make toll calls because of the price. The market inefficiencies resulting from this government sanctioned implicit cross subsidy produce results that are not reflective of a free market environment. To the extent that access charges exceed

¹³³ See section VIII, pp. 94-96, Table 15, and Figure 1 on page 106, on local competition for discussion of Qualified Companies under the Ventura Administration's proposed local regulatory framework.

¹³⁴ See *id.*

their underlying costs, interexchange carriers will have higher service costs and customers will have higher toll rates. Because the purchasing decisions of consumers for long distance service are based on rates, high rates repress demand for toll service. Further, companies with high toll usage may expend capital to bypass LEC facilities, which they might not otherwise do if toll rates were priced at cost. This is a wasteful use of capital investment that could be better used to promote other goals of the State.

ILECs and CLECs also use access charges to place undue hardships on their potential competitors for local service. When an ILEC or CLEC provides interexchange service, customers of the ILEC or CLEC for local service are likely to be customers of the same company for interexchange service. This is particularly true in the case of CLECs. Since U S WEST is not yet permitted to provide interexchange service, CLECs have been promoting their services by packaging local and long distance services. A practice of the CLECs is to charge high rates to terminate calls to their local customers. Because customers subscribe to the CLEC for both local and long distance services, the CLEC may have low originating rates but high terminating rates. Because other carriers will be forced to pay the terminating rates of the CLEC for a call originating from a customer served by a different local carrier, a CLEC with high terminating access rates can create a financial hardship for its competitors.

Current Minnesota law actually sanctions these market inefficiencies by requiring long distance companies to pay the LEC to use the local loop.¹³⁵ This law essentially mandates the imposition of the CCLC in Minnesota, which as explained above has no cost basis. Because there is no incremental cost associated with the loop with respect to usage, this statute results in long distance companies, and consumers through toll rates, implicitly subsidizing the cost of consumers to access the network. Elimination of this requirement would promote the Ventura Administration policy objective of replacing implicit subsidies with explicit support. However, in a monopoly environment, the local switching and transport elements could still be priced significantly higher than cost if the CLEC is eliminated. This cross-subsidy would cause the same inefficiencies in the marketplace that existed with the CCLC. To ensure that all implicit subsidies are eliminated, the Ventura Administration favors a law that prohibits long distance carriers from subsidizing the cost of the local loop. It must be emphasized, however, that when this implicit subsidy is removed, *telephone service to high cost areas will not be affordable in the absence of some other form of subsidy program*. The universal service program should provide explicit support to high cost areas to make up this difference.¹³⁶

The intrastate markets can be made more efficient by reducing access charges to bring prices closer to long run incremental cost. Access services should be priced appropriately to create a level playing field for competitors of both local and long distance services.

The chart below provides the Ventura Administration's rough estimate of the economic impact this proposal would have on local telephone companies:

¹³⁵ Minn. Stat. § 237.12, Subd. 3.

¹³⁶ See discussion at pp. 66-68.

Company	Annual Access Reform Impact¹³⁷
U S WEST	\$15,000,000
GTE	\$8,000,000
Sprint/United	\$7,500,000
Frontier	\$6,000,000
Independents	\$57,386,307
Total	\$93,886,307

- b. Access Charges Relate to Essential Service and Thus Fall Under Either Category I (Non-Qualified Company) or Category II (Qualified Company) Under the Ventura Administration's Proposed Local Regulatory Framework.¹³⁸

While long distance telephone companies have an incentive to reduce or eliminate any subsidies currently being made to local service rates through price increases, there are not currently forces in the intrastate marketplace strong enough to push access service prices all the way to cost. Interexchange carriers are currently captive to the access charges of the LEC, particularly for terminating access. When a customer selects an interexchange carrier to place a toll call, the carrier is billed the access charges of the LEC. To avoid high access prices, an interexchange carrier would need to bypass the facilities of the LEC. This is possible for originating traffic, but unless the customer has sufficient traffic to pay for the additional costs that will be incurred, such a configuration is not economically feasible. For terminating traffic, there is less opportunity to bypass the LEC facilities because the call is carried by the carrier selected by the customer originating the call. While bypass of terminating traffic is possible in some circumstances, it is uncommon. Because the interexchange carrier is generally unable to select the local service provider of the customer, the interexchange carriers are a captive market where exploitation by ILECs and CLECs is possible, and indeed has been the practice in the past.

There is little or no difference in cost for the local company to originate or terminate a call that is local versus long distance. Further, the local company should be indifferent as to whether a call that terminates to one of its customers originated in the same local calling area or not. However, the pricing structure that is currently in place is different for calls that are local and calls that are long distance. Local calls are subject to the fees specified in the local interconnection agreements or in the company's tariffs as local termination charges. Long distance calls are subject to tariffed access charges. This pricing structure creates perverse incentives for the companies operating in the telecommunications market.

¹³⁷ These calculations are rough. For U S WEST, the figure is based only on elimination of the Common Carrier Line Charge. U S WEST's costs for transport and switching are in line with cost due to their AFOR Plan. Estimates for GTE and Frontier are based on 1997 switched access data, as well as the elimination of the CCL. Estimates for Sprint are based on data filed for Sprint's January 1999 access rate reduction pursuant to their AFOR Plan. Estimates for independent telephone companies are based on 1995 minutes of use, multiplied by a 20% growth factor to reflect Year 2000 use. All estimates assume switching rates of \$.01 per minute for origination and termination, and \$.01 per minute for transport.

¹³⁸ See section VIII of this Plan, at pp. 94-98 and Figure 1 at p. 106.

An example of what may occur if access charges are not driven towards cost for ILECs is that interexchange carriers may choose not to serve those areas where they cannot make a reasonable profit. Past regulatory policies have not permitted interexchange carriers to exit a market within Minnesota without MPUC approval. Also, since interexchange carriers have had considerable profit margins, exchanges with high access charges and with low volume did not warrant a significant amount of concern by interexchange carriers. However, as competition continues to intensify and excess contributions are squeezed out of the prices charged to consumers, interexchange carriers will choose not to serve the areas with high access charges unless they are permitted to charge higher toll rates to the customers in those areas. State law now requires long distance carriers to offer services statewide.¹³⁹

Finally, there has been significant controversy on whether calls placed over the internet should be assessed access charges. ILECs should be indifferent as to whether a call is local, toll, or to a local internet provider. So should be the State's regulatory framework. To eliminate the anti-competitive conduct that is possible with the current access structure and to help enable consumers to make purchasing decisions based on the costs their decisions will impose on the system, the charges for the functions provided by the ILEC should be priced at cost and should not differ based on the technological platform being used to provide service by the interconnecting company.

To ensure a level competitive playing field, accountability and fairness to consumers, access services should be regulated under either Category I or Category II of the Ventura Administration's local service regulatory framework described in section VIII below.

c. Access Charge Reductions Will Not Necessarily Be Revenue Neutral to ILECs.

Access charge reform will mean that ILECs will want to either increase local service rates to achieve desired rates of return, or recover the lost access contribution from the state universal service fund. However, neither ILECs nor any other company should be *entitled* to a public subsidy. Under the proposed Ventura Administration universal service plan, companies will need to demonstrate that their high cost of service warrants the receipt of a public subsidy.¹⁴⁰ Being small provides no excuse for not being accountable to consumers.

The actual amount of access charge reductions and the resulting universal service support cannot feasibly be determined by the Legislature. The Legislature, however, can provide the MPUC with specific standards and directions to apply in determining the exact access charge reduction amount, and the amount of universal service subsidy that an ETC should receive. The Ventura Administration believes that these tasks should occur sooner rather than later. There is no reason to wait for the FCC to act. The Ventura Administration recommends that the Legislature direct the MPUC to complete a proceeding to reduce access charges to economic cost. Since the termination of local traffic should also be at cost, the fee to terminate local, long distance or internet traffic should be the same. Interconnection agreements should address the reciprocal compensation of the companies.

¹³⁹ Minn. Stat. § 237.74, Subd. 2.

¹⁴⁰ See discussion at pp. 66-68.

Where interconnection agreements are not established, a single cost based charge should be used for the origination and termination of all traffic, irrespective of whether it will eventually terminate with the local calling area. Price ceilings would be set at this amount and could be increased by the MPUC upon a showing that “actual competition” exists for these services.¹⁴¹

3. High Cost Fund

- a. Federal Law and Sound Public Policy Require That Rates for Essential Telecommunications Services in High Cost Areas in Minnesota Be Reasonably Comparable to Rates Paid in Urban or Suburban Areas After Implicit Subsidies Are Removed From Rate Structure.

Section 254 of the 1996 Act requires that consumers in rural, insular, and high cost areas have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. The Ventura Administration believes Congress’ use of the term “access” is significant. It is clear that when implicit subsidies are removed from the telecommunications rate structure in Minnesota, without universal support, the cost of essential local telephone services will increase dramatically. Thus, without a subsidy, the high cost of providing service to these areas, creates a barrier to access of these services. In order to keep rates for essential telephone services in high cost areas reasonably comparable to those charged in urban areas, as required by federal law, universal service subsidies must support the provision of essential telephone services in those areas.

There are also good public policy reasons for ensuring that rates for essential telecommunications services are affordable in Greater Minnesota. The availability of affordable basic telecommunications services is critical to the economic survival of Greater Minnesota. Access to affordable telecommunications services is vital to commerce, health care, education, and community life. Without access to basic telecommunications services, residents in Greater Minnesota would have no access to emergency 911 services and would be unable to place local or long distance calls to reach family members. Affordable telecommunications reduces the “cost of distance” for Greater Minnesota.¹⁴² E-mail, distance learning programs, and telecommuting applications offer residents in Greater Minnesota the ability to reduce the time and cost involved in traveling and provide residents economic opportunities not otherwise available to Greater Minnesota.

Citizens in Greater Minnesota are demanding these types of services. In discussions with rural community representatives at public forums, and through correspondence, the message is getting through to the Ventura Administration that these services are not just nice to have; they are vital to the long-term survival of Greater Minnesota.

¹⁴¹ See discussion at pp. 95-96.

¹⁴² M. Werner, "Providing Access to Information/Communications Technology for Rural Minnesota – Preliminary Report" (Center for Rural Policy and Development October 1999).

Consistent with the need to make implicit subsidies explicit, state law should more explicitly reflect Minnesota's commitment to invest in rural economic development. The state's definition of universal service should be revised to reflect this commitment. Moreover, the state should not wait for the FCC to act on universal service for small telephone companies. Greater Minnesota cannot wait. The Legislature should communicate a sense of urgency to the MPUC to develop a state universal service plan that addresses Greater Minnesota's burgeoning demand for telecommunications infrastructure and services.

b. Services to be Supported by the High Cost Fund

Federal law requires that, at minimum, the state's universal service fund support the nine services described above.¹⁴³ In addition, the Ventura Administration believes that the following items should also be supported:

- i. All ETCs should provide long distance carriers equal access to customers. Requiring ETCs to provide equal access will ensure the continuation of robust competition for long distance services in the State. Long distance competition can only occur when end-users have a choice of long distance companies.¹⁴⁴
- ii. Statewide telecommunications relay service. The Telecommunications Access for Hearing Impaired Persons (TACIP) is federally mandated and one of the most essential of all Minnesota's programs serving people with hearing loss, speech impediments, and mobility difficulties.¹⁴⁵ In order to assure that essential telecommunications services are available to all Minnesotans, all ETCs should continue to be required to provide the state relay service.
- iii. Access to facilities capable of providing voice-grade service and high-speed data services of at least 256 Kbps to residential customers. Section 254 of the 1996 Act requires that consumers in rural, insular, and high cost areas have access to telecommunications and information services, including . . . advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. Advanced services, as defined under federal law include high-speed data services.¹⁴⁶ Maps 5 and 13 demonstrate that while access to high-speed services is arriving in urban areas through technologies such as DSL and cable modem service, access to high-speed services is not available in most of Greater Minnesota. Although many telephone companies commented on their infrastructure inventory forms that they were planning to add high-

¹⁴³ See pp. 43-44.

¹⁴⁴ Order Granting Certificate of Authority to Provide Equal Access Services In re Minnesota Independent Equal Access Corporation's Application for a Certificate of Public Convenience and Necessity, Docket No. P3007/NA-89-76 at 2 (MPUC Jan. 10, 1991).

¹⁴⁵ During the past several years, members of Minnesota's deaf community have objected to the use of the word "impaired" within the context of the state program entitled TACIP. Although the TACIP statute (237.50) contains numerous references to impaired persons, constituents are concerned primarily with the use of the word impaired in the program's official title. Therefore, the Ventura Administration proposes changing the official title of the program to Telecommunications Access Minnesota (TAM). The State of Maryland successfully addressed a similar situation by changing Maryland's program title to Telecommunications Access of Maryland.

¹⁴⁶ See Appendix F.

speed service capabilities, there are no guarantees that access to such services will ever be offered. The Ventura Administration believes that if a telecommunications company receives public subsidies, that company should have an obligation to invest that subsidy in advanced services which will contribute to the health and vitality of Greater Minnesota.

In order to receive any support, an ETC must demonstrate that it is able and willing to provide all of the above listed services throughout its designated service area.¹⁴⁷ This means that the MPUC's blanket designation of all KECs as ETCs should be revoked by the Legislature. All companies must certify that they meet the proposed ETC criteria. The service area should be determined on the basis of an ETC service area at the time they apply for ETC designation.¹⁴⁸ The receipt of a public subsidy should carry with it more than the obligation to provide a minimal level of telephone service. Some telephone companies, particularly the smaller independent telephone companies have used the implicit subsidies they receive through access charges to reinvest in their communities. Many such companies are upgrading plant and equipment to provide high-speed data services. However, Minnesotans should expect the same commitment from all telephone companies if they are to receive a public subsidy to do business, and should not have to pay monopoly rates for basic telephone services in order to finance investment in advanced technology. The survival of Greater Minnesota depends on this investment. If a company receives a public subsidy, it should have a legal obligation to invest in Greater Minnesota's future by serving all customers within their designated service area.

The Ventura Administration also recommends that universal service support only primary residential telephone lines. Access to affordable telecommunications services does not require subsidization of multiple lines per home. The objective of the universal service fund is access to essential telecommunications services reasonably comparable to that available in urban areas. Secondary lines for residences are not essential services. Further, the Ventura Administration proposes using a \$1 per number charge on telephone numbers to subsidize the cost of essential telecommunications services for rural businesses. The Ventura Administration estimates that this charge will raise \$240 million per year for support of rural businesses. The line charge would also serve the dual function of deterring the waste of telephone numbers by ILECs.¹⁴⁹ The Ventura Administration believes this subsidy will help rural communities attract and retain businesses, improving the economic vitality of Greater Minnesota.

4. Low-income Support

- a. Federal Law and Sound Public Policy Require that Universal Service Funds Keep the Cost of Basic Telecommunications Services Affordable to the State's Poor.

One of the bedrock principles of the 1996 Act and the Ventura Administration is to ensure that quality services are available to low-income consumers at just, reasonable, and affordable rates.¹⁵⁰ Section 254(b) of the 1996 Act specifically states that consumers in all regions of the nation, including low-income consumers,

¹⁴⁷ 47 U.S.C. §214(e)(1).

¹⁴⁸ See Initial Brief of the MDOC, MCC Petition, Docket No. P5695/M-98-1285 at 42 (MPUC July 19, 1999).

¹⁴⁹ See discussion at pp. 126-127.

¹⁵⁰ 47 U.S.C. § 254(b)(1).

should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services.¹⁵¹ The Ventura Administration believes that these provisions require the maintenance of a fund which offsets the cost of basic local telephone service to low-income consumers.

b. The State TAP Statute Must Be Re-written to Comply With FCC Lifeline Eligibility Criteria.

The state must ensure that residents who qualify for federal Lifeline assistance obtain the full amount of the federal subsidy available. There are currently approximately 43,900 residents in Minnesota who qualify for TAP. The Minnesota Department of Human Services (MDHS) estimates that an additional residents would qualify for TAP and the federal Lifeline program if the State's eligibility criteria were modified to conform to the federal eligibility criteria. Because of the State's non-compliance with the federal Lifeline eligibility criteria, Minnesotans are losing out on \$9.5 million in support each year.

However, changing the criteria using 150% of federal poverty guidelines as the qualifying factor to match the federal criteria would increase the number of residents who are eligible for TAP. Persons would no longer need to demonstrate they are disabled or 65 or older in order to qualify for the TAP program if Minnesota law is changed to conform to the FCC's rules. As of Spring 1997, there were 283,000 households in Minnesota who have telephones, whose income is below 150% of federal poverty guidelines, and were eligible for federal Lifeline assistance. Based on estimates supplied by MDHS, conforming the state law to the federal rule would increase the number of residents eligible for Lifeline support, and consequently the TAP program by 119,500 households. This estimate is reached based on the following calculation:

<i>Number of Households Eligible for Federal Lifeline Assistance</i>	<i>283,000¹⁵²</i>
<i>Less Number of Households Currently Enrolled in TAP</i>	<i>43,900¹⁵³</i>
<i>Equals Total Number of Additional Households Eligible for TAP and Federal Lifeline Matching Funds</i>	<i>239,100</i>
<i>Assumed "Take Rate"</i>	<i>50%</i>
<i>Equals Estimated Number of Additional Households that would Participate in TAP and Federal Lifeline Matching Funds if Law were Changed</i>	<i>119,550</i>

Table 9 - Estimated Increase in TAP Participants if State Law Changed to be Consistent with Federal Law

Assuming both the State TAP program and the federal Lifeline program remained at current funding levels, the total economic impact on Minnesota is calculated below:

¹⁵¹ 47 U.S.C. § 254(b)(2).

¹⁵² MDHS estimate.

¹⁵³ See Comments of the MDPS in re Annual Consideration of Possible Changes in the TAP Surcharge and TAP State Credit for Calendar Year 1999, Exhibit A, MPUC Docket No. P-999/CI-98-1720 (May 6, 1999).

	<i>Benefit Amount per month</i>	<i>Number of households</i>	<i>Total monthly economic impact</i>	<i>Annualized economic impact</i>
Current State TAP Benefit				
<i>Non-lifeline participants</i>	\$5.25	17,560	\$92,190	\$1,106,280
<i>Lifeline participants</i>	\$1.75	26,340	\$46,095	\$553,140
Total		43,900	\$138,285	\$1,659,420
TAP if State Law Changed				
<i>Current Participants</i>	\$3.50	43,900	\$153,650	\$1,843,800
<i>Additional Participants</i>	\$3.50	119,550	\$418,425	\$5,021,100
Total		163,450	\$527,075	\$6,864,900
State TAP Funding if Law Changed				
<i>Benefits</i>				\$5,205,480
<i>Administrative Costs¹⁵⁴</i>				\$266,000
Current Federal Lifeline Support				
<i>Current Lifeline & TAP partici- pants</i>	\$5.25	26,340	\$138,285	\$1,659,420
<i>Lifeline recipients not receiving TAP</i>	\$5.25	40,000	\$210,000	\$2,520,000
Total		66,340	\$348,285	\$4,179,420
Potential Federal Support if state law changed (at estimated take rate)	\$7.00	163,450	\$1,144,150	\$13,729,800
Increase in Federal Support if state law changes				\$9,550,380
Total Low-Income Support if State Law Changed				\$20,594,700

Table 10 - Economic Impact if State Law Changed to Capture Additional Federal Funding

In other words, Minnesota is losing out on over \$9.5 million in federal Lifeline matching support due to the state law’s non-conformance with the FCC Lifeline eligibility criteria. Under current federal matching fund levels, the State would need to invest an additional \$5.2 million to qualify Minnesota low-income consumers for the federal money.

The Ventura Administration recommends that the state law be changed to conform to the federal Lifeline eligibility criteria, and that the Legislature initially set the TAP credit at a level of \$3.50 per month. This approach provides the “optimum level of return” with respect to Minnesota’s investment in the TAP fund. Under the Ventura Administration’s proposal, an additional \$5.2 million in state investment over current TAP funding levels results in an additional \$9.5 million of federal support to low-income consumers compared to the amount that is available to low-income consumers today. These changes in the law will further the goals of Congress and the Ventura Administration to ensure that quality, affordable telecommunications services are available to all Minnesotans regardless of income level.

5. Funding Universal Service

¹⁵⁴In order for MDHS to enroll and certify eligibility for an additional 119,500 applicants, administrative costs will increase. MDHS presently receives \$314,000 annually for TAP administrative expenses. It is anticipated that with start up costs, the TAP administrative budget would need to be increased by \$266,000 to \$580,000 in the first year of operation. After the first year the TAP administrative budget will reduce to \$530,000.

- a. Supporting Minnesota’s Telecommunications Infrastructure Should Be Accomplished Through Explicit Subsidies Approved By Elected Representatives.

One of the overriding principles of the 1996 Act and the Ventura Administration is that historical implicit subsidies embedded in the traditional rate structure of the telecommunications services industry should be made explicit.¹⁵⁵ The Ventura Administration’s positions on access charge reform and geographic deaveraging explained above provide the Legislature with recommendations on how implicit subsidies should be eliminated. However, the removal of implicit subsidies takes care of only half the issue. Once implicit subsidies are removed, they must be replaced with a “specific, predictable, and sufficient” system of explicit subsidies to ensure that rates in Greater Minnesota are reasonably comparable to those in urban areas of the State.

In general, the Ventura Administration believes that social goals, such as universal service, should be programs shaped and funded out of dollars approved by the Legislature, just as other state social programs are shaped and funded. Moreover, given the amount of money involved in the state universal service program, the Ventura Administration strongly believes that decisions on the amount of the funding and the manner in which it is spent should be decided by elected representatives, not the MPUC. The Ventura Administration acknowledges the risk this adds to achieving the federal requirement that rates in rural and urban areas be reasonably comparable. However, the Ventura Administration is confident that the Legislature will ensure that the MUSF remains funded at levels that do not place the State at risk of violating federal law.

Congress and the FCC have already made some of these decisions for the State. The decision on how much should be collected and for what purposes universal service funds can be used can be made by the Legislature. Section 254 of the 1996 Act provides:

A State may adopt regulations not inconsistent with the Commission’s rules to preserve and advance universal service. *Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State.* A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms (emphasis added).¹⁵⁶

This section requires telecommunications providers, not consumers, to contribute to the establishment and maintenance of a universal service fund. The FCC has

¹⁵⁵ 47 U.S.C. § 254(d)-(e); Joint Explanatory Statement of the Committee of the Conference (H.R. Rep. No. 458, 104th Cong., 2d Sess.) (Joint Explanatory Statement) at 131.

¹⁵⁶ 47 U.S.C. §254(f)

ruled that carriers should be allowed the flexibility to decide how they should recover their universal service contributions.¹⁵⁷ The FCC found that as telecommunications carriers and providers begin merging telecommunications products into single offerings (e.g. package prices for local and long distance service), they will offer bundled services and new pricing options. The FCC found that mandating recovery through an assessment on telecommunications service providers based on end-user revenue would eliminate carriers' pricing flexibility to the detriment of consumers.

The Ventura Administration recommends that the Legislature fund the state universal service program through legislatively approved assessments on telecommunications service providers based on end user charges. This mechanism allows the decision of how much should be spent on universal service to be made by elected representatives, while at the same time not resulting in a state mandated increase in rates for telecommunications services. The law should require the MPUC to report to the Legislature annually on the status of the MUSF and the Legislature should be required to make adjustments to the fund to ensure that universal service principles under the 1996 Act are capable of being upheld, given the health of the fund as reported by the MPUC. This allows the Legislature to more adequately predict how much funding is required and ensure that a sufficient amount is allowed each year, taking into account changes in technology and the marketplace. The Ventura Administration's proposed method would allow telecommunications carriers discretion in determining whether and how much of the assessment to pass on to subscribers.

It should be emphasized that the proposed MUSF funding program does not involve the use of State tax dollars. While the charge operates like a tax, it does not go into the general fund. Rather, the fund would be collected by the Department of Administration and distributed by the MPUC based on the principles provided by the Legislature.

b. State Universal Service Funding Formula

There should be two primary components to the state universal service program: (i) the high cost fund; and (ii) low-income support.

i. High Cost Fund

The high cost fund will need to be large enough to support the cost of providing basic telephone service to Greater Minnesota after the elimination of rate averaging and after reduction of access charges to economic cost. The high cost fund should support the provision of basic telephone services to high cost areas, but only to the extent that it: (i) keeps rates for essential telecommunications services at levels reasonably comparable to those paid in urban areas; and (ii) provides telephone companies the capital needed to invest in infrastructure that provides access to advanced telecommunications services in Greater Minnesota.

It is impossible to state with precision how large the state high cost fund needs to be to achieve the goals of the Ventura Administration. In the world of telecommunications econometrics, depending from which advocacy perspec-

¹⁵⁷ *Universal Service Order*, at ¶853.

tive an economist comes from, one can obtain two completely different answers to the same question: What is the economic cost of service? Despite vexing anachronistic conundrums caused by the fundamental change in regulatory philosophy about the use of forward-looking versus embedded costs in the telecommunications regulatory context, Congress has chosen to base its local competition and universal service rules on forward-looking cost methodologies. The State just spent nearly \$500,000 litigating the HAI cost model, which uses a forward-looking methodology. This investment should not be wasted. The Ventura Administration believes that economic cost should be determined on the basis of a forward-looking cost methodology.

Because economic cost is such a vital concept to telecommunications regulation in a marketplace which is undergoing such radical changes in structure, and because the cost models by which economic cost is measured are by nature hypothetical and inexact, and because of the large amounts of money at stake, the Ventura Administration recommends that the Legislature provide as specific direction to the regulatory agencies as possible with respect to how universal service support is funded and paid out. The Ventura Administration believes the Legislature, not the MPUC, should develop the formula for determining the amount of high cost universal service support that each ETC will receive. The MPUC should implement the formula based on direction from the Legislature.

The Ventura Administration believes that high cost support should be provided to ETCs whose cost of service exceeds a statewide average cost of service, all determined using the HAI economic cost model to estimate the Total Element Long Run Incremental Cost (TELRIC) of service. ETCs whose wire center cost, applying the HAI model, exceeds the statewide average cost should receive a subsidy from the high cost fund equal to the amount of the excess. The concept of a benchmark to establish an amount above the statewide average cost is reasonable because it provides public acceptance of what is "high cost." It is also necessary in order to calculate a reasonably sized MUSF. ETCs with wire center costs below the statewide average, will not receive a subsidy. Thus, for companies like U S WEST, their higher cost exchanges will generate a USF subsidy. Their lower cost exchanges will not. Any money received from the federal universal service plan by an ETC should offset any support otherwise due from the state USF program.

The Ventura Administration proposes using the following method for calculating the estimated high cost funding requirement:

1. Economic cost models provide the most accurate updated estimates of TELRIC. The economic cost for every exchange in Minnesota should be estimated using this methodology.
2. Economic cost models should be run to calculate a statewide average cost of service. For example, the statewide average calculated by MDOC for U S WEST's local loop is \$17.87.
3. Wire centers or rural area cluster costs should be calculated for all of Minnesota.

4. The wire center or rural area cluster costs should be subtracted from the statewide average cost to produce a high cost universal service funding requirement.
5. The wire center or cluster funding requirements will be added to obtain an estimate of the total amount of the State high cost fund requirement.
6. Estimated amounts of high cost support from the federal program will offset the total amount required from the State fund.

The Ventura Administration believes that the HAI model best estimates cost based on the most efficient network technology available today. Thus, the ability of an ETC to provide access to advanced telecommunications services is built into the HAI cost model.

Below, the Ventura Administration has set out a ball park estimate of the required funding for the MUSF. This estimate is based on the Ventura Administration's proposed formula, except that economic costs could not be calculated for each wire center. To estimate economic cost by wire center, the Work Team used nine density zones created on the HAI cost model. The model attributes an economic cost to each density zone. Using census block data researched by Minnesota Planning, the Ventura Administration was able to calculate the number of actual households in each one of these density ranges to complete Step 4 outlined above.¹⁵⁸ This calculation yields the following estimate of the annual funding required for the MUSF:¹⁵⁹

¹⁵⁸The number of households per square mile was presumed to correlate closely with the number of access lines per square mile.

¹⁵⁹The Ventura Administration has attached the raw data, a spreadsheet showing the fund estimate calculations, and a map of the household density calculations, for each of the nine HAI density zones as Appendix G to this Plan.

<i>Estimated Aggregate Excess of Wire Center Cost Over Statewide Average Cost</i>	<i>\$294,585,492</i>
<i>Less Federal High Cost Support</i>	<i>\$40,452,720</i>
<i>Total Estimated High Cost Fund Requirement</i>	<i>\$254,132,772</i>

Table 11 - Proposed High Cost Funding

ii. Low-income Fund

The Ventura Administration recommends that the state law be brought into conformance with federal law regarding eligibility for federal Lifeline assistance. In conjunction with that change, the Ventura Administration recommends initially setting the amount of the State TAP credit at \$3.50 per customer. The Ventura Administration has reviewed above the economic impact it believes its proposal will have. The Ventura Administration recommends that \$7 million be collected from all “telecommunications service” providers in the State and reserved in the state universal service fund for distribution to residents meeting the FCC’s Lifeline eligibility criteria. The State should provide a \$3.50 credit to any resident meeting the FCC’s Lifeline eligibility criteria.

iii. State Universal Service Fund Assessment

The Ventura Administration’s estimated funding requirement for the high cost fund is \$254.1 million (rounded). The Ventura Administration also proposes a \$1 per phone number charge assessed on telecommunications service providers to raise an additional \$240 million for support of essential telecommunications services to rural businesses. It must be emphasized that these figures are estimates and may be subject to revision later. The estimated funding requirement for the low-income fund will be \$5.2 million. This creates a total estimated state universal service program funding requirement of approximately \$499.3 million per year. These estimates are summarized in the table below.

<i>State USF Component</i>	<i>Required Funding Estimate</i>
<i>High Cost Fund</i>	<i>\$254.1 million</i>
<i>Support for Rural Business</i>	<i>\$240 million</i>
<i>Low-income Fund</i>	<i>\$5.2 million</i>
<i>TOTAL STATE USF</i>	<i>\$499.3 million</i>

Table 13 - State USF Funding Estimates

The Ventura Administration recommends that the state universal service program be funded through contributions from all providers of telecommunications services in the state based on end user revenue. Federal law allows, and principles of competitive neutrality dictate that all providers of telecommunications services in the State, including wireless carriers and cable operators, contribute to the State universal service program. The decision to include all

providers of telecommunications services is consistent with the Ventura Administration's principle of technology neutrality.

Basing contributions on end-user revenues, rather than gross revenues, is competitively neutral because it eliminates the problem of double counting revenues. Double counting disadvantages resellers. For example, assuming a 10% USF contribution rate on gross revenues, if Frontier sells \$200.00 worth of telecommunications services directly to a customer, its contribution would be \$20.00. If the reseller buys \$180.00 worth of wholesale services from Frontier and sells the same retail services in competition with Frontier for \$200, the reseller would owe a contribution of \$20.00 on these \$200 worth of services, but would also be required to recover the portion of the \$18.00 contribution that Frontier must make and would likely pass on to the reseller. Therefore, while Frontier would face \$200.00 in service costs and \$20.00 in support costs, the reseller would face \$200.00 in service costs and almost certainly substantially more than \$20.00 in support costs.

Given the estimated funding requirements for the universal service fund, the Ventura Administration believes that the Legislature should initially set the contribution for telecommunications service providers at 30% of end user revenue. The Ventura Administration estimates that this percentage will yield the annual MUSF requirement estimated above. These figures were derived by dividing the total MUSF costs identified above by the number of access lines in Minnesota [this count does not include wireless or high-speed data, which will also be subject to the surcharge – so the 30% is probably a high end estimate], and then extrapolating a surcharge percentage based on statistics estimating the average monthly expenditures of Minnesotans on telecommunications services, including wireline, broadband, and wireless.

6. Accountability

ETCs should also be held accountable for the universal funding they receive. The Ventura Administration recommends that ETCs be required to submit annual verifications to the MPUC that demonstrate that MUSF funds received have been used solely to offset the costs of supported services.

7. Implementation and Enforcement

The Ventura Administration sees no need to wait to implement the Minnesota Universal Service Fund (MUSF). The basic framework of the FCC's universal framework is sufficiently well constructed to provide states with guidance in developing and implementing state universal service programs. In fact, several other states, including California and Nebraska, have finalized state universal service programs. The Legislature should provide a sense of urgency to the MPUC to implement the MUSF, in accordance with the Ventura Administration's proposed framework, within one year of the effective date of any state telecommunications reform legislation.

The Ventura Administration also believes that if its recommendations are adopted by the Legislature, the MPUC will have sufficient direction to implement the MUSF without a rule making process. To avoid the delays caused by rulemakings, the Legislature should specifically authorize the MPUC to implement the MUSF without a rulemaking.

C. Recommendations

1. Implicit subsidies in the form of rate averaging and access charges should be replaced with explicit subsidies to the extent necessary to support the provision of essential telecommunications services to high cost areas of Minnesota.
2. Geographic deaveraging of wholesale rates in Minnesota should be required under Minnesota law at every wire center or rural access line cluster in the State.
3. Geographic deaveraging of wholesale rates should not be allowed until the new MUSF program is in operation.
4. The Legislature should direct the MPUC to establish deaveraged wholesale rates effective at the same time the MUSF becomes effective.
5. The results of cost studies conducted for the purposes of deaveraging, should have mandatory cross application to setting rates for UNEs and parameters for fair retail local competition.
6. Generally, retail deaveraging should not be allowed unless and until underlying wholesale rates are deaveraged.
7. Implicit subsidies in the form of intrastate access charges should be eliminated.
8. Access charges are services subject to the Ventura Administration's proposed local competition regulatory framework.
9. Long distance companies should not be required by law to pay for the local loop "costs" as is now required by section 237.12, Subd. 3. Further, the law should prohibit ILECs from receiving any implicit subsidy from access charges paid by long distance companies.
10. Access charges should be driven toward economic cost either through competition or regulation so that there is no difference in the cost to terminate a local, long distance or internet call.
11. Revenue neutrality should not be guaranteed to ILECs losing revenue as a result of intrastate access charge reform.
12. State law should work to assure that rates for and the level of access to essential telecommunications services in rural areas are reasonably comparable to those in urban areas after removal of implicit subsidies from the rate structure.
13. State law should more specifically reflect Minnesota's commitment to the rapid development of Greater Minnesota's advanced and competitive telecommunications infrastructure.
14. Minnesota should not wait for the FCC to issue universal service rules applicable to rural carriers before implementing the MUSF. The MPUC should be given a sense of urgency to implement the MUSF.
15. The MUSF should support the following services for primary residential and business lines only: voice grade lines; long distance equal access; state telecommunications relay services; flat rate local usage; DTMF signaling; single party service; 911 and E911; access to operator service; access to directory assistance; toll limitation capability.

16. The MUSF should also support *access* to high-speed data services at rates of at least 256 Kbps for residents and businesses in high cost areas.
17. All applicants for designation as an Eligible Telecommunications Carrier (ETCs) must demonstrate an ability and willingness to provide the supported services to their entire service area.
18. Federal law and sound public policy require that the MUSF keep the cost of essential telecommunications services affordable for the State's poor.
19. The statutory framework for the Telephone Assistance Program should be rewritten to conform with federal Lifeline assistance eligibility criteria.
20. Because residents will be able to obtain a larger credit from the federal government under the Ventura Administration's proposed TAP legislation, the amount of the TAP credit should be set at \$3.50.
21. MUSF support should be funded through a system of explicit subsidies approved by elected representatives.
22. The MPUC should be required to report annually to the Legislature on the health of the MUSF. The Legislature should be required to review and, if necessary, adjust the funding amount annually to ensure the fund is capable of assuring that the State upholds all federal universal service principles under the 1996 Act.
23. The MUSF high cost fund should support high cost areas only to the extent needed to keep rates reasonably comparable to those paid in urban areas and must include upgrading networks to provide advanced services to all areas of the State.
24. The MPUC should be directed to implement MUSF based on directions from the legislature within one year from the effective date of any state telecommunications regulatory reform statute.
25. High cost support should go only to those exchanges whose cost of service exceeds a statewide average benchmark cost.
26. The MUSF contributions should be assessed on all telecommunications service providers, including wireless companies and cable operators based on end-user revenue.
27. Carriers shall be allowed, but not required to pass through the universal service contributions to consumers in their bills.

VI. LOCAL COMPETITION

A. Background

The Ventura Administration has presented background discussion of the status of local competition in Minnesota earlier in this Plan.¹⁶⁰ Next, the existing federal and state laws and regulations governing local telephone competition in Minnesota will be reviewed. Finally, the Ventura Administration's analysis and recommendations for local telecommunications regulatory reform will be provided.

B. Telecommunications Act of 1996 Local Competition Provisions

1. General Duties of Telecommunications Carriers

All "telecommunications carriers," as defined under the 1996 Act have a legal duty to interconnect with the facilities and equipment of other telecommunications carriers.¹⁶¹ All telecommunications carriers also have a duty not to interfere with the accessibility of the public switched telephone network (PSTN), or the free flow of information over the PSTN.¹⁶²

2. Duties of Local Exchange Carriers

Local exchange carriers, which includes both ILECs and CLECs under the 1996 Act, may not impose unreasonable or discriminatory conditions or limitations on the resale of telecommunications services.¹⁶³ Moreover, all LECs must provide local number portability in accordance with FCC rules.¹⁶⁴ Further, all LECs must provide "dialing parity" to competing LECs and long distance companies, and provide customers of all such providers nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.¹⁶⁵ All LECs also have a duty to establish reciprocal compensation arrangements with each other for the transport and termination of telecommunications. Finally, all telecommunications carriers have a duty to negotiate interconnection agreements in good faith.¹⁶⁶

3. Interconnection Obligations of ILECs

Congress placed special duties on ILECs which are not applicable to CLECs. First, ILECs have a duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the ILEC's network for the transmission, and routing of telephone exchange service and exchange access.¹⁶⁷ ILECs must allow for this interconnection at any technically feasible point within their networks. The interconnection must be at least equal in quality to that provided by the ILEC to itself or to anyone else to whom an ILEC provides interconnection. Finally, the interconnection must be provided on rates, terms, and conditions that are just, reasonable, and nondiscriminatory.

¹⁶⁰ See section VIII of this Plan.

¹⁶¹ 47 U.S.C. § 251(a).

¹⁶² *Id.* § 256.

¹⁶³ *Id.* § 251(b).

¹⁶⁴ *Id.*

¹⁶⁵ "Dialing parity" is synonymous with equal access. See page 128 of this Plan for a discussion of equal access.

¹⁶⁶ 47 U.S.C. § 251(c)(1).

¹⁶⁷ *Id.* §251(c)(2).

ILECs must also provide nondiscriminatory access to unbundled network elements (UNEs) at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory. An ILEC must provide UNEs in a manner that allows requesting carriers to combine them in order to provide telecommunications service. Third, ILECs must offer for resale *at wholesale rates* any telecommunications service that the ILEC provides on a retail basis. Fourth, ILECs must provide reasonable public notice to interconnecting carriers regarding any changes in information necessary for the transmission and routing of services which use the ILEC's facilities or networks. Finally, ILECs must provide, on rates, terms, and conditions that are just, reasonable, and nondiscriminatory, for physical collocation of equipment necessary for interconnection or access to UNEs at the premises of the ILEC. However, an ILEC may provide for virtual collocation if the ILEC can demonstrate to the MPUC that physical collocation is not practical for technical reasons or because of space limitations.

4. Rural Exemptions

The UNE requirements under section 251(c) of the 1996 Act do not apply to a rural telephone company until the company has received a bona fide request (BFR) for interconnection, services, or network elements, and the State determines that the request is not “unduly economically burdensome, is technically feasible, and is consistent with the universal service provisions of the 1996 Act.”¹⁶⁸

Rural carriers with fewer than 2% of the Nation's subscriber lines may petition the MPUC for a suspension or modification of the application of the interconnection obligations under sections 251(b) and (c).¹⁶⁹ The MPUC must grant the petition if it finds it is necessary to: (a) avoid a significant adverse economic impact on users of telecommunications services; (b) to avoid imposing a requirement that is unduly economically burdensome; or (c) to avoid imposing a requirement that is technically infeasible. The MPUC must also find that the exemption is in the public interest.

5. Advanced Telecommunications Services

The 1996 Act requires states to encourage the deployment of advanced telecommunications capabilities through price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.¹⁷⁰

6. Implementation

Congress gave the FCC six months after the effective date of the 1996 Act “to complete all actions necessary to establish regulations to implement the requirements of this section.” In determining what UNEs should be unbundled, Congress directed the FCC to consider whether access to a UNE is *necessary*; and whether the failure to provide access to a UNE would *impair* the ability of a telecommunications carrier seeking access to the UNE to provide the services that it seeks to offer.¹⁷¹ This “necessary and impair” standard became very important in the FCC's list of required UNEs.

¹⁶⁸ *Id.* § 251(f).

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* ¶706(a). Congress' definition of "advanced services" is discussed in Appendix F.

¹⁷¹ *Id.* § 251(d)(2).

The FCC's decision about which elements ILECs are required to unbundle was eventually appealed to the United States Supreme Court.

C. FCC Local Competition Rules

1. Jurisdiction

Six months after the 1996 Act was passed, the FCC issued its local competition rule,¹⁷² and the fight over jurisdictional boundaries between states and the FCC began. It was recently resolved by the United States Supreme Court in *AT&T Corp. v. Iowa Utilities Board*.¹⁷³ The Supreme Court concluded that the FCC had jurisdiction to adopt local competition rules under sections 251 and 252 of the 1996 Act.¹⁷⁴ The Court held that the 1996 Act extended the FCC's jurisdiction to cover not only interstate matters, but also purely intrastate matters – all for the purpose of implementing the 1996 Act's local competition provisions. While the Court's decision generally affirmed the FCC's implementation of the local competition provisions of the 1996 Act, it required the Commission to reevaluate the standard it uses to determine which network elements an ILEC must unbundle. Below are reviewed the key provisions of the FCC's local competition rules, and the FCC's revised UNE rules in light of the Supreme Court's decision in *Iowa Utilities Board*.

2. Definition of “Technically Feasible”

The FCC concluded that the term “technically feasible” refers solely to technical or operational concerns, not economic, space, or site considerations.¹⁷⁵ The FCC further concluded that the duty to interconnect and provide UNEs where “technically feasible” includes a duty for ILECs to modify their facilities to the extent necessary to accommodate interconnection or access to UNEs. The FCC stated that “specific, significant, and demonstrable network reliability concerns associated with providing interconnection or access at a particular point” would be regarded as relevant evidence of technical infeasibility. However, the FCC also concluded that preexisting interconnection or access at a particular point evidences the technical infeasibility of interconnection or access at similar points. Finally, the FCC concluded that ILECs bear the burden of proving to the MPUC that a particular interconnection or access point is not technically feasible. Stated in plainer terms, “technically feasible” means “Is it possible?”¹⁷⁶

3. Just, Reasonable, and Nondiscriminatory Rates, Terms, and Conditions of Interconnection

The FCC ruled that the term “nondiscriminatory,” as used throughout section 251, applies to the terms and conditions an ILEC imposes on third parties as well as on itself.¹⁷⁷ By providing interconnection to a competitor in a manner less efficient than an ILEC provides itself, the FCC ruled that the ILEC violates the duty to provide interconnection on terms and conditions that are just, reasonable, and non-

¹⁷² *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) (First Report & Order).

¹⁷³ S. Ct. No. 87-876 (1999).

¹⁷⁴ *Id.*

¹⁷⁵ First Report & Order at ¶198.

¹⁷⁶ *Id.* ¶ 202.

¹⁷⁷ *Id.* at ¶ 218.

discriminatory. The FCC also concluded that ILECs must provide interconnection and UNEs of an “equal quality” to that which it provides to itself.¹⁷⁸

4. UNEs

In its *First Report & Order*, the FCC adopted rules which addressed the duty of ILECs to provide UNEs, pricing of UNEs and a minimum list of required UNEs. The rules dealing with the latter issue were overturned by the Supreme Court in *Iowa Utilities Board*.¹⁷⁹ The Supreme Court held that the FCC had failed to apply the “necessary and impair” standard in determining the list of required UNEs. The FCC has since announced its revised list of required UNEs in light of the Supreme Court’s order.¹⁸⁰

The FCC’s revised list of required UNEs is: (i) loops, including loops used to provide advanced telecommunications services, including high-speed data service¹⁸¹; (ii) network interface; (iii) local circuit switching (except for larger customers in major urban markets); (iv) dedicated and shared transport; (v) signaling and call-related databases; and (vi) operational support systems (OSS).¹⁸² States are free to add to this list, as long as the State applies the “necessary and impair” standard in determining whether a network element is required to provide on an unbundled basis.¹⁸³

In its *First Report & Order*, the FCC also clarified the requirement under the 1996 Act requiring ILECs to provide UNEs in a manner that allows requesting carriers to combine them in order to provide telecommunications service. First, the FCC ruled that ILECs may not impose restrictions on requests for, or the sale or use of, UNEs that would impair the ability of requesting carriers to offer telecommunications services in the manner they intend.¹⁸⁴ The FCC also concluded that ILECs must provide requesting carriers with all of the functionality of a particular element, so that requesting carriers can provide any telecommunications services that can be offered by means of the element. Further, the FCC ruled that ILECs cannot separate elements that are ordered in combination, unless a requesting carrier specifically asks that such elements be separated. ILECs must also perform the functions necessary to combine requested elements in any technically feasible manner, either with other elements from the ILEC’s network, or with elements possessed by new entrants. However, the FCC distinguished this last requirement. ILECs cannot be required to combine network elements in any technically feasible manner requested by a carrier. In other words, ILECs cannot be required to combine elements that are “not ordinarily combined” in the ILEC’s network.¹⁸⁵

¹⁷⁸ *Id.* at ¶ 224.

¹⁷⁹ S. Ct. No. 97-826 (1999).

¹⁸⁰ “FCC Promotes Local Telecommunications Competition,” FCC News (September 15, 1999). The full text of the FCC’s order is not yet available to the public.

¹⁸¹ The FCC has ruled that ILECs must provide “conditioned” loops on an unbundled basis if technically feasible. Loop conditioning means that certain technical modifications are made to make a loop useful for the desired functionality of the requesting carrier. Examples of technically feasible loop conditioning include removal of “load coils” or “bridged taps” which interfere with the transmission of data signals. An example of a technically infeasible loop conditioning requirement would be if a carrier requested an ILEC to shorten the length of a loop to allow for the provision of DSL to a customer. *See First Report & Order* at ¶¶381-382.

¹⁸² *Id.*

¹⁸³ *First Report & Order* at ¶244.

¹⁸⁴ *Id.* at ¶292.

¹⁸⁵ *Id.* at ¶296.

5. Collocation

In order for a competitor to interconnect with an ILEC's network, the competitor must have access to the network. Congress addressed this need by requiring ILECs to provide physical collocation when technically feasible at rates, terms, and conditions that are just, reasonable, and nondiscriminatory.¹⁸⁶ In the event that physical collocation is impossible, the 1996 Act calls for incumbent local exchange carriers to provide virtual collocation. With virtual collocation, the competing provider is responsible for the procurement of its own transmission equipment, which is then handed over to the ILEC, the party responsible for installation and ongoing maintenance of that equipment.¹⁸⁷

The FCC has addressed a number of issues regarding collocation requirements outlined in the Act.¹⁸⁸ These issues include:

a. Caged or Cageless Collocation

The FCC requires ILECs to make available to requesting CLECs shared caged and cageless collocation arrangements. This rule prevents CLECs from having to bear the cost and delay of waiting for ILEC required cage facilities to be built to house a competitor's collocated equipment.¹⁸⁹ Moreover, when collocation is exhausted at a particular ILEC location, ILECs must permit collocation in adjacent controlled environmental vaults or similar structures to the extent technically feasible. Interconnection achieved through proposed mandated "spot frames", as proposed by U S WEST, were specifically rejected by the FCC.

b. Presumed Technical Feasibility

The FCC ruled that a collocation method used by one ILEC or mandated by a state commission is presumptively technically feasible for any other ILEC.

c. Security

The FCC ruled that ILECs may adopt reasonable security measures to protect their central office equipment. However, ILECs may not require CLEC equipment to meet more stringent safety requirements than those the ILEC imposes on its own equipment.

d. Collocation of Equipment with Functions Not Directly Related to Access to Unbundled Elements

The FCC ruled that ILECs must permit competitors to collocate all equipment "used or useful" for interconnection and/or access to unbundled network elements (UNEs), even if it includes a "switching" or enhanced services function.¹⁹⁰ In addition, the FCC ordered that ILECs cannot require that the switching or enhanced services functionality of equipment be disengaged.

¹⁸⁶ *Id.* at ¶551.

¹⁸⁷ *See* Newton's Telecom Dictionary at 857.

¹⁸⁸ First Report and Order in re Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147 ¶¶ 18-56 (FCC March 31, 1999)(herein the "*Collocation Order*").

¹⁸⁹ *Collocation Order* at ¶42.

¹⁹⁰ *Collocation Order* at ¶28.

e. Denial of Collocations by ILECs

The FCC ruled that if ILECs deny space to a requesting CLEC, the ILECs must permit a CLEC to tour the entire central office in which that CLEC has been denied collocation space. It also ruled that ILECs must provide a list of all offices in which there is no more space. In addition, ILECs must remove obsolete, unused equipment, in order to facilitate the creation of additional collocation space within a central office.

f. Pricing for Collocation

The FCC charged state commissions with the responsibility of determining fair and reasonable prices for collocation. In Minnesota, pricing issues have been and are currently being addressed for collocation at U S WEST in its generic cost case.

g. Provisioning Intervals

The FCC's collocation rules serve as minimum standards, and permit states to adopt additional requirements. The FCC has not adopted specific provisioning intervals at this time but points out that several state commissions have taken significant steps to lessen the time periods within which ILECs provision collocation space. As an example, it noted that the Texas PUC has required Southwestern Bell Telephone Company (SWBT) to provide CLECs with information on space availability in a SWBT premises within ten days of receipt of a collocation request.

6. Pricing of Interconnection and UNEs

The FCC ruled that the prices for interconnection and UNEs should be set by states using a forward looking cost methodology. The FCC held that in dynamic competitive markets, firms take action based on the relationship between market-determined prices and forward-looking economic costs. If market prices exceed forward-looking economic costs, new competitors will enter the market. If forward-looking economic costs exceed market prices, new competitors will not enter the market and existing competitors may decide to leave. The FCC held that new entrants should make their decisions whether to purchase unbundled elements or to build their own facilities-based on the relative economic costs of these options.

The FCC also addressed issues regarding rate structure for UNEs. As a general rule, the FCC held that ILECs should only be allowed to recover costs for interconnection and UNEs in a manner that reflects the way they are incurred.¹⁹¹ Flat rate prices should be charged to recover costs which are non-recurring. Similarly, recurring costs must be recovered through recurring charges. However, the FCC also ruled that states may, but need not, require ILECs to amortize nonrecurring costs through recurring charges over a reasonable period of time, as long as there is no multiple recovery for ILECs.¹⁹² Further, the FCC held that costs of shared facilities should be recovered in a manner that efficiently apportions costs among users that share the facility.

7. Resale

¹⁹¹ *First Report & Order* at ¶745.

¹⁹² *Id.* at ¶749.

The FCC recognized that resale is an important entry strategy for many new entrants, especially in the short term when they are building their own facilities. The FCC ruled that there are no limitations, other than those provided for by Congress in the resale statute, on the services which ILECs must offer for resale. In other words, ILECs must do what the statute tells them to do: provide for resale, any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers. The FCC ruled there was no need to establish a minimum list of services required to be provided for resale with such a clear statutory standard.

The FCC provided two methods for determining the discount rate at which ILECs will be required to provide service wholesale to CLECs. The first, and preferred, method requires state commissions to identify and calculate “avoided costs” based on avoided cost studies. Avoided costs are the costs of marketing, billing, collection, and other costs that will be avoided by ILECs when they provide services at wholesale rates. The second method allows states to select, on an interim basis, a discount rate from within a default range of discount rates adopted by the FCC. They may then calculate the portion of a retail price that is attributable to avoided costs by multiplying the retail price by the discount rate.

The FCC further concluded that any restrictions placed by ILECs on resale are presumptively unreasonable.¹⁹³ The FCC found that the ability of ILECs to impose resale restrictions and conditions is likely to be evidence of market power and may reflect an attempt by ILECs to preserve their market position. In a competitive market, an individual seller would not be able to impose significant restrictions and conditions on buyers because such buyers turn to other sellers. Specifically, the FCC ruled that ILECs could not exempt all promotional offerings from their resale obligation. ILECs are allowed to provide promotions of short duration (90 days) without having to provide the services wholesale. However, long term customer specific contracts and other non-standard offerings are subject to the wholesale obligation.

The FCC declined to adopt rules governing the withdrawal of service by an ILEC to avoid having to provide the service wholesale to competitors. The FCC ruled that states should be responsible for developing regulations that address this issue.

The FCC ruled that wholesale services made available for resale should be provisioned at least equal in quality to the way they are provided by the ILEC to itself or to its customers.

The FCC also ruled that ILECs will continue to receive access charge revenues when local services are resold under section 251(c)(4). Long distance companies must still pay access charges to ILECs for originating or terminating interstate traffic, even when their end user is served by a telecommunications carrier that resells ILEC retail services.

8. Reciprocal Compensation

Reciprocal compensation describes the method by which local exchange carriers compensate each other for the transport and termination of local exchange traffic that originates on the local exchange network of another carrier. Like the application of access charges to long distance traffic, reciprocal compensation attempts to recognize the costs incurred by a terminating telephone company when it transports and ter-

¹⁹³ *Id.* at ¶939.

minates a call. In a local monopoly environment, one carrier is responsible for originating all calls made by its customers and terminating all calls received by its customers. The monthly revenues the local exchange carrier receives from its customers compensate that carrier for the cost of both originating and terminating calls within a local calling area. In local calling areas that are large enough to be served by several local monopolists, the local providers must agree on the terms for exchanging traffic. In a competitive local environment, the originating carrier of the call may be different than the terminating carrier even for calls within the same exchange. Reciprocal compensation recognizes that the terminating carrier will incur costs in transporting and terminating calls to its customers that are placed by other carriers.

The FCC ruled that reciprocal compensation requirements under the 1996 Act apply to the transport and termination of local telecommunications traffic within a local area.¹⁹⁴ Traffic to or from a CMRS network that originates and terminates within the same metropolitan area is also subject to reciprocal compensation obligations, rather than interstate and intrastate access charges.¹⁹⁵

The FCC ruled that rates for the transport and termination of traffic will be established based on forward looking economic costs, or alternatively, a bill-and-keep arrangement.¹⁹⁶ In a bill-and-keep arrangement, neither of the two interconnecting carriers charges the other for the termination of local traffic originated on the other carriers network.¹⁹⁷ The FCC further ruled that rates for transport and termination will be symmetrical, meaning that the rates charged by a competitive carrier to an ILEC are equal to the rates charged by the ILEC for the same services. A state may establish asymmetrical rates only if the competitive carrier is able to demonstrate a cost basis upon which to base a higher rate than that being charged by the incumbent, or for certain paging providers.¹⁹⁸

9. Advanced Telecommunications Services

The FCC has taken the position that cable operators should not be required to allow ISPs to interconnect with their broadband networks for the purposes of providing competing high-speed internet service. In support of its position, the FCC cites (a) its right to determine a national policy as opposed to multiple policies that would emerge if state or local governments set rules for interconnection; (b) its stated policy of “unregulation” of the internet; (c) the presence of other forms of broadband access aside from cable that include DSL, satellite transmission, an emerging fixed wireless technology combined with FCC efforts to free up additional spectrum, and (d) its policy of maintaining a “watchful eye” on the situation.¹⁹⁹

On the other hand, the FCC has ruled that ILECs, which provide advanced services (DSL) over telephone systems, are subject to the market-opening requirements of section 251 in their provision of advanced services.²⁰⁰ The FCC based that conclusion on

¹⁹⁴ *Id.* at ¶1033.

¹⁹⁵ *Id.* at ¶1036.

¹⁹⁶ 47 C.F.R., §51.705

¹⁹⁷ 47 C.F.R., § 51.713

¹⁹⁸ 47 C.F.R., §51.711

¹⁹⁹ *See* “The FCC and the Unregulation of the Internet,” FCC Office of Plans and Policy Working Paper No. 31 # at 21 (July 1999).

²⁰⁰ *See Collocation Order* ¶14.

the determination that DSL services are “telecommunications services.” The FCC imposed collocation requirements on ILECs with respect to the provision of both voice and high-speed data transport services. The FCC also mandated line sharing.²⁰¹ Line sharing is the shared use of the spectrum available on twisted copper pairs. Line sharing technology makes it possible to send traditional analog services over low frequencies on the copper pairs in the local loop, leaving the higher end of the spectrum available for the transmission of digital signals. Line sharing makes it possible for ILECs, including U S WEST, to offer its “Megabit” DSL service to customers.

D. State Implementation of Telecommunications Act of 1996

The 1996 Act and the FCC’s rules delegated much of the responsibility for implementing the local competition provisions of the 1996 Act and the rules to states. Since the adoption of the 1996 Act, the State of Minnesota has spent a great deal of time bogged down by litigation and delay. There are three primary reasons for this.

1. The 1996 Act Was Poorly Written. As Justice Antonin Scalia stated in the concluding paragraph of his opinion in *Iowa Utilities Board*:

It would be gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. That is most unfortunate for a piece of legislation that profoundly affects a crucial segment of the economy worth tens of billions of dollars. The 1996 Act can be read to grant (borrowing a phrase from incumbent GTE) “most promiscuous rights” to the FCC vis-à-vis the state commissions and to competing carriers vis-à-vis the incumbents—and the Commission has chosen in some instances to read it that way. But Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency.²⁰²

2. ILECs Have Chosen to Litigate Rather Than Compete

It has been three years since the adoption of the 1996 Act, and its local competition provisions, and U S WEST has still not agreed to a price for unbundled network elements.²⁰³ The fact that ILECs have chosen litigation over competition is the primary theme characterizing the three years since the adoption of an Act that was intended to open up local markets to competition. A brief review of just some of the “competitive” decisions U S WEST has made over the past three years underscores the problem.

- a. Litigation of the FCC’s Local Competition Order

U S WEST participated in the litigation over the FCC’s *First Report & Order*.

²⁰¹ “FCC Action to Accelerate Availability of Advanced Telecommunications Services For Residential and Small Business Consumers,” FCC News (November 18, 1999).

²⁰² *Iowa Utilities Board*, St. Ct. No. 97-876 (1999).

²⁰³ See also discussion at pp.55-56.

b. Litigation over Interconnection Agreements Approved By MPUC

U S WEST brought six (6) lawsuits against various competing carriers and the MPUC contesting over 50 major interconnection issues. The Federal District Court upheld the MPUC on 38 of these issues.²⁰⁴ Six issues were remanded because of the U.S. Supreme Court's decision in *Iowa Utilities Board*. The court

overturned the MPUC on ten issues. This litigation took nearly two years. The MPUC is only now addressing the issues that were remanded by the Federal District Court in these lawsuits.

In August 1999, U S WEST appealed four of the Federal District Court's rulings to the Eighth Circuit Court of Appeals, including issues relating to whether and to what extent U S WEST must offer combined UNEs, or UNE "platforms." A decision from the Eighth Circuit is still pending.

c. Refusal to Settle UNE Pricing Issues

U S WEST has chosen to continue litigating rather than settling issues regarding pricing of UNEs. U S WEST filed motions for reconsideration of the MPUC's May 3, 1999 Order regarding UNE pricing. U S WEST has stated its intentions to appeal many of the conclusions in the MPUC's UNE decision.

d. Operational Support System (OSS) Testing

One of the keys to successful local competition lies in the performance of U S WEST's operational support systems. OSS handle all of the ordering, provisioning, and billing functions for a local telephone company. The systems are highly complex. Under the 1996 Act, OSS is a UNE which must be provided to CLECs on non-discriminatory terms. That means that CLECs must have the capability to seamlessly access customer information from U S WEST's OSS, place orders, change billing arrangements, and provision service. If U S WEST's OSS systems are not functioning properly, consumers could experience disruptions in service, receive billing from two companies, and experience other problems, all leading to consumer confusion and frustration. Most consumers will blame this problem on their decision to change carriers, and may decide to cancel their switch, or will at least be reluctant to ever switch carriers again.

In August 1999, the MPUC commenced an investigation into U S WEST's progress in providing OSS on terms which are non-discriminatory, just, and reasonable. The MDOC feared that U S WEST was engaging in a pattern and practice of favoring itself over its competitors with respect to the provision of OSS.²⁰⁵

OSS is also one of the items on the 14 point checklist that RBOCs must meet in order to gain state and FCC approval to enter the interLATA market (section 271

²⁰⁴ U S WEST v. AT&T, File No. 97-913, slip op. (March 31, 1999); U S WEST v. OCI Communications of Minnesota, File No. 97-1921, slip op. (March 31, 1999); U S WEST v. Triad Minnesota, File No. 97-1963, slip op. (March 31, 1999); U S WEST v. Sprint Communications Co., File No. 97-2179, slip op. (March 31, 1999); U S WEST v. AT&T Wireless Services, File No. 98-914, slip op. (March 31, 1999); U S WEST v. Aerial Communications Inc., File No. 98-1295, slip op. (March 31, 1999).

²⁰⁵ In re Investigation of U S WEST Communications Operational Support Systems, MPUC Docket Nos. P999/CI-96-1114 and P442,5321,421/CI-97-381 (Sept. 24, 1999).

approval). In order to obtain 271 approval, U S WEST must show the MPUC, and then the FCC that it complies with the 14 point competitive checklist.

e. Reciprocal Compensation

On April 20, 1999, U S WEST filed a request for a ruling that traffic to ISPs was not subject to the reciprocal compensation requirements of the 1996 Act. This challenge came despite express FCC language allowing the MPUC to enforce the reciprocal compensation provisions of interconnection agreements with ISPs.

f. U S WEST and other ILECs opposed Minnesota Cellular Corporation's (MCC) petition for ETC designation, which would allow MCC to receive the same universal service support that ILECs receive to provide local telephone service in Greater Minnesota. The MPUC granted conditional ETC status to MCC.²⁰⁶ U S WEST and other ILECs have filed requests for reconsideration of the MPUC's decision.

3. While U S WEST has been engaged in litigation, it is also the subject of several complaints related to alleged anti-competitive activity or poor quality service, including:

a. Payments of nearly \$6 million in fines imposed by the MPUC for failure to meet minimum customer service standards.

b. A complaint filed by AT&T accusing U S WEST of failing to provide them with adequate quality wholesale service, including allegations that U S WEST failed to provision facilities necessary for AT&T to serve new customers, and serve them in a timely manner.²⁰⁷

c. MCI alleged that U S WEST engaged in anti-competitive behavior and violated terms of its interconnection agreements with MCI. The MPUC determined that U S WEST had breached the interconnection agreement and failed to provide MCI with adequate service in violation of state law.²⁰⁸

d. InfoTel petitioned the MPUC for an order prohibiting U S WEST from imposing "termination penalties" on U S WEST contract customers who decide to switch to InfoTel's resale service. The MPUC ordered that termination penalties were not permissible for resold services under U S WEST's tariffs. U S WEST then filed a tariff that would permit them to charge the type of penalty rejected by the MPUC. U S WEST appealed. U S WEST has now agreed to withdraw its court challenge and refile a new proposal to be heard by the MPUC on an expedited basis.

²⁰⁶ See Order in re Application of Minnesota Cellular for Designation to be an Eligible Telecommunications Carrier, MPUC Docket No. P5695/M-98-1285.

²⁰⁷ See AT&T Access Service Quality Complaint Against U S WEST, MPUC. Docket No. P421/C-98-1183 (filed August 18, 1999).

²⁰⁸ MCI Complaint Against U S WEST for Alleged Anti-Competitive Behavior, MPUC Docket No. P421/C-97-1348, Order Finding Breach of State Law and Interconnection Agreement and Requiring Compliance Negotiations and Filings (July 19, 1998); Order After Reconsideration (October 22, 1998).

- e. The MDOC and the Office of the Attorney General filed a complaint against U S WEST for anti-competitive behavior in the roll out of its Megabit DSL service. The petition accused U S WEST of favoring its ISP affiliate, U S WEST.net, over ISP services offered by competitors. One of the key allegations was that at the time U S WEST initiated a promotion, it was impossible for a customer to get Megabit service unless the customer subscribed to U S WEST.net's ISP service. The parties settled the case on terms that included measures requiring competitive neutrality in marketing and adherence to market conduct specifications.
 - f. The MDOC has filed a petition against U S WEST for violation of the company's AFOR Plan. U S WEST agreed to a 77¢ reduction in basic residential service rates, and a rate freeze for 5 years. Within 45 days of the effective date of the AFOR plan, U S WEST began passing through a 53¢ charge on telephone bills of residential customers to recover costs related to the implementation of local number portability. The MDOC participated in a proceeding at the FCC which resulted in a 10¢ reduction in the charge because U S WEST had overstated its LNP costs. The MDOC is seeking elimination of the rest of the charge on the ground that it violates the rate freeze provision of the AFOR Plan.
4. While U S WEST is battling issues over competitive entry, and fending off complaints of anti-competitive conduct and poor service quality, the company has requested the following regulatory relief on the theory that competition exists in its service territory:
- a. U S WEST filed a petition with the MPUC to have its St. Cloud area declared a competitive zone. U S WEST requested that its services in St. Cloud be completely deregulated. U S WEST offered no quantitative or substantial qualitative evidence of the presence of effective competition in the area. Moreover, U S WEST asked for this relief despite not yet having complied with the 14 point competitive checklist required under the 1996 Act. The MPUC dismissed all of U S WEST's claims.
 - b. U S WEST filed and obtained permission to raise its prices for private line services 300% within the next year.²⁰⁹
 - c. U S WEST filed to increase its rates for white pages premium business listings by 400%. The MPUC denied this request.

²⁰⁹ See MPUC Docket No. P421/AM-99-1195.

5. State Law is Fraught With Anachronisms and Patchwork, Inhibiting Competition.

The general problems with state law have been discussed earlier in this Plan.²¹⁰ Below is a discussion of the specific flaws that work against the development of effective competition in Minnesota.

E. State Law

Minnesota Statutes Chapter 237 is poorly organized. Below, the Ventura Administration has outlined in a logical manner the various provisions scattered throughout the Chapter without exhaustively reciting the provisions of each section.

1. Stated Policy and Purpose of Chapter 237

Chapter 237 lists the following goals for the MPUC to consider in executing its duties: supporting universal service; maintaining just and reasonable rates; encouraging economically efficient deployment of infrastructure for higher speed telecommunication services and greater capacity for voice, video, and data transmission; encouraging fair and reasonable competition for local exchange telephone service in a competitively neutral regulatory manner; maintaining or improving quality of service; promoting customer choice; ensuring consumer protections are maintained in the transition to a competitive market for local telecommunications service; and encouraging voluntary resolution of issues between and among competing providers and discouraging litigation.²¹¹ Chapter 237 also suggests that the MPUC and the MDOC strive to ensure economically efficient investment and just and reasonable rates when setting rates, adopting rules, or issuing orders related to telecommunication matters that affect deployment of the infrastructure.²¹² State law also encourages settlement rather than litigation of disputes involving telephone regulatory matters.²¹³

2. Definitions and Exemptions from Regulation

The Ventura Administration has already discussed at length the definitional issues that currently exist under Chapter 237.²¹⁴ However, it is also important to understand that many of those definitions are designed to relate to regulatory exemptions contained in other sections of Chapter 237.

“Local service” provided by CLECs is exempt from rate of return regulation, earnings investigations, and depreciation regulation.²¹⁵ To the extent a CLEC provides “local service,” it is subject to all other provisions of Chapter 237. The term “local service” is not defined in Chapter 237.

²¹⁰ See pp. 24-25.

²¹¹ Minn. Stat. § 237.011.

²¹² *Id.* § 237.082.

²¹³ *Id.* § 237.076.

²¹⁴ See Appendix F and pp. 28-36.

²¹⁵ Minn. Stat. § 237.035(e).

Hotels, motels, lodges and other similar businesses that provide telephone services to customers are exempt from most of Chapter 237.²¹⁶ Rates charged by these establishments must be fair and reasonable. Customers must be provided notice of such charges, and the MPUC can initiate investigations into the reasonableness of these charges.

3. Entry Regulation

Minnesota law regulates the entry of local telecommunications service providers. The MPUC must authorize and may prescribe conditions on the construction of any new telephone lines or exchanges, or the provision of any “local service” within the State.²¹⁷ No person is allowed to provide telephone service in Minnesota without a finding by the MPUC that the person possesses the technical, managerial, and financial resources to do so in compliance with state law. Companies may expand their service territory by filing notice with the MPUC. If there are no objections from other parties, an amended certificate of authority is granted.

Municipalities wishing to provide telephone exchange service within their corporate boundaries may do so upon compliance with the requirements of section 237.19. That section requires a referendum to be held. If 65% of the people voting on the referendum vote for the operation of a local exchange, the municipality may move forward with obtaining a certificate of authority from the MPUC under section 237.16.

The MPUC’s rules apply different requirements to different types of new entrants who provide local services.²¹⁸ Also, there are redundant entry rules due to Minnesota Statute section 237.16, Subd. 8, which required one set of rules for local entry to be promulgated for large telephone companies, and another promulgated for small telephone companies.²¹⁹

²¹⁶ Minn. Stat. § 237.067.

²¹⁷ Minn. Stat. § 237.16.

²¹⁸ Compare Minn. Rules 7811.0300, .0350, .0400, .0500.

²¹⁹ Compare Minn. Rules 7811.0300-.0500 to Minn. Rules 7812.0300-.0500.

4. Rate Regulation

a. Generally Applicable Requirements

All “telephone companies” must file with the MPUC tariffs for every kind of non-competitive service and a price list for every kind of service subject to emerging competition, together with all rules and classifications used by it in the conduct of the telephone business, including limitations on liability. Explanations of these “service classifications” are provided below.

b. Individual Case Base (ICB) Pricing

ICB pricing is allowed for non-competitive and emerging competitive services when justified by cost or market conditions.²²⁰ The MPUC must approve any such proposals to ensure that the provider is not engaging in unreasonable price discrimination.

c. Price Discrimination

Minnesota law prohibits “telephone companies” from charging more for any “in-trastate service” than it charges to any other person of a similar class. In other words, a telephone company can charge different rates for business versus residential service. A telephone company that offers or provides service, service elements, features, or functionalities on a separate, stand-alone basis to any customer must provide the same to all similarly situated persons, including competitors.

Telephone companies cannot discriminate in pricing wholesale services in a manner which discriminates against competitors who will use that service to compete against the telephone company provisioning the service.²²¹

d. TAP, TACIP, and 911 Charges

Local telephone companies must collect surcharges for TACIP, TAP, and 911 through a combined surcharge on a customer’s bill, and remit them to the Department of Administration for processing.

e. Promotions

Minnesota law regulates the manner in which telephone companies may offer promotions in Minnesota.²²² Promotions cannot last longer than 90 days. The service being promoted must have a price that is above the incremental cost of the service, including amortized cost of the promotion. The telephone company offering the promotion must provide notice to the MPUC containing a description of the promotion and a cost study indicating no predatory pricing (price below incremental cost). The telephone company must report back to the MPUC after the conclusion of the promotion.

f. Rate of Return Regulation

Minnesota Statutes sections 237.075 and .081 provide the traditional basis for the rate regulation of telephone companies. Minnesota Statute section 237.075 out-

²²⁰ Minn. Stat. § 237.071, 237.60, Subd. 3.

²²¹ Id. § 237.09, Subd. 2(b).

²²² Id. § 237.626.

lines the framework for a rate case proceeding in which the traditional rate base/rate of return considerations are made. This law has origins dating back to 1977, and it was revised numerous times between 1977 and 1989. A company whose general revenue requirement is determined under section 237.075 may also make rate changes and other changes in service offerings under Minnesota Statutes sections 237.60 and 237.63, which were both enacted in 1987. These statutes allow for changes that do not require a review of the company's earnings.

Under section 237.60, a company was able to elect to have certain of its services classified as subject to emerging competition. A company that did not make this election, and the services of a company that remained classified as non-competitive, were subject to the requirements of 237.63. This statute provides the regulatory vehicle for making changes to a company's rates and services outside of a general rate case. For example, the rates for custom calling features could be increased or reduced without a review of the company's earnings under these statutes. These changes included reducing rates for basic local service because a rate reduction did not require a review of the company's earnings. Increasing rates for basic local service remained subject to the requirements of Minnesota Statutes section 237.075. These provisions expired on August 1, 1999.

Minnesota Statutes section 237.081 provides the basis for MPUC investigations of any matter relating to the provision of telephone service, including the level of rates charged by the company. If the MPUC believes that a service is inadequate or cannot be obtained or that an investigation of any matter should be made, it may initiate an investigation. The MDOC is technically responsible for actually investigating the matter. Complaint investigations may be initiated against a telephone company by any other provider, by the governing body of a political subdivision, or by no fewer than 5% or 100, whichever is the lesser number, of the subscribers. For an investigation concerning the reasonableness of the rates for noncompetitive services of a telephone company whose general revenue requirement is determined under section 237.075, the MPUC must order the company to initiate a rate proceeding in accordance with section 237.075. Other investigations are conducted under the authority established in 237.081.

Under rate of return regulation, a telephone company's rates for various services are set by the MPUC based on a "revenue requirement" demonstrated by the telephone company and investigated by the MDOC. Many factors are considered in determining the revenue requirement. The goal of regulators is to design a rate structure which does not allow the regulated company to abuse its monopoly power by overcharging customers, but at the same time allow the company to earn a reasonable rate of return on investment. Rate of return regulation has both benefits and detriments to consumers and the industry. For consumers, rate of return regulation keeps rates for basic telephone services reasonable. On the other hand, rate of return regulation provides telephone companies less incentive to invest in upgrading facilities or offer new services because their rate of return is guaranteed. However, the company is guaranteed a rate of return on investment. Companies not subject to rate of return regulation often invest less in the network if it will increase their profitability, even though it may cause their service qual-

ity to suffer.²²³ For the industry, rate of return regulation limits the profitability of the company.

g. Alternative Form of Regulation (AFOR) Plans

AFOR plans have been used in Minnesota as a substitute for rate of return regulation. AFOR plans commonly provide some consumer protections, such as rate freezes for basic services, while eliminating earnings reviews and allowing the company more pricing flexibility. The Minnesota Statutes that authorize AFOR plans give telephone companies the choice to opt into an AFOR plan.

Minnesota Statutes sections 237.761-.764 describe alternative regulation plan services, rates/prices, exemption from rate-of-return regulation and rate investigations, and the effect of adopting an AFOR plan. Minnesota Statutes section 237.773 describes alternative regulation for small telephone companies. These laws were first effective in 1995 and expire in 2006. The plans approved by the MPUC for large companies may include requirements beyond those identified in statute, as the MPUC must ensure that the plans are in the public interest. Small companies simply opt to be under an AFOR without a decision by the MPUC to the plan. Thus, small companies have been able to avoid rate of return regulation although there may not be competitors available to help constrain the rates charged by the local telephone monopoly.

Minnesota Statutes section 237.761 (for large companies) states that all telephone services are classified into three buckets labeled as price regulated, flexibly priced, or non-price regulated. Price regulated services are essential for providing local telephone service and access to the local telephone network. Flexibly priced services are services determined not to be either a price or non-price regulated service. Non-price-regulated services have sufficient competitors providing the same service. The classification of the service impacts how the service is regulated over the term of the AFOR plan. For example, with the U S WEST AFOR plan, price regulated services are capped for the term of the plan, although after two years the Plan allows for certain changes for items such as investments required due to government mandates. Flexibly priced services may be subject to price increases, but the AFOR requires that any changes must be fair and reasonable. For service classified as non-price regulated, changes in price can be made at the discretion of the company. The AFOR plan also addresses changes other than price for each of the service classifications.

Minnesota Statutes section 237.773 states that a local telephone company with fewer than 50,000 subscribers may elect to become a “small telephone company” by notice to the MPUC. After making the election, it may not be revoked for three years, and while the election remains in effect, a small telephone company is not subject to the rate-of-return regulation or earnings investigation provisions of Minnesota Statutes sections 237.075 or 237.081.

Section 237.773, Subd. 3 provides that local rates, for small companies that opt to be regulated under an AFOR, shall not be increased for two years after making an

²²³T. Roycroft, “Alternative Regulation and the Efficiency of Local Exchange Carriers: Evidence from the Ameritech States,” 23 Telecommunications Policy 469 (July 1999).

election. Following one year after election, a small company may change rates for local services except switched network access services to reflect:

- i. changes in state and federal taxes;
- ii. changes in jurisdictional allocations from the FCC, the amount of which the small telephone company cannot control;
- iii. substantial financial impacts of investments in network upgrades (20% of the gross plant investment or as the result of government mandates).

The large company AFORs have a specified term. The U S WEST AFOR expires on January 1, 2004, although the plan does allow for a possible one-year extension. The small companies do not have specified terms for their AFOR plans. However, both the large company and small company AFOR statutes expire on January 1, 2006. There is no provision under Minnesota law or any AFOR Plan that indicates how services are to be regulated after the expiration of an AFOR Plan or the AFOR statute. Currently, there are three large companies under AFOR Plans: U S WEST, Sprint, and Frontier. Sixty-two small telephone companies have elected AFOR under section 237.772.

h. Incentive Regulation

In 1989, the Legislature adopted an incentive regulation scheme which it overlaid onto the existing state and federal regulatory framework. To the Ventura Administration's knowledge, only one company, U S WEST, ever attempted to utilize the incentive plan framework. This effort faded presumably because the AFOR statute was adopted, and was viewed by U S WEST as more favorable to its economic interests. Several of the incentive regulation provisions expired on August 1, 1999. The provisions that survived are reviewed below.

Section 237.57 sets forth three categories of services. Services are "effectively competitive" when competitive services are available to over 50% of the petitioner's customers for the service.²²⁴ "Emergingly competitive services" are those services for which competitive alternative services are available to over 20% of the company's customers for that service.²²⁵ A service can also be classified as "emergingly competitive" if "there is a trend toward effective competition, or if it is a new service offered for the first time after August 1, 1994, that is not integrally related to the provision of adequate telephone service or access to the telephone network or to the privacy, health, or safety of the company's customers."²²⁶ Services are "non-competitive" if they fail to meet either the definition of "effectively competitive" or "emergingly competitive."²²⁷ Section 237.59, Subd. 1 provides a list of "emergingly competitive" services. This section also provides that a company may petition the MPUC to have other services not specifically listed in section 237.59, Subd. 1 classified as "emergingly competitive."²²⁸ Section 237.59 also allows the MPUC to reclassify a competitive service as a non-competitive

²²⁴ Id. § 237.59, Subd. 5(b).

²²⁵ Id. § 237.59, Subd. 5(c).

²²⁶ Id. § 237.57, Subd. 3.

²²⁷ Id. § 237.57, Subd. 6.

²²⁸ Id. § 237.57, Subd. 2.

service if the competitive market fails and the MPUC finds it necessary to re-regulate the services to protect the public interest.²²⁹

The statutes that gave companies providing “competitive services” regulatory relief with respect to those services have expired. Because many of the substantive provisions of this regulatory scheme have expired, it is now unclear what benefit there would be to a company that provides competitive services, as classified under section 237.57, Subd. 2 under the current statutory structure.

i. Depreciation

Minnesota Statutes section 237.22 requires the MPUC to develop rules for the depreciation and amortization of telephone company property. All telephone companies must conform their depreciation accounts for non-competitive services to the rates and methods allowed under the MPUC’s rules. Telecommunications carriers are exempt from depreciation regulation.

Entering into an AFOR Plan does not exempt a large telephone company (over 50,000 lines) from depreciation regulation. However, Minnesota Statutes section 237.773, Subd. 5 exempts a small telephone company under an AFOR from the requirement of MPUC approval of its depreciation rules. Small companies electing regulation under the small company AFOR statute remain subject to complaints concerning depreciation rates, and must submit the reports required by Minnesota Rules 7810.7700 and 7810.7800.²³⁰

5. Interconnection

For telephone companies with over 50,000 access lines, state law requires prices for network elements to be based on forward-looking costs.²³¹ State law also prohibits any size telephone company from: failing to disclose information necessary for interconnecting facilities; intentionally impairing a customer’s quality of service; failing to provide wholesale or retail service in compliance with tariffs, price lists, contracts, or MPUC rules; and imposing unreasonable restrictions on the resale of telecommunications services.²³²

6. Intercarrier Service Quality

The MPUC has authority over examining service quality standards for wholesale services, including resold services, interconnection and unbundled network elements as part of its authority under the 1996 Act for approving and arbitrating interconnection agreements.²³³ The MPUC has approved service quality standards in arbitration proceedings.²³⁴

²²⁹ Id. § 237.59, Subd. 10.

²³⁰ The MPUC varied its depreciation rules by Order on November 24, 1999 relieving telephone companies of the duty to secure certification of depreciation rates and methods every five years. See In re Request by the Department of Public Service for the Minnesota Task Force on Telephone Depreciation to Revise the Rules for Depreciation on Telephone Plant, Order Granting Two Year Variances to Certain Depreciation Requirements, MPUC Docket No. P999/R-99-880 (November 24, 1999).

²³¹ Id. § 237.12, Subd. 4.

²³² Id. § 237.121(a)(5).

²³³ 47 U.S.C. §252(e)

²³⁴ In the Matter of the Consolidated Petitions of AT&T Communications of the Midwest, Inc. MCIMetro Access Transmission Services, Inc. & MFS Communications Company for Arbitration with U S WEST Communications, Pursuant to Sec-

In addition, Minnesota Statutes section 237.16, Subd. 1(2) grants the MPUC the authority to “establish terms and conditions for the entry of telephone service providers so as to protect consumers from monopolistic practices and preserve the state’s commitment to universal service.” Minnesota Statutes section 237.16, Subd 8, further requires the MPUC to adopt rules for competitive entry, “using any existing federal standards as minimum standards and incorporating any additional standards or requirements necessary to ensure the provision of high quality telephone services throughout the state.”

Although the Eighth Circuit Court of Appeals struck down the FCC Rules requiring ILECs to provide superior service quality for unbundled network elements and interconnection if technically feasible,²³⁵ the U.S. District Court for Minnesota found that the MPUC had authority under state law to require superior quality, if the MPUC deemed such a standard necessary.²³⁶ The 1996 Act, provides that a state commission can establish “other requirements of State law in its review of an agreement, including requiring compliance with intrastate telecommunications service quality standards or requirements.”²³⁷ The District Court found that the MPUC has authority under Minnesota law to order superior service quality.²³⁸ Additionally, Minnesota Rule 7812.0700, subpart 3, states that ILECs may be required to provide a CLEC with, “services, network elements, or interconnection at a level of quality exceeding that which the LEC provides itself or its affiliates.”

In the last legislative session, the MPUC was granted additional authority to resolve complaints through an expedited proceeding, and to assess penalties when it found a knowing and intentional violation of Minnesota Statutes sections 237.09, 237.121 and 237.16 and any rules adopted under those sections. Complaints regarding difficulties in obtaining unbundled network elements, interconnection and resale services could all be brought under these sections. Minnesota Statutes section 237.462 grants the MPUC the authority to issue an order assessing a penalty of between \$100 and \$10,000 per day for each knowing and intentional violation, and allows the MPUC the latitude to order an expedited proceeding regardless of the agreement of the parties, if the MPUC finds that the public interest is best served by such a proceeding. Cases can be brought before district courts for penalties of up to \$55,000 per day per violation. Minnesota Statute section 237.462 provides the MPUC additional power to resolve complaints in a more timely manner, and to punish anti-competitive behavior by companies.

7. Mergers & Acquisitions

Since the adoption of the 1996 Act, the telecommunications industry has witnessed a dramatic increase in the concentration of market power through industry consolidation in the form of mergers and acquisitions. The Herfindahl-Hirshman (HHI) index is one method of measuring industry market concentration. The HHI index is used by

tion 252(b) of the Federal Telecommunications Act of 1996, P421,442/M-96-855, P5321,421/M-96-909 & P3167,421/M-96-729, Order Resolving Arbitration Issues and Initiating a U S WEST Cost Proceeding, December 2, 1996., hereinafter, the Arbitration Order

²³⁵ 47 C.F.R. §51.305(a)(4) and §51.311(c)

²³⁶ U S WEST v. Minnesota Public Utilities Commission, et. al. Memorandum Opinion and Order, File No. Civ. 97-913/ADM/AJB, p. 21-25 (D. Minn. 1999).

²³⁷ 47 U.S.C. §252(e)(3)

²³⁸ Minn. Stat. §237.081, 16, Subd 1(2) and 8.

the United States Department of Justice and the FCC. An HHI below 1000 is considered to represent an uncontested market. An HHI above 1800 is considered a concentrated market. The table below shows the trend in market concentration within the telecommunications industry since 1984 at the national level. A monopoly market yields a score of 1000. A market with two firms, each with 50% market share, would yield an HHI score of 5000.

<i>Year</i>	<i>HHI Index</i> ²³⁹
1984	1003
1995	1123
1999	1972
<i>With SBC/Ameritech Merger</i>	1994
<i>With GTE/Bell Atlantic Merger</i>	2106
<i>With both</i>	2521

Table 13 - HHI Market Concentration Index

As the HHI index indicates, since just after the breakup of AT&T, the telecommunications industry has become increasingly consolidated. Consumer groups are growing concerned that the benefits promised by the 1996 Act are going to shareholders rather than consumers. The American Association of Retired Persons (AARP) recently released a study indicating that customer service quality had declined after the SBC/Pacific Telesis merger in 1997.²⁴⁰ The number of customer complaints against Pac Bell increased 229% compared to 1995, and the time needed to repair phone lines increased 71%. In May 1999, AT&T, Sprint, and the Competitive Telecommunications Association urged the attendees at the National Conference of State Legislatures' Commerce and Communications Committee to empower utility commissions to require binding arbitration of disputes between ILECs and competitors and provide for severe penalties against anti-competitive conduct by ILECs.²⁴¹

With growing public concern over the rapid (re)consolidation of the telecommunications industry, the State's ability to review mergers and acquisitions to protect the public interest is becoming one of the more important regulatory tools at its disposal. Telephone companies and telecommunications carriers are required to obtain the consent of the MPUC prior to the acquisition, merger, or reorganization with another company.²⁴²

Minnesota Statutes section 237.23 applies to asset acquisitions. No company can acquire any asset of a telephone company without the prior approval of the MPUC. Minnesota Statutes section 237.231 applies to the sale of exchanges by large telephone companies. In order for a large telephone company to sell exchanges, it must obtain approval of the MPUC after notice, a resident survey, and local public hearing. The MPUC may approve the sale of exchanges if it finds the telephone company selling the exchanges has complied with all service quality standards under law and the

²³⁹ FCC Statistics of Common Carriers.

²⁴⁰ "AARP Sees Few Benefits From Bell Company Mergers," 65 Telecommunications Reports No. 29 at 6 (July 19, 1999).

²⁴¹ "State Legislators Urged to Put Conditions on Telecom Mergers," 65 Telecommunications Reports No. 19 (May 10, 1999).

²⁴² *Id.* § 237.23, .74, Subd. 12.

proposed buyer has the financial capability and human resources to maintain service quality standards.

Minnesota Statutes section 237.74, Subd. 12 requires telecommunications carriers to obtain the consent of the MPUC before acquiring any telephone line, plant, system, or any extension thereof.²⁴³

²⁴³ Id. § 237.74, Subd. 12.

8. Carrier of Last Resort Obligations

The term “carrier of last resort” (COLR) refers to a carrier’s obligation to serve all customers in a specific exchange or area. In exchange for their monopoly positions, local telephone companies historically were obligated to provide service within a reasonable period of time at affordable rates to all customers within the company’s authorized service area. ILECs are now arguing that in this era of “competition,” COLR obligations should be imposed on ETCs, or that at least CLECs ought to share proportionately in fulfilling the COLR duty.²⁴⁴ Another issue related to the COLR doctrine concerns the extent to which the State can and should assign or force companies to serve undesirable areas, some of which are not served by any telephone companies at the present time.

At the federal level, the FCC has expressly declined to impose the same COLR obligations on ETCs, as are placed on ILECs as conditions of ETC eligibility.²⁴⁵ The FCC reasoned that the ETC obligation to provide quality and affordable service throughout the entire designated ETC area is similar enough to state imposed COLR protections that it is unnecessary to expressly impose them as conditions for ETCs.

The term “carrier of last resort” is not defined by state statute; rather it is a regulatory concept articulated in several sections of the Minnesota Statutes and Rules. Minnesota law provides that every telephone company has a duty to furnish reasonably adequate service and facilities for the accommodation of the public at fair and reasonable rates.²⁴⁶ Minnesota law prohibits telephone companies²⁴⁷ and telecommunications carriers²⁴⁸ from unreasonably limiting their service offerings to particular geographic areas, unless facilities are not available and cannot be made available at reasonable cost. MPUC rules state that all Local Service Providers (LSPs) must serve all customers in their service area, unless the LSP is not an ETC and does not have facilities close to the customer. The language could be read to imply that CLECs that are not ETCs face a weaker requirement because there is not a requirement to build facilities even if facilities can be built at reasonable cost.²⁴⁹

Recently, citizens of Ely, Minnesota petitioned the MPUC to assign an ETC to serve previously unassigned territories in Northern Minnesota.²⁵⁰ The MPUC currently has authority to designate an ETC for every area of the State and used that power to require GTE to provide service to the unassigned territory in Ely.²⁵¹ However, the procedures for assigning companies to serve unassigned territories are unclear. As an alternative to the MPUC having the authority to order companies to provide service to unassigned territories, some have called for a competitive bidding process to be

²⁴⁴ See U S WEST Communication Inc.’s Petition for Establishment of a Competitive Zone in St. Cloud, Waite Park, and Sauk Rapids, Docket No. P421/AM-99-957 (July 14, 1999).

²⁴⁵ *Universal Service Order* at ¶143.

²⁴⁶ Minn. Stat. §237.06.

²⁴⁷ Minn. Stat. §237.60, Subd. 3.

²⁴⁸ Minn. Stat. §237.74, Subd. 2

²⁴⁹ Minn. Rules 7811.2200 and 7812.2200 imply that Minn. Stat 237.60, Subd. 3 applies to CLECs, unless other parts of 7811 and 7812 provide different guidance. Minn. Rules 7811.0600 and 7812.0600, subp. 3 provide such different guidance. However, the rules 7811 and 7812 do not diminish the effect of Minn. Stat. 237.60, Subd. 3 on ILECs.

²⁵⁰ Order Requiring GTE to Provide Service to Territory, MPUC Docket No. P999/CP-98-1193 (July 28, 1999).

²⁵¹ 47 U.S.C. §214(e)(3); Minn. Rules 7811.1400; 7812.1400 (1998).

followed in assigning an ETC to serve unassigned territory.²⁵² Competitive bidding has not been adopted by the FCC, but has been adopted by several states, including Kentucky, Hawaii, and California.

Relinquishment of the COLR obligation is not easy. ETCs cannot relinquish their designation unless the ETC can demonstrate that customers in the designated service area will not be left without a provider.²⁵³ At the state level, relinquishment of the COLR obligation is not addressed by state statute. But MPUC rules provide that an LSP is not permitted to terminate service in an area unless another qualified LSP is capable of serving all customers in that area.²⁵⁴ This rule applies equally to LECs and CLECs. This rule does not say that the MPUC must approve the LSPs withdrawal from a service area, only that the MPUC must be notified, thus providing the MDOC or the Office of the Attorney General the opportunity to comment and intervene if necessary.

F. Analysis

As the Ventura Administration’s competition analysis and the FCC’s data on the use of UNEs indicates, the state of Minnesota’s competitive telecommunications environment is poor. The Ventura Administration believes this is because the current regulatory system has not provided ILECs with adequate economic incentives to open up their networks for use by competitors. It is clear that premature deregulation of the ILECs is not the solution. Comparing Nebraska, which has for all practical purposes deregulated U S WEST, to New York, which has taken a much more aggressive approach to promoting competition through incentive regulation, it is clear to the Ventura Administration that the Nebraska approach does not work.

	<i>Total Lines</i>	<i># of UNE Loops</i>	<i>% of total lines</i>
<i>Minnesota (U S WEST)²⁵⁵</i>	<i>2,284,000</i>	<i>2,000</i>	<i>0.1%</i>
<i>Nebraska (U S WEST)</i>	<i>533,000</i>	<i>**</i>	<i>0.1%</i>
<i>New York (Bell Atlantic)</i>	<i>11,917,000</i>	<i>49,000</i>	<i>0.4%</i>

Table 14 - Lines Provided By Large ILECs to CLECs as UNE Loops

Competition is not being allowed to work in Minnesota. The intransigence and litigiousness of ILECs, the anti-competitive subsidization of local service rates through rate averaging and access charges, and the protections offered to small ILECs all contribute to a market for local services that will not become more competitive without a major regulatory overhaul. The Ventura Administration has developed proposed local regulatory framework which provides standards-based incentives for ILECs to open their networks, embrace competition rather than litigation, and let competition work to bring lower rates, better quality services, and the accelerated deployment of advanced and competitive telecommunications services to all of Minnesota. Temporary solutions like the AFOR statute and the incentive regulation plan set forth under now expired Minnesota Statute section 237.625 have not worked. A long term solution is required.

²⁵² 81st Minnesota Legislature, Senate File No. 2133, Article 4, section 2 (March 1999).

²⁵³ 47 U.S.C. §214(e)(4).

²⁵⁴ Minn. Rules. 7811.0600, Subpt. 6; 7812.0600, Subpt. 6.

²⁵⁵ It is worth noting that GTE does not even register on the FCC’s data for Minnesota.

1. Minnesota's telecommunications laws should be reorganized and rewritten to provide a clear pathway for companies to move from a regulated environment to a deregulated environment.

Minnesota's current telecommunications laws are cluttered with ambiguity, redundancies and anachronisms, and are not technology neutral. The lack of technology neutrality creates an uneven regulatory environment, which favors certain competitors over others. Minnesota's telecommunications laws must be streamlined, simplified, and uniform to eliminate regulatory ambiguity, clarify duties, provide certainty to stakeholders, eliminate regulatory overlap, and ensure competitive neutrality. Regulatory exemptions for special classes of service providers or particular technologies should be allowed only when required by federal law or when compelling public interest dictates. Minnesota's telecommunications laws should be designed to shift the burden of performance in the marketplace from regulators to competitors. Minnesota's current telecommunications statutes do not possess these qualities.

Minnesota's telecommunications laws and the enforcement of those laws should provide compelling incentives for companies to move out of a regulated regulatory framework and into a deregulatory framework. Monopolists, duopolists, oligopolists or companies who engage in anti-competitive behavior should be encouraged to shed these characteristics under Minnesota's regulatory framework. Current Minnesota law does not provide this incentive. It provides two choices: regulation or more regulation with punishment.

Passage out of a stricter regulatory framework should be based on standards considering the competitiveness of the market and the degree to which the service being provided is essential to the public health, safety, and welfare. There should be qualitative and quantitative standards for evaluating the competitiveness of a market for a service.

2. Proposed Streamlined Regulatory Framework

- a. Category I - Non-Qualified Companies

Companies falling under Category I would be those dominant providers of essential local telecommunications services in a non-competitive market. Any local telecommunications service provider not meeting the criteria for Category II described below would be deemed a Non-Qualified Company. Services offered by such companies will be regulated very strictly. Rate of return regulation will continue to apply. Non-Qualified Companies should have absolutely no pricing flexibility. Tariffs will be required. The State will continue to strictly regulate service quality. There will be reductions in access charges to cost, and universal service subsidies available for upgrade of plant and equipment. Non-Qualified Companies will, therefore, be forced to look for alternative revenue sources. One of the few alternatives available to Non-Qualified Companies will be providing wholesale services to competitors. The other alternative for an ILEC under this framework would be to compete in other exchange areas.

- b. Category II - Qualified Companies

Category II would be the most complex regulatory category. A Non-Qualified Company can become a Qualified Company if it can demonstrate that one or more competitors are offering facilities-based competitive local exchange services to 25% of the residential customers in its state wide service area. Wireless service

providers would only count toward this percentage if they were a state ETC. When a Non-Qualified Company demonstrates this to the MPUC, it triggers eligibility for the company to enter into an AFOR Plan.

Under the Ventura Administration's proposed basic framework, a Qualified Company may serve markets which are competitive, and may serve markets that are non-competitive. To address this reality, each service provided by a Qualified Company would be regulated under one of four categories of service distinguished on the basis of the level of competition within each of the company's individual markets. Each service provided by a Non-Qualified Company would be evaluated individually to determine under which competitive category it would be regulated. The first subcategory would be for non-competitive markets (similar to price regulated services under the current AFOR statute) offered by a Qualified Company. This would include any markets not meeting the test for imminent, actual, or effective competition described below.

The second subcategory would be for markets characterized by "imminent competition." Whether competition is "imminent" would be determined by the company's demonstration of one of two facts: (I) that a competitor has facilities in place, and/or any necessary interconnection agreements executed to the extent they would allow the competitor (including wireless ETCs) to pass 50% of the Qualified Company's total customer base for a particular exchange; or (II) a competitor (including wireless ETCs) has presubscribed 50% of the Qualified Company's customer base for the particular exchange, but is not yet providing service. Under imminent competition, a Qualified Company should be allowed to respond to competition by lowering its price to a level at or above the competitor's rate, as long as the Qualified Company's rate does not drop below the economic cost of providing service to the exchange area. In the words of MPUC Commissioner Greg Scott, this ensures that "when we unles[h] the incumbent, we [aren't] going the CLEC at the same time."²⁵⁶ Oversight of promotions would still be required to protect against anti-competitive price discrimination or cross-subsidization. However, individual case based (ICB) pricing would not be allowed.

The third subcategory would be markets with "actual competition." The Ventura Administration asserts that "actual competition" exists when one or more competitors (including wireless ETCs) are offering competitive services to 50% or more of the Qualified Company's customer base in the relevant service area. Under this test, the Ventura Administration recommends that the FCC's definition of "offered" be applied. Under that definition a competitive service is deemed "offered" when the Qualified Company proves: (I) that a competitor is physically able to deliver service to potential customers, with the addition of no or only minimal additional investment by the competitor, in order for an individual subscriber to receive service; and (II) that no regulatory, technical or other impediments to customers taking service exist, and potential customers in the service area are reasonably aware that they may purchase the services of the competing service provider.²⁵⁷ If a Qualified Company were able to meet the "actual compe-

²⁵⁶ Comments of MPUC Commissioner Greg Scott at the oral arguments In re U S WEST Competitive Zone Filing, (October 26, 1999).

²⁵⁷ See 47 C.F.R. § 76.905 (1998).

tion” test, the Ventura Administration recommends that the company should be allowed to competitively respond with price reductions at any level above the economic cost of providing service within the exchange area. This would allow the Qualified Company to compete on price, while removing the danger of a destructive predatory pricing war in a duopoly or oligopoly scenario. Individual Case Based (ICB) pricing would be allowed.

The fourth subcategory would be markets subject to “effective competition.” In addition to being subject to “actual competition,” effectively competitive markets would require the Qualified Company to demonstrate that its network is completely and irreversibly open to competition, applying a test akin to the 14 point checklist set forth in the Telecommunications Act of 1996.²⁵⁸ Under “effective competition,” the service is completely deregulated. Market forces will keep prices in line with economic cost. If all of a Qualified Company’s services become subject to actual competition or effective competition, there would be no need for continued oversight of the Company’s practices with respect to promotions.

Qualified Companies providing services subject to competition should be prohibited from subsidizing competitive services with revenue from non-competitive services.

c. Category III - Non-Essential, Non-Competitive Services

Category III would include those services which are non-essential, but also non-competitive, such as CLASS services like call waiting. Generally, these services would be unregulated, as long as they are not being provided by a company or an affiliate of a Non-Qualified or Qualified Company. If the services are offered by a Non-Qualified Company, such services would be subject to rate-of-return regulation, with all of that company’s other services. If the services are offered by a Qualified Company, they would be subject to the competitive categories of regulation described earlier with respect to Qualified Companies.

If Category III services are provided by other than a Qualified or Non-Qualified Company, the services become unregulated. However, the Ventura Administration would monitor the provision of such non-competitive services for anti-competitive behavior, investigate any wrongdoing, and enforce any violations of anti-trust law or consumer protection laws.

d. Category IV - Non-Essential, Competitive Services

Category IV services are non-essential services provided in an effectively competitive market. They will be completely deregulated (except for non-telecommunications related business regulation to which any other normal business is subject), regardless of which company is providing them.

Under the proposed Ventura Administration framework, a Qualified Company could regress into a Non-Qualified Company if less than 25% of the company’s residential customer base is offered service by competing facilities-based carriers. Similarly, services within the Qualified Company’s competitive categories may move to other competitive categories. For instance, services which are subject to “imminent competition” today could become non-competitive or subject to “ac-

²⁵⁸ 47 U.S.C. § 271 (1998).

tual competition” tomorrow. The MDOC or any provider would be allowed to bring an action to have services of any Qualified Company re-classified. In other words, a competitor would have standing to petition to have a competitor’s services re-classified.

The framework would apply to any local telecommunications service provider. For example, at first CLECs would not be coming from a position of market dominance in the local market. However, if they ever achieved market dominance, they would fall under the proposed framework. Thus, if a CLEC ever achieved a market position in which its facilities-based competitors did not offer service to 25% of the CLEC’s statewide residential customer base, the CLEC would become a Non-Qualified Company. If the Non-Qualified CLEC’s competitors rose above that mark, the CLEC would need to enter into an AFOR.

The local regulatory framework should also address how affiliates relationships would be regulated. An affiliate should be defined as any legal entity controlled by, under common control with, or under the control of another carrier. If a company competes in the same service territory as an affiliated local telecommunications service provider, both companies would count as one for the purposes of classification under the Ventura Administration’s proposed local regulatory framework.

AFOR Plans currently under effect would be grandfathered under the new law to avoid disruptions in the marketplace, and to allow for any new legislation to be properly implemented. The small company AFOR statute should be eliminated in favor of the proposed new local regulatory framework. Companies that have elected to be governed under the small company AFOR statute would have a grace period of one year before becoming subject to the new local regulatory framework. However, at the expiration of the AFOR plan (or the one year grace period for small companies), all providers would be subject to the new local service regulatory framework. In the event that the proper classification could not be determined for a company coming out of a grandfathered AFOR prior to the expiration of the AFOR Plan or the grace period, it would be presumed that the company is Non-Qualified.

The matrix below presents a visual picture of the Ventura Administration’s proposed local regulatory framework:

<p>I. NONQUALIFIED COMPANIES</p> <ul style="list-style-type: none"> • Rate of Return rate regulation • No pricing flexibility • Mergers and acquisitions subject to strict review for net public benefit • Tariff filings required • Service quality regulation continues 	<p>II. QUALIFIED COMPANIES</p> <ul style="list-style-type: none"> • Company qualifies for AFOR Plan if 25% of statewide retail market served by one or more facilities-based competitors. • Mergers and acquisitions subject to strict review for net public benefit. • Competitive Zones provided for in AFOR Plan • <u>Non-competitive zones</u> -Includes any zone not meeting test for imminent, actual, or effective competition -Price caps -Rate Freeze -No pricing flexibility -Quality of service standards under AFOR apply -Tariffs required • <u>Imminent Competition</u> -Limited pricing flexibility allowed if competition is imminent -Can't price below competitor's price, or below economic cost -Quality of service standards apply • <u>Actual Competition</u> -Pricing flexibility allowed if actual competition exists -Can't price below economic cost -Quality of service regulations dropped • <u>Effective Competition</u> -Deregulated
<p>III. NONESSENTIAL/ NONCOMPETITIVE SERVICES</p> <ul style="list-style-type: none"> • If offered by a Category I, all services offered are regulated under Category I. • Companies monitored for anti-competitive behavior. • If offered by a Category II company, all services regulated under Category II • Otherwise deregulated 	<p>IV. NONESSENTIAL/ COMPETITIVE SERVICES</p> <ul style="list-style-type: none"> • Deregulated

Table 15: Proposed Local Regulatory Framework Matrix

3. The local competition regulatory framework should contain a burden shifting mechanism that encourages the production of market share data to ensure the correct decisions are made about competitive classifications of services.

One of the most frustrating aspects of the regulatory environment today is that regulated companies frequently cry competition, but seldom provide any proof that competition actually exists.²⁵⁹ The law should provide an incentive to companies to produce this information. The Ventura Administration believes this can be resolved by establishing a burden shifting analysis, and clarifying under the Data Practices Act what information in the telecommunications regulatory context is protected data.

Specifically, data regarding the competitiveness of markets should be classified as protected data when submitted to a government agency for the purposes of having a service reclassified. Moreover, the burden of producing *prima facie* evidence necessary to reclassify a service should lie with the party seeking to have a service reclassified (the petitioner). If the MPUC believes this burden has been met, the burden would then shift to the respondent to provide evidence that outweighs the evidence

²⁵⁹ See, e.g., U S WEST's Petition for Competitive Zone in St. Cloud; Frontier/Worthington.

produced by the petitioner. The MPUC would make the decision based on the weight of the evidence presented.

4. There should be expedited administrative procedures for determining competitive classifications or reclassifications of service.

A petition for reclassification of a service would become automatically effective after thirty days unless an objection was submitted by either the Department or the Office of Attorney General. The MPUC would then be required to make a decision within ninety days of receiving the petition for classification or re-classification of a service. With the burden of proof placed on the party seeking classification or re-classification, there should be incentive to provide the MPUC with the information necessary to make an informed decision. If the evidence necessary for the MPUC to make an informed judgment is not presented, the MPUC should deny the petition for re-classification.

5. Entry regulations should be changed and streamlined to require only the information necessary to protect the public from harm.
 - a. Entry by Privately Owned Providers

The current MPUC rules related to market entry contain many unnecessary requirements. For example, Rule 7811.0300(G) asks applicants for information about the type of technology the applicant company plans to use to provide local service. The Ventura Administration questions why this information is necessary. Minnesota law should be clear about what criteria a company must show to provide local telephone service. It should eliminate redundant and unnecessary filing requirements, and thereby reduce the delay to market caused by these regulations. The Ventura Administration believes the following criteria should be applied in determining whether a company should receive authority to provide local service in Minnesota: (i) the company's managerial qualifications to provide local service in Minnesota; (ii) the company's financial ability to provide service in Minnesota; (iii) the company's legal authority to do business in Minnesota; and (iv) whether the public health, safety, or welfare is threatened by granting the application. Utilizing these categories, the Ventura Administration has compiled the following list of information it believes is necessary for the MPUC to evaluate in deciding whether to allow a company to enter the local service market in Minnesota.

- i. General information (i.e. name address, telephone number, service area map). This information is necessary for general registration purposes and for the convenience of the MDOC, the MPUC, and the public.
- ii. List of affiliates providing telecommunications services in Minnesota. This information is necessary in order for the MPUC to monitor market concentration, cross subsidization, and other anti-competitive activity in Minnesota.
- iii. Statement of experience in providing local telecommunications service in Minnesota or elsewhere. This information is necessary to determine if the company has the minimum managerial qualifications to provide local telephone service in the state.

- iv. Income statement, balance sheet and statement of sources and uses of cash for most recent fiscal year, or proforma statements for one year if the company has no operating history. This information is necessary to determine whether the company has the financial ability to provide the local services they are seeking authority to provide in Minnesota.
- v. A price list or tariff containing the prices, terms, and conditions of service, unless the services for which the company seeks authority to provide are subject to effective competition.
- vi. A description of the company's customer service operations, policies, and procedures, unless the services for which the company seeks authority to provide are subject to effective competition.
- vii. The company's 911 Plan as currently required under Minnesota Rule 7812.0550.
- viii. Any other information a company wishes to provide to augment its application for authority.

These application requirements would apply to all types of local service providers, whether facilities-based or resale. However, companies providing only Category III or IV services would not be subject to any entry regulation.

Finally, there is no reason the MPUC needs two sets of entry rules -- one applicable to large telephone companies, and one applicable to small telephone companies. In fact most of Minnesota Rules Chapter 7811 is identical to Chapter 7812. One entire chapter of rules could be eliminated.

b. Municipal Entry

The Ventura Administration prefers that the private sector address the competitive and advanced telecommunications needs of all of Minnesota. However, it has become clear to the Ventura Administration that the private sector is not addressing these needs, particularly in Greater Minnesota.²⁶⁰ Greater Minnesota cannot wait and should not have to wait. The Ventura Administration believes a community ought to be allowed to pool its resources and provide the infrastructure or the services themselves with certain conditions. Currently, Minnesota Statutes section 237.19 requires a community to hold a referendum before owning or operating a telephone exchange in Minnesota. The Ventura Administration believes this requirement should be eliminated.²⁶¹ It is a barrier to competition and the development of advanced telecommunications infrastructure in Minnesota. It should be replaced with a law that allows any municipality to construct a local telecommunications network, if it can demonstrate to the MPUC that its local telecommunications market is non-competitive based on the "actual competition" standard set forth under the Category II regulatory framework. In other words, if a municipality can show that more than one company is not offering facilities-based services to 50% or more of the customer base in the community, the municipality should be allowed to construct, own and operate its own telecommuni-

²⁶⁰ See Maps 5, 13 and 14.

²⁶¹ However, municipalities should be prohibited from reselling telecommunications services in Minnesota. Resale does nothing to improve the local telecommunications infrastructure of a community.

cations network, subject to the entry regulatory requirements applicable to other new local service providers. The municipal system must be designed to provide competitive open access to customers for the provision of basic and advanced telecommunications services. A municipally owned telecommunications company would be subject to the same regulatory framework as other local telecommunications service providers.

Finally, partnerships and joint ventures between public and private entities should be allowed for any purpose which furthers the development of a community's local telecommunications infrastructure, subject to municipal law and regulations.

6. Minnesota law must ensure that all qualified competitors have ready quality access to customers through resale or interconnection with those companies that control capital intensive local network facilities.

The backbone of the local competition framework of the 1996 Act is the interconnection obligations under section 251. Federal law and FCC regulations have adequately defined the interconnection duties of ILECs. There is no need for state legislation to supplement these laws and rules, and to do so may cause more confusion and litigation which would further delay the development of robust local competition. The federal law, however, is not clear about what service quality standards ILECs should be held to in providing exchange access, UNEs, collocation, and interconnection to competitors.

At the wholesale level, poor service quality hurts the ability of competitors to effectively compete for customers. Competitors unable to obtain interconnection trunks, unbundled elements, or who receive poor service quality from the underlying carrier for resold services will be unable to attract and keep customers. The MDOC has fielded several complaints from consumers and CLECs involving poor quality inter-carrier service.²⁶²

Effective, meaningful, and self-enforcing service quality standards are necessary at the wholesale level, to ensure that competitors receive non-discriminatory treatment and are afforded a meaningful opportunity to compete, as required by the 1996 Act. If retail service quality standards are eliminated or reduced based on the assumption that a competitive market will keep quality high, and competitors are not assured of receiving high service through strong wholesale standards, then consumers will be left unprotected by adequate service standards, and have no competitive options.

Minnesota law should go beyond federal regulations to ensure that all competitors have quick, high quality access to customers over the facilities of the dominant local telecommunications carrier. Specifically, the Legislature should direct the MPUC to complete a rulemaking to address interconnection service quality standards within one year of the effective date of the passage of any telecommunications reform legislation. Specific topics that should be addressed are time intervals for responding to and provisioning orders, what comparisons are appropriate to determine non-discrimination for interconnection and unbundled network elements, how to interpret statistical tests comparing performance results, and the appropriate action or

²⁶² See e.g. In the Matter of a Complaint by McLeod USA Telecommunications Services, Inc. and U S WEST, Inc. Regarding Lost Phone Service for Pinnacle Copy Service, MPUC Docket No. P5323,421/C-98-621.

penalties to be applied if a statistical test indicates unlawful discrimination. The law should be clear that the standards to be set by the MPUC are minimum standards, and that the parties are free to negotiate stricter standards and enforce the minimum or stricter standards under the purview of interconnection agreements. Moreover, the law should be clear that performance above the minimum standards may be necessary in order to meet the FCC's interconnection service quality standard -- to provide competitors service quality as high a quality as a company provides itself.

It is important to emphasize that compliance with strong, wholesale service quality standards will be necessary even with facilities-based competition. Because they are using their own facilities to provide service, facilities-based CLECs will be less dependent on the service provided by the ILEC to serve customers, but they are not completely independent of the ILEC. Facilities-based CLECs still must interconnect their facilities with those of the ILEC, and doing so requires the provision of interconnection trunks. Likewise, facilities-based CLECs will still need access to ILEC customer service records to ensure that customers switching to the CLEC are able to obtain all the same features currently available to the ILEC.²⁶³ Consequently, compliance with service quality standards will still be important to ensuring that facilities-based competitors are able to obtain timely interconnection with the incumbent.

Finally, given the fact that the behavior of ILECs indicates that it is still more economically beneficial for them to compete in the courtroom rather than the marketplace, the penalties law adopted in 1999 should be strengthened to deter litigation and anti-competitive behavior by companies attempting to protect their dominance in the marketplace. The Legislature should expand the scope of the penalties law to cover any company that is required to provide UNEs or discounted resale in accordance with section 251(c) of the 1996 Act. The penalties law should also be modified to clarify that penalties apply to any FCC or MPUC rules related to the provisioning of UNEs, resale or interconnection service quality standards. Finally, penalties should apply to any frivolous claims made before the MPUC or a court by a company that is required to provide UNEs or discounted resale in accordance with section 251(c). Delays that hinder the development of competition or waste valuable public resources cost Minnesotans millions of dollars each year in lost savings from the benefits of competition. Decisions to litigate must not continue to be made lightly.

7. The filed rate doctrine should be abolished in Minnesota.

MPUC rules currently provide telephone companies with a government sanction of the reasonableness of rates filed under tariffs with the MPUC.²⁶⁴ This government sanction, embodied in several places throughout Minnesota Statutes and Rules, places consumers at a disadvantage because they arbitrarily preclude investigations into the reasonableness or fairness of rates filed. Tariff documents are often voluminous documents, containing large amounts of detailed information. It is practically infeasible for regulatory agencies to inspect each tariff filing thoroughly and, outside any context, make a determination of reasonableness. Minnesota Statutes and rules operate to supply companies with a presumption of reasonableness with respect to rates filed. In many cases, the operation of the filed rate doctrine precludes regulatory agencies from reviewing the fairness or reasonableness of filed rates in response

²⁶³ Comments of MediaOne Communications, MPUC Docket No. P421/CI-96-1114 (September 10, 1999).

²⁶⁴ Minn. Rules 7827.0300, 7829.1400, .3000.

to inquiries or complaints from consumers. Regulatory agencies should be allowed to challenge the reasonableness of regulated rates filed with the State at any time such rates are in effect. Ensuring this change under state law would provide consumers with added protections against unreasonable or unfair rates as Minnesota moves from a competitive to a non-competitive environment. The filed rate doctrine should be abolished in Minnesota.

8. All mergers between Qualified and/or Non-Qualified companies should be reviewed by the State and not approved unless the companies demonstrate that a net benefit to the public will result from the merger or acquisition.

To date, industry consolidation does not appear to have benefited consumers. At the very least, it cannot be said with confidence that there is a causal nexus between merger or acquisitions and consumer benefits. Promised cost savings to be passed on to consumers as a result of merger synergies have not materialized. Rates for non-competitive services provided by consolidating companies have increased unless regulated. Customer service quality does not improve. Deployment of advanced or competitive telecommunications services has not been accelerated because of industry consolidation.

Most companies petitioning the MPUC for approval of mergers allege vague public interest benefits as a result of the mergers (i.e. increased local competition, accelerated deployment of services, becoming a stronger competitor). But few companies are able to provide any tangible evidence of public benefit from mergers. The Ventura Administration acknowledges that it is difficult for emerging companies to prove what will happen in the future. However, the industry is representing that these benefits will occur as a result of a merger. Consequently, the State's review of mergers becomes an exercise in risk analysis. A substantial portion of the cost savings from mergers may well be going toward investment in new plant and equipment, the deployment of advanced services, or the geographic expansion of business. But the reality of any merger is that it effectively removes a competitor from a marketplace already short on competitors. Moreover, there is usually no assurance that the promise made by the companies about the merger will actually materialize. Capital originally targeted for Minnesota, may go to other states. Business plans may change. For companies providing essential services, the question becomes whether the risk to consumers is outweighed by the likely benefits of the merger to consumers.

Given these circumstances, the State's ability to review mergers becomes a valuable tool for protecting and serving the public interest. The State's ability to review mergers and attach conditions to merger approvals is critical to the development of competitive markets in Minnesota and the protection of consumers being served by carriers whose size and market dominance continues to grow. The Legislature should set a standard to be applied in MPUC merger/acquisition reviews which clarifies that there must be a net benefit to the public that results from any proposed merger/acquisition between companies.

With respect to mergers or acquisitions involving Qualified or Non-Qualified Companies or the property of such companies, the companies should be required to provide notice to customers of the merger/acquisition which describes the transaction, and informs them of their opportunity to participate in the regulatory review process. This notice should be given to customers at least 30 days in advance of any public hearings held. All mergers/acquisitions between Qualified or Non-Qualified Compa-

nies should also be the subject of public hearings at places to be determined by the MPUC.

9. Current carrier of last resort obligations under federal and Minnesota law are competitively neutral and promote universal service objectives, but should be clarified to require MPUC approval of relinquishment of state COLR obligations.

Carrier of last resort obligations touch on both universal service and local competition issues. Federal and state laws are clear that all ETCs are required to serve their entire designated service area. These legal requirements should not be changed. Public subsidies to businesses should carry with them an obligation to serve all areas within the designated service area, not just those which are most profitable to the carrier.

The current state law is also competitively neutral because it requires all companies, both ILECs and CLECs, to serve areas unless facilities are not available and cannot be made available at reasonable cost. The data presented on Tables 3 and 14, and the litany of delay and litigation that ILECs have participated in since the adoption of the 1996 Act indicate that ILECs are not making facilities available to CLECs at a reasonable cost throughout the ILECs' service areas. When these facilities become available to all telecommunications service providers in Minnesota at reasonable costs, ILECs should be able to enforce provisions like Minnesota statutes section 237.60, Subd. 3, which requires companies to provide service to all geographic areas of the State unless facilities are not available.

With respect to unassigned territory, the Ventura Administration does not favor the competitive bidding approach. Given the high cost of serving unassigned areas, it is likely that the State may receive no bids in a competitive bidding process because effort can be expended on more profitable ventures. The lost opportunity cost, even with the incentive of a public subsidy could result in a failed RFP process, leaving the territory unserved. Also, in areas put up for bid in which there emerged a winning bidder, the Ventura Administration submits that the subsidy would have to be portable to competitors under federal law. Moreover, the winning bidder may have to make the facilities available for use by competitors under federal interconnection laws. These possibilities create more disincentives for companies to bid to serve unassigned territories and defeats the purpose of the competitive bidding process.

There is a reason certain territories are unserved in Minnesota. Telecommunications service providers have chosen to pursue more profitable ventures before choosing to commit capital to serve sparsely populated areas. The Ventura Administration believes the MPUC should be expressly authorized to assign a company to serve unassigned territories based on a petition filed and signed by at least 50% of the full-time residents and businesses domiciled within an unassigned territory that is also within a three mile radius of the nearest technically feasible wired or wireless linkage point of an ETC. The MPUC should be given the discretion to determine whether a petition should be granted, which ETC should be required to build out the facilities, and what the most cost effective technology would be for providing a universal service offering to the petitioning area. The amount of the subsidy would be determined in accordance with the funding methodology set out in section VII of this Plan. The Ventura Administration believes this "three miles at a time" approach provides a methodological objective approach to achieving federal and state universal service goals while

leaving an objective decision maker to take into account the circumstances involved in these difficult decisions.

The carrier of last resort doctrine should also be changed to clarify that MPUC approval is required before any non-ETC company can relinquish its COLR obligations under federal and state law. This will ensure that no area of Minnesota is ever left without connectivity to the telephone network.

G. Recommendations

1. Minnesota's telecommunications laws should be reorganized and rewritten to provide a clear pathway for companies to move from a regulated environment to a deregulated environment.
2. Regulatory exemptions for special classes of service providers or particular technologies should be allowed only when required by federal law or when compelling public interest dictates.
3. The decision tree that follows summarizes the Ventura Administration's proposed local competition regulatory framework:

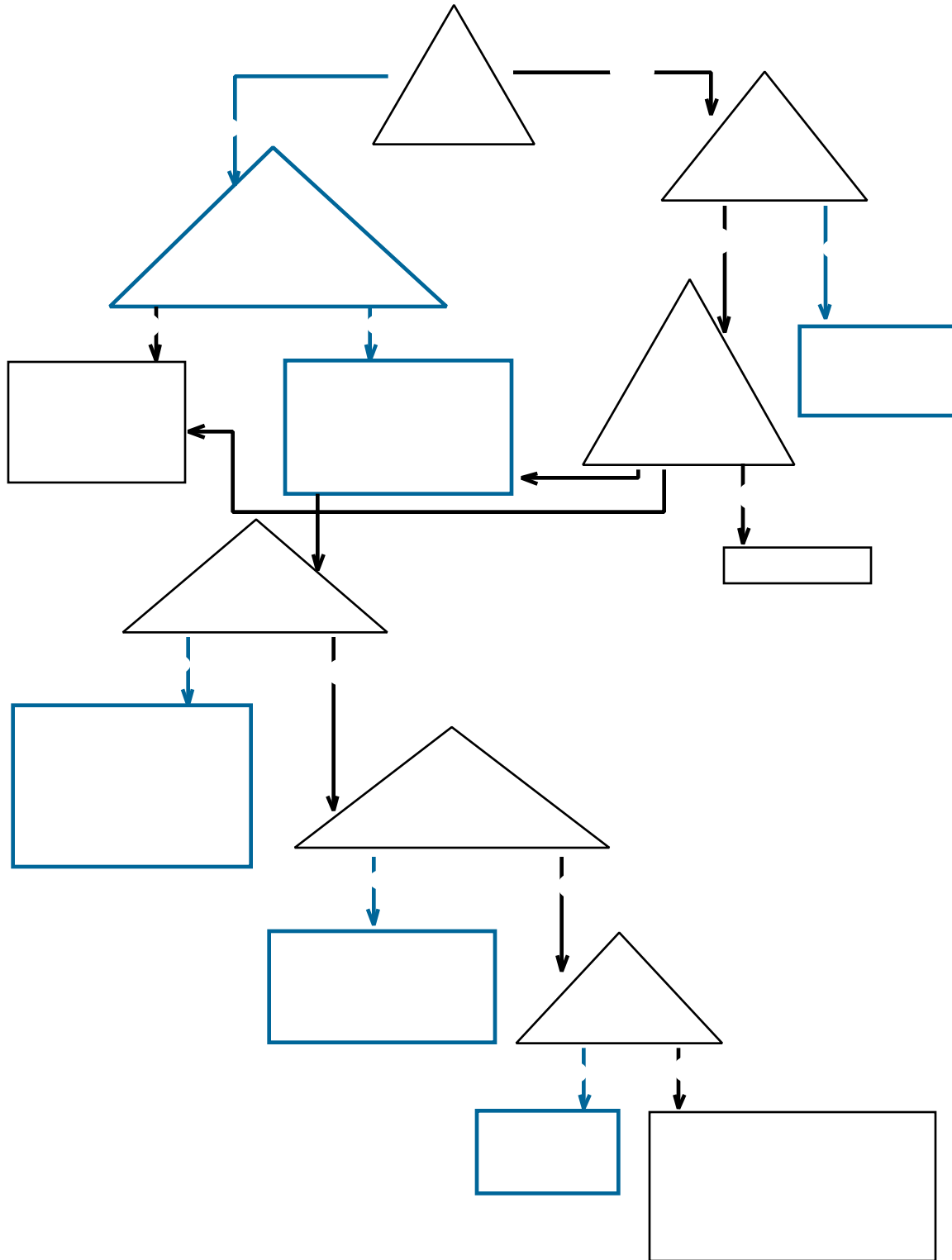


Figure 1: Decision Tree for Proposed Local Regulatory Framework

4. The local competition regulatory framework should be static and apply equally to all local telecommunications service providers.

5. The Department or any provider should be allowed to petition the MPUC to have services of any company re-classified to a different competitive category.
6. AFOR Plans currently under effect under the new law should be grandfathered in under the new law to avoid disruptions in the marketplace, and to allow for any new legislation to be properly implemented. Small telephone companies under alternative forms of regulation under Minnesota Statutes section 237.773 would have a one-year grace period before becoming subject to the new local regulatory framework.
7. In the event that the proper classification cannot be determined for a company on or before the date an AFOR Plan expires, it should be presumed that the company is Non-Qualified.
8. The local competition regulatory framework should contain a burden shifting analysis that encourages the production of market share data to ensure the correct decisions are made about competitive classifications of services.
9. Data regarding market share for essential telecommunications services should be classified as protected data when submitted to a government agency for the purposes of having a service reclassified.
10. State law should provide for expedited administrative procedures for determining competitive classifications or reclassifications of service.
11. Entry regulations should be changed and streamlined to require only the information necessary to protect the public from harm.
12. A municipality should be allowed under state law to construct, own and operate a local telecommunications network, if it can demonstrate to the MPUC that its local telecommunications market is non-competitive or that demand for advanced telecommunications or quality service standards are not being met. The referendum requirement under section 237.19 should be eliminated as a barrier to the deployment of advanced and competitive telecommunications services.
13. The filed rate doctrine should be abolished in Minnesota.
14. Joint ventures between public and private entities should be allowed for any purpose which furthers the development of a community's local telecommunications infrastructure.
15. Municipally owned and operated telecommunications networks should be subject to the same regulatory framework as are applied to the private sector.
16. Minnesota law must ensure that all qualified competitors have ready quality access to customers through resale or interconnection with those companies that control capital intensive local network facilities.
17. There is no need for state legislation to supplement federally prescribed interconnection duties.
18. The Legislature should direct the MPUC to commence a rulemaking to address interconnection service quality standards within one year of the effective date of the passage of any telecommunications reform legislation.
19. The penalties law adopted in 1999 should be strengthened to deter litigation and anti-competitive behavior by companies attempting to protect their dominance in the marketplace.

20. Current COLR obligations under federal and Minnesota law are competitively neutral and promote universal service objectives, but should be clarified to require MPUC approval of relinquishment of state COLR obligations.
21. The MPUC should be provided the authority to assign an ETC to serve any unserved area “three miles at a time” based on objective criteria as well as the circumstances of each case.
22. The COLR doctrine should be changed to clarify that MPUC approval is required before any non-ETC company can relinquish its COLR obligations under federal and state law.

VII. CONSUMER PROTECTION AND SERVICE QUALITY REGULATION

A. Background

Most telephone companies in the State provide their customers with exceptional service quality. Unfortunately, the State's largest telephone company, U S WEST, has experienced serious problems in providing customers with minimal levels of service quality. In the past four years, U S WEST has been fined nearly \$6 million for failures to meet minimum service quality standards pertaining to telephone responsiveness, delays on new installations, and restoration of service outages. U S WEST's announced merger with Qwest Communications raises fears that already precious capital allocated to improving customer service performance will be diverted to other business concerns. In a competitive marketplace, customers would choose another carrier. However, U S WEST does not operate in a competitive marketplace in most areas, and it is therefore necessary to hold the company to minimal levels of customer service.

Minnesota is not the only State where U S WEST experiences customer service problems. U S WEST has experienced similar problems throughout their service territory, but particularly in Oregon and Colorado. A recent article in the *Denver Post* illustrates how serious the problem of customer service can get when a company has no competitive incentive to do better. The article reports that USWC acknowledged it deliberately kept some Colorado customers in the dark about when they would get telephone service. The practice was referred to, at least casually within U S WEST, as "customer not educated." The policy was used "almost exclusively" with residential customers and not with business customers, the company said in written testimony released at a Colorado Public Utilities Commission hearing. U S WEST defended the policy used by its customer-service representatives, saying it didn't want to alarm residential customers about a delay that might never occur. U S WEST also stated that it abandoned the 2-year old practice. U S WEST service representatives now can warn customers immediately of possible delays. Prior to the hearing, U S WEST had characterized the specific allegations in a lawsuit brought against the company to stop the practice as "inflammatory and untrue."

1. Retail Service Quality

Service quality covers a wide range of consumer protections, including the unauthorized change in a customer's chosen interexchange or local carrier (slamming), the appearance of unauthorized services on a customer's bill (cramming), standards to ensure timely restoration of service when an outage is reported, timely installation of a service when it is ordered, engineering standards to ensure that customer's calls are not blocked, and standards governing disconnection and deposits to ensure that customer's have an opportunity to obtain and continue service. In addition to service quality standards aimed at ensuring that local and interexchange carriers provide quality service to their customers, service quality must include consumer education programs aimed at eliminating customer confusion, and providing information so customers can make informed choices in an increasingly complicated telecommunications market.

2. Consumer Outreach and Education

A competitive market presumes the existence of well-informed consumers, and the availability of adequate information on which to base decisions. Evolving competition and technology will bring new pressure on consumers. Marketing campaigns, new terminology, new entrants, business failures, different packages of bundled serv-

ices, changes in the identity of providers, and an increasingly complex web of business relationships between service providers will create confusion among consumers for the indefinite future. Providing a guaranty that the information provided to consumers in this era will be accurate, clear, accessible, and understandable is not necessarily in the industry's collective competitive interest. Government will continue to play an important role in ensuring that accurate, clear, accessible, and understandable information is provided to consumers.

B. Retail Service Quality

1. Federal Anti-Slamming Requirements

The federal government has jurisdiction over the service quality of all interstate communications services – in other words, interstate long distance services. In December 1998, the FCC adopted rules aimed at curtailing the unauthorized switch of a customer's interexchange carrier also known as slamming.²⁶⁵ The Rules require that carriers obtain authorization, in written form, from an independent third party verification, or electronically from the subscriber before switching a customer.²⁶⁶ Separate authorization and verification must be obtained for each type of telecommunications service being provided (i.e. local exchange service, intraLATA/intrastate toll, interLATA/interstate toll). Carriers that fail to comply with these requirements are liable to the subscriber's authorized carrier for any amounts paid by the subscriber during the time of the violation, and subscribers who have been slammed are absolved of liability for charges imposed by the unauthorized carrier for the first 30 days of service, and are obligated to pay for service beyond 30 days only at the rate that would have been paid to the authorized carrier.²⁶⁷ Finally, the rules establish procedures for investigating complaints, and for the customer to freeze their preferred carrier.

2. State Law

a. State Local Service Provider Disclosure Requirements

Minnesota Statutes section 237.66 requires local service providers to disclose all service options available to the customer, when a customer initiates or changes service, and annually in the form of a bill insert. In addition, local exchange providers are required to inform customers of their right to require their local exchange provider to obtain their authorization prior to changing the customer's designated interexchange carrier. Such a restriction, known as a primary interexchange carrier (PIC) freeze, is intended to protect customers from slamming. Finally, local exchange carriers must inform customers of the ability to block calls, including 900 and international calls. Minnesota Rule 7812.1200 obligates local service providers to comply with Minnesota Statutes section 237.66 for local service provider changes, as well as interexchange carrier changes.

b. State Anti-Slamming Requirements

Minnesota Statutes section 237.661 further sets out the anti-slamming duties of the local telephone company, and of the soliciting carrier. If a customer has

²⁶⁵ Implementation of the Subscriber Carrier Selection Changes Provisions of the Telecommunications Act of 1996, Policies and Rules Concerning Unauthorized Changes of Consumers' Long Distance Carriers, Second Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 94-129, December 23, 1998, hereinafter Second Report and Order

²⁶⁶ 47 C.F.R., §64.1150

²⁶⁷ 47 C.F.R., § 64.1100

elected a PIC freeze, as allowed under Minnesota Statutes section 237.66, the local telephone company is prohibited from processing any request to change telecommunications carriers without first obtaining prior authorization from the customer. The statute sets forth the information that a telecommunications carrier must confirm before processing a change in a customer's long distance service provider. In addition, the carrier must be able to produce, upon complaint by a customer, evidence that the carrier verified the customer's authorization to change their long distance provider. If a carrier is unable to provide evidence of authorization, the switch is deemed to be unauthorized, and the carrier must pay all costs of returning the customer to their original service provider, as well as, all costs of serving the customer during the period of unauthorized service.

c. State Long Distance Provider Disclosure Requirements

Minnesota Statutes section 237.662 sets forth the information that a long distance provider must disclose to its customers when soliciting their business. This information includes all price information relating to "1+" presubscribed calls, including time of day pricing, and differences between prices for interstate and intrastate, interLATA and intraLATA services, and any promotional offerings and limitations on those promotional offerings. In addition, disclosure of any minimum volume requirements, flat monthly service charges, termination charges or other non-service specific charges, including any one-time charge for changing providers is required. Minnesota law also requires long distance providers to send to all customers selecting their service written information reiterating the pricing information within seven business days of the date of the verification of the customer's authorization.

d. State Law on Cramming

Minnesota Statutes section 237.663 requires that local exchange providers not bill a customer for a service that the MPUC has not required be offered, or for which a customer has not explicitly contracted. The local service provider must notify customers of their ability to block services from future use, and provide a credit on the next month's bill if notified by the customer that a service was not authorized.

e. State Customer Bill of Rights

Minn. Rule 7812.1000 requires customers be notified at the time service is initiated, and at least annually thereafter of their rights and obligations. The notice must include a description of the complaint process, and methods for contacting both company and MPUC representatives, the customer's rights with respect to payment of bills, disconnection of service, privacy, deposits, low-income assistance, blocking options, and hearing-impaired programs, and a summary of service quality standards and available remedies to customers for failure to meet those standards.

f. State Requirement for Adequate Service

Minnesota Statutes section 237.081 grants the MPUC the authority to investigate whenever it believes a service is, "inadequate or cannot be obtained or that an investigation of any matter relating to any telephone service should for any reason be made." Under the statute, the MPUC has authority to order corrective action whenever it determines that, "any regulation, measurement, practice, act, or

omission affecting or relating to the production, transmission, delivery, or furnishing of telephone service or any service in connection with telephone service, is in any respect unreasonable, insufficient, or unjustly discriminatory, or that any service is inadequate.”²⁶⁸

g. Minnesota Service Quality Rules

Minnesota Rules Chapter 7810 governs the day-to-day requirements for service quality in Minnesota. Rules governing disconnection, deposits, complaint resolution, delays in service due to a lack of facilities, directories, engineering requirements to limit call blocking, trouble report rates, and restoration of service are among the areas included in Chapter 7810. Minnesota Rule 7812.0700 obligates CLECs to comply with Minnesota Chapter 7810, or any successor rules.

h. Minnesota Service Quality under Alternative Forms of Regulation

Approval of an AFOR is conditioned upon MPUC approval of an existing service quality plan or evidence that current service quality substantially complies with existing MPUC rules. In addition, the AFOR must contain provisions for reporting service quality levels over the term of the AFOR, informing customers of their rights and obligations under the AFOR, and specific standards for (1) the time intervals for installation; (2) time intervals for repair of service; (3) trouble report rates; (4) exchange access line held orders, and (5) customer service center answer times. Finally, an approved AFOR must contain customer-specific remedies that are provided to customers when a company fails to meet specific service quality standards. The Plan must also provide for penalties.

i. State Service Quality Obligations in a Multi-Carrier Environment

In a multi-carrier environment, assigning blame for a particular service quality problem will become more complex. Minnesota Rule 7812.0700 requires that a local service provider is, “directly responsible to its customers for the quality of service provided to those customers. Nothing in this subpart may be interpreted or applied to impact the allocation of liability between two or more telecommunications service providers in connection with quality of service issues.”

C. Consumer Education Efforts

1. Federal Truth-in-Billing Requirements

On May 11, 1999, the FCC issued its First Report and Order and Further Notice of Proposed Rulemaking In the Matter of Truth-in-Billing and Billing Format.²⁶⁹ The Order requires that telecommunications carriers provide clear, understandable billing information to consumers. The guidelines apply to all wireline providers, and in part to wireless providers. The FCC has undertaken an additional rulemaking to determine the applicability of all of these rules to wireless providers.

The FCC’s guidelines require: (i) that telephone bills be clearly organized and highlight new service provider information; (ii) that charges be identified in a non-misleading manner; and (iii) that the bill clearly identify and provide a toll-free

²⁶⁸ Minn. Stat. §237.081, Subd. 4

²⁶⁹ First Report and Order and Further Notice of Proposed Rulemaking in the Matter of Truth-in-Billing and Billing Format, CC Docket No. 98-170 (FCC May 11, 1999).

number for contacting the company should a customer have an inquiry, or wish to dispute a charge.

2. State Telecommunications Consumer Outreach Programs

The State currently does not have any formal consumer outreach program. Recently, the MPUC granted the MDOC use of \$890,500 in U S WEST penalties for failure to meet minimum service quality standards. The MDOC will use these funds to begin a targeted consumer outreach campaign to educate consumers about their telephone bills. Information provided to consumers will include an explanation of surcharges for TAP, TACIP, 911, as well as subscriber line charges, the primary interexchange carrier charge (PICC) and local number portability charges. In addition, the campaign will cover consumers' ability to choose different carriers for their inter and intra-LATA markets, and improve understanding of the scope of those markets in Minnesota. Finally, the campaign will direct consumers to appropriate avenues for pursuing complaints, as well as naming additional sources of information.

D. Analysis

1. Retail service quality regulations should not be eliminated or revised by the MPUC until after minimum wholesale service quality regulations are in place.

To ensure that customers receive high quality telephone service at reasonable rates, effective and meaningful service quality standards are necessary at the wholesale level. Failure to have adequate service standards at the wholesale level could effectively thwart competitive entry, and leave customers without competitive options. If retail service quality standards are eliminated or reduced based on the assumption that a competitive market will keep quality high, and competitors are not assured of receiving high service through strong wholesale standards, then consumers will be left unprotected by adequate service standards, and have no competitive options.

Under the 1996 Act, an ILEC is required to provide service to the CLEC at levels at least equal to the service it provides to its own customers.²⁷⁰ The 1996 Act directly ties the level of service provided to an ILEC's competitors to the level of service provided to its own customers. Without strong retail service standards, an ILEC has an incentive to cut costs by cutting service levels, thus reducing the level of service it provides to its own customers. This reduction in service to its own customers, in turn, reduces the standard by which the ILECs performance to the CLECs is judged. For example, under Minnesota Rule 7810.5800, an ILEC is expected to clear 95% of its out-of-service trouble reports within 24 hours. With the entry of competitors to a particular calling area, this requirement might be eliminated on the assumption that competition will ensure that service is restored in a timely manner because customers will choose those competitors best able to serve their needs. The ILEC may cut costs by reducing staff, or may simply refocus its workforce on marketing activities, but in either case, the average time to restore service lengthens dramatically. The ILEC is bound by its interconnection agreements to restore service for its competitors in substantially the same time and manner as it restores service to its own customers. Thus, strong wholesale standards must be in place and functioning effectively before retail standards are revised.

²⁷⁰ 47 U.S.C §251(c)(3) and (c)(4)

2. Once permanent wholesale service quality standards are in place, the level of retail service quality regulation should correlate with the competitiveness of the market on a geographic basis.

Once wholesale service quality standards are in place, the applicability of current customer service standards should depend on the competitive classification of the company's retail service in each of its markets. As Table 15 indicates, current service quality regulations should apply to any Qualified company. Service quality regulations should also be incorporated into the terms of AFOR plans. However, service quality regulations should not be applicable in geographic zones subject to actual or effective competition.

3. The Legislature should fund a consumer outreach and education program to ensure that citizens have access to objective information to make intelligent decisions in a competitive marketplace.

Minnesota law makes some provision for informing customers of their rights and obligations, but laws themselves cannot educate consumers or adequately address many areas of confusion, such as billing, slamming, tips on how to differentiate competitors and explanations on how to use services, and more. Strict enforcement of the existing statutes and rules will address some of the education needs of consumers; however, it will not provide consumers with the level of information they deserve and need to make intelligent decisions about their telecommunication services. The Ventura Administration does not believe that consumers can rely on competitors to provide them with objective information about services in a competitive telecommunications marketplace. Moreover, it is infeasible for state regulatory agencies to monitor all consumer information disseminated by the industry for inaccuracies or violations of law. The Ventura Administration believes the State can play a role in ensuring that consumers have readily accessible information to make intelligent decisions in the marketplace. The consumer education campaign being developed by the MDOC with the use of U S WEST's service quality money should be funded long-term by the Legislature. The MDOC should be directed to develop a consumer education campaign aimed at providing broad-based customer education about telecommunications issues, including changes resulting from the advent of a competitive market. In this manner, customers will be better armed to advocate on their own behalf with their carrier, and less dependent on regulatory agencies to intervene for them.

The Ventura Administration believes that this consumer outreach campaign should be multimedia. The goal should be to direct consumers to sources of educational information on the types of subjects identified above. The Ventura Administration believes this consumer outreach campaign should be funded at a rate of \$1 million annually in the biennial appropriation for MDOC.

4. The Legislature should establish an expedited complaint process and provide mediation services to resolve consumer complaints relating to long distance service.

With the increased level of deregulation of telecommunications services, the MPUC will have to rely more heavily on the complaint process to resolve customer problems. In a more deregulatory environment, an issue may not be brought to the attention of the MPUC until a rate or policy has been put into effect and the customer has a bill in hand. This creates the potential for more consumer complaints, and it becomes important to resolve disputes expeditiously. For this reason, the MDOC is rec-

ommending the adoption of an expedited complaint process and the development of a mediation program to resolve complaints relating to long distance service. Furthermore, both the MPUC and the Department should be given authority to mediate and resolve consumer complaints informally.

E. Recommendations

1. Retail service quality regulations should not be eliminated or revised by the MPUC until after minimum wholesale service quality regulations are in place.
2. Once permanent wholesale service quality standards are in place, the level of retail service quality regulation should correlate with the competitiveness of the market on a geographic basis.²⁷¹
3. The Legislature should fund a consumer outreach and education program to ensure that citizens have access to objective information to make intelligent decisions in a competitive marketplace.
4. The Legislature should establish an expedited complaint process and provide mediation services to resolve consumer complaints relating to telecommunications services.

²⁷¹ See Table 15.

VIII. EXTENDED AREA SERVICE

A. Background

Extended Area Service (EAS) represents the expansion of the toll free calling area so that calls placed between adjacent telephone exchange areas will no longer be considered long distance calls priced on a per minute basis. EAS arose in response to customer recognition that two communities have begun to interact frequently enough to be considered a single larger community. For example, prior to the early 1950s, consumers in Minneapolis were charged an extra 5 cents every time they placed a telephone call to St. Paul, or vice versa. This pricing arrangement struck some as unjust, especially those living near the common borders of the cities. Advocates representing such consumers eventually persuaded regulatory officials to eliminate these surcharges. This rationale was gradually applied to many other “communities of interest.” By 1967, the Twin Cities had the largest toll-free calling area in the United States.²⁷²

During the AT&T monopoly days, the practical effect of EAS on the telephone company was to shift revenue flow from one AT&T subsidiary to another. However, that changed after the 1984 divestiture. After the break-up of AT&T and the emergence of long distance competition, numerous long distance carriers lost revenue whenever a toll route was converted to a local service calling area. As a result, the MPUC placed a hold on all pending EAS petitions in the mid-1980’s, and then decided later to reject any EAS petition *per se*. This decision spurred the 1989 Legislature to adopt a detailed law compelling EAS proceedings to continue. This law expired in 1995. EAS procedures have since been established by an MPUC order.²⁷³

B. MPUC EAS “Super Order”

The Super Order requires customers who desire EAS to file a petition with the MPUC. The petition must be signed by 15% or more of the customers, or 600 (whichever is less) in the petitioning exchange. The MPUC must grant the petition when the following criteria are met:

1. The petitioning exchange is contiguous to an exchange or local calling area to which EAS is requested;
2. Polling by the MPUC shows a majority of the customers responding to the poll in the petitioning exchange favor EAS;
3. 50% of the customers in the petitioning exchange make three or more calls per month to the exchange or local calling area to which EAS is requested, as determined by a traffic study.

When the petitioned exchange is somewhere in the seven county metropolitan area, the telephone company serving the petitioning exchange must offer local measured service or another lower cost alternative to basic flat rate service available to customers in the petitioning exchange.

²⁷² Connecting the North Star State, Minnesota Telephone Association at 146 (1988).

²⁷³ *Order After Reconsideration in re Investigation into the Appropriate Local Calling Scope, in Accordance with Minn. Stat. 237.161 (1994)*, MPUC Docket No. P999/CI-94-296. The full text of the EAS “Super Order” is attached as Appendix J to this Plan.

For EAS to the seven county metro area, 75% of the cost of providing EAS must be apportioned to the petitioning exchange and 25% of the cost is apportioned to the petitioned exchange. For EAS to other local calling areas, the MPUC has the discretion to apportion costs, but between 50% and 75% of the cost must be apportioned to the petitioning exchange. The MPUC must establish rates for EAS that are income neutral for both telephone companies. The costs for EAS are added to the monthly telephone bills of subscribers in the form of “rate additives.”

The MPUC is not allowed, under the Super Order, to remove EAS within 5 years after ordering it for an area. The MPUC cannot consider a new petition for two years after denying a request from the petitioner.

EAS petitions have been a topic of concern for the regulatory agencies in Minnesota for a long time. One of the key problems is that not everyone in the petitioning exchange desires extended area service to the petitioned exchange at the rates established by the MPUC. If more than 50% of the telephone subscribers responding to a poll in the petitioning exchange vote in favor of EAS at the stated rates, to eliminate toll charges for calling between the two service areas, then all customers in the exchange will be subject to the higher rates.

The EAS rate additives in the petitioned area have been generally smaller than those in the petitioning area for two reasons. First, more than half of the total revenue requirement for any EAS route is usually arbitrarily allocated to the petitioning exchange. Second, EAS has almost exclusively involved petitions from small calling areas in comparison to the petitioned area. The revenue requirement for the EAS route to the customers in the petitioned exchange has been spread over a greater number of access lines, resulting in a significantly smaller rate additive than the petitioning exchange.

In addition to the high costs that have been imposed on consumers involved in some EAS petitions, new problems with EAS have arisen with the introduction of local competition in Minnesota. Monetary transactions have occurred with the implementation of EAS routes to keep each participating ILEC income neutral. There is a question as to whether such transactions have a negative impact on the development of competition in the market for local service. There are also issues that local competition has brought such as which customers can petition for EAS, which customers can participate in the balloting process, and whether CLECs should participate in any income neutrality calculations.

C. Analysis and Filings

1. The current method of allocating the revenue requirement between petitioning and petitioned exchanges is arbitrary, unfair to customers, and is not competitively neutral.

The manner in which companies have maintained income neutrality when EAS is implemented can be seen through example. Consider a case where LEC A serves the petitioning exchange and LEC B serves the petitioned exchange.²⁷⁴ LEC A has annual facility cost of \$2000 and annual lost access contribution of \$8000 for a total annual revenue requirement from the EAS route of \$10,000. For the same route, LEC B also has annual facility cost of \$2000 and annual lost access contribution of \$8000. Thus, for LEC A and LEC B, the total annual cost plus lost access contribution is \$20,000. If

²⁷⁴ For the purposes of this discussion, the term LEC refers to both ILECs and CLECs.

the Commission orders a 75/25 split, the rates established for the petitioning customers in LEC A will be set to recover 75% of \$20,000, or \$15,000. The rates for customers in LEC B will be set to recover 25% of \$20,000 or \$5000.

If LEC A serves 100 customers and LEC B serves 10,000 customers, the EAS rate additives would be calculated as follows:

	<i><u>Petitioning</u></i> <i><u>LEC A</u></i>	<i><u>Petitioned</u></i> <i><u>LEC B</u></i>
<i>Annual Facility Cost</i>	<i>\$2000</i>	<i>\$2000</i>
<i>Lost Access Contribution</i>	<i>\$8000</i>	<i>\$8000</i>
<i>Total Revenue Requirement</i>	<i>\$10,000</i>	<i>\$10,000</i>
<i>Allocation of Revenue Requirement</i>	<i>75%</i>	<i>25%</i>
<i>To be recovered from customers annually</i>	<i>\$15,000</i>	<i>\$5,000</i>
<i>To be recovered from customers monthly</i>	<i>\$1,250</i>	<i>\$416.67</i>
<i>Customers</i>	<i>100</i>	<i>10,000</i>
<i>Monthly EAS Rate</i>	<i>\$12.50</i>	<i>\$.04</i>

Table 16 - Current EAS Cost Allocation Method

Since LEC A is collecting \$5000 more than necessary to achieve income neutrality and LEC B is collecting \$5000 less than necessary, a transfer payment is made from LEC A to LEC B in the amount of \$5,000. These payments remain unchanged even though the data used in the calculation of the transfer payment is likely to change over time. This underlying data includes customer counts, facility costs and access rates.

The current EAS cost allocation method described above is not fair to consumers because it apportions EAS costs arbitrarily and subsidizes lost access contributions to telephone companies. In the above example, the customers in the petitioning exchange have rates established to recover \$5000 of the facility cost and lost access contribution of the petitioned exchange. This happens because of the arbitrary allocation of the revenue requirement between the petitioning and petitioned areas.

The current EAS allocation process is also not competitively neutral. The allocation of revenue between the petitioning and petitioned exchange, together with the income neutrality provisions that are part of the current system, cause cross subsidies between companies. The cross subsidies have a negative influence on competition in the markets in both the petitioning and petitioned service areas. Using the example set out in Table 16, because the \$5000 payment from LEC A to LEC B is independent of the number of customers that LEC A serves, if LEC A loses customers to a competitor, LEC A will have a higher cost per unit for all units that remain with LEC A. If LEC A were to increase its rates, it would theoretically lose more customers. Because LEC A is not only supporting its own cost, but also part of the cost of another LEC, the market cannot function properly to maximize the benefits of competition to consumers. This point is illustrated with the following example:

<i>Customers of LEC A in petitioning exchange at the time EAS is implemented</i>	<i>100 customers</i>
<i>Burden placed on consumers in LEC A for the costs and contribution in LEC B</i>	<i>\$5000</i>
<i>Burden per subscriber in LEC A</i>	<i>\$50/year \$4.17/month</i>
<i>Assume LEC A loses 20% of its customers to a competitor</i>	<i>80 customers</i>
<i>Transfer to LEC B is unchanged</i>	<i>\$5000</i>
<i>New burden per subscriber in LEC A</i>	<i>\$62.50/year \$5.21/month</i>

Table 17 - Current EAS cost allocation method is not competitively neutral

As LEC A loses customers to a competitor, its cost per subscriber to support LEC B increases. The more customers it loses, the higher its costs are on a per customer basis. Because LEC A is losing customers to a competitor, increasing prices will only cause it to lose additional customers. The market in this example is not functioning properly because LEC A is not competing with a competitor based on its own cost structure. While LEC A may try to become more efficient with its own costs in the presence of competition, it retains the burden of supporting the costs and lost access revenue of another LEC. Because the competitor is basing its prices on the prices of the LEC, consumers cannot receive all of the benefits of competition since prices are unable to be driven to the true underlying costs of providing service, as would occur in a competitive market.

In the exchange of LEC B, the competitor would be disadvantaged because the rates of LEC B are being subsidized by LEC A customers. This subsidy will give LEC B a competitive advantage over a CLEC attempting to serve in the petitioned exchange of LEC B, as well as any other exchange where LEC B provides service. This happens because the customers of LEC A are paying for not only the facilities of LEC B to implement EAS, but also an amount applied to common overhead costs and profits of LEC B. By receiving a payment from LEC A that contributes toward common overhead and profit, all of the LEC B exchanges benefit. In other words, LEC B does not need to obtain revenue from its own customers to earn its desired level of return. Thus, consumers in the exchanges of LEC B cannot experience all of the benefits of competition because LEC B is receiving a subsidy that does not also flow to its competitors.

2. State law should eliminate the anti-competitive and unfair implicit subsidies that flow between companies due to the current EAS process.

To promote the development of competition, subsidies that flow between companies due to EAS should be eliminated or minimized. Lost access contribution is not a cost; rather, it is a displaced revenue stream. The contribution from access rates is used to cover the costs of other services, common overhead costs and profits. Because customers in petitioning exchanges have been responsible for the costs and lost revenues of other companies, the EAS rate additives in numerous exchanges have been excessive. For example, the rates for local service including the EAS rate additive in Zimmerman are \$47.04 and \$82.62 for residence and business respectively.

The rates for local service including the EAS rate additive in Big Lake are \$46.53 and \$81.69 for residence and business respectively. In Waverly, the flat rate for local service including the EAS rate additive is \$52.70 for both residence and business. In Montrose the flat rate for both residence and business is \$59.10. These rates are not based on cost, but primarily support the lost access contribution of other companies. The existing EAS methodology is simply unfair to customers.

Using the same example as above, the rates calculated with the arbitrary 75/25 cost split and the transfer payments eliminated are as follows:

	<i>Petitioning LEC A</i>	<i>Petitioned LEC B</i>
<i>Annual Facility Cost</i>	<i>\$2000</i>	<i>\$2000</i>
<i>Lost access contribution</i>	<i>\$8000</i>	<i>\$8000</i>
<i>Total revenue requirement</i>	<i>\$10,000</i>	<i>\$10,000</i>
<i>Allocation of revenue requirement</i>	<i>N/A</i>	<i>N/A</i>
<i>To be recovered from customers annually</i>	<i>\$10,000</i>	<i>\$10,000</i>
<i>To be recovered from customers monthly</i>	<i>\$833.33</i>	<i>\$833.33</i>
<i>Customers</i>	<i>100</i>	<i>10,000</i>
<i>Monthly EAS rate</i>	<i>\$8.33</i>	<i>\$.08</i>

Table 18 - EAS Rates With Transfer Payments Eliminated

When each LEC recovers its own cost and lost access revenue, the rates for the petitioners are reduced from \$12.50 to \$8.33 and the rates to the petitioned area increase from \$.04 to \$.08. Moreover, implicit subsidies are removed from the EAS rate model, allowing for fair competition in both the petitioning and petitioned exchange.

3. EAS pricing should not guarantee income neutrality for telephone companies by allowing the recovery of lost access charge contribution when a toll route is converted to EAS.

The recovery of lost access contributions permitted under the current EAS Super Orders is not fair to customers and is not competitively neutral. A high level of toll calling between areas often reflects the community of interest that exists between the areas, and translates into a significant amount of access charge contribution for the LEC because access rates are too high. Since lost access contribution is typically the largest component in the development of the EAS rates, it has been the primary cause of excessive EAS rate additives to customers in the petitioning exchange. The arbitrary allocation of costs between exchanges causes the petitioning exchange customers to pay for the lost access contribution of the petitioned exchange. If LECs are no longer permitted to receive payments from other companies for their own costs and lost access contribution, the problem with the petitioners supporting the underlying costs and profits of the petitioned LECs will be eliminated.

Recovery of access charge contributions also results in unfairness to customers of different exchanges of the same company. For a LEC with multiple exchanges, if the customers in one exchange cause there to be high levels of contribution, other exchanges do not need to contribute as much for the company to earn a reasonable rate

of return. By requiring customers in the petitioning area to pay monthly EAS rates at a level targeted to continue the same revenue stream to the company, these consumers are paying a disproportionate rate in comparison with customers in other exchanges of the same company. It is unfair for one geographic area to be targeted to contribute more to common overhead and profit than another geographic area.

Allowing the recovery of lost access contribution through high rate additives and transfer payments is also not competitively neutral. The current process results in the petitioning exchange contributing a disproportionate share towards the LEC's common costs and profit. Thus, a competitor may be unable to enter the market with its own facilities and compete for those services because an exchange that is uninvolved with an EAS petition is able to price its services below cost. There simply is not a sufficient margin to entice a competitor to choose to compete in this scenario.

Additionally, by including lost access contribution in the development of the EAS rate additive, the EAS rate provides implicit support of universal service. The EAS rate additive, as a rate charged for what is now local service, should not logically be providing such implicit support. To the contrary, the 1996 Act states that implicit universal support is to be made explicit. The 1996 Act establishes this requirement as a necessary step in the development of a competitive marketplace.

4. LECs should not be allowed under law to recover lost access charge revenue through EAS rate additives.

Because it is anti-competitive and unfair to customers to include lost access contribution in the EAS rate additive, this practice should stop. Instead, EAS rates should reflect the actual cost to implement the EAS route plus a reasonable contribution toward common costs and profit. The procedure to establish fair EAS rates should not be concerned with lost access contribution. Any revenue stream that a company perceives that it needs to earn a fair return should be recovered in accordance with the form of regulation that currently applies to the affected companies. A company subject to an AFOR plan may have different limitations than a company subject to rate of return regulation. While any company should be permitted to submit a proposal for lost revenue recovery to the MPUC, a guarantee of income neutrality should not occur for companies that are not subject to rate of return regulation. Companies subject to traditional rate of return regulation (Category I companies) are entitled to file for rate increases to basic local service rates if they believe they have an inadequate return.

5. The Legislature should establish a new process and criteria for establishing EAS communities.
 - a. The Petition

When a petition has been filed in the past it has been from an exchange served by a single local service provider. With numerous local service providers now potentially serving an area, it must be resolved whether customers of competitive LECs may also be allowed to petition for EAS. In the absence of such an ability, customers of a competitive LEC will be treated differently than the incumbent LEC. The Ventura Administration believes that EAS should be approved based on whether the petitioning exchange has a community of interest with another local calling area. Which LEC serves the customer should not determine whether a valid petition has been filed.

b. Requirement of Adjacency

There could be situations in the future where a CLEC has a calling area greater than that of the ILEC. It is possible that consumers served by the CLEC could have a pricing plan that provides toll free calling to the area adjacent to the area desired for toll free calling, but the ILEC does not serve that area. The toll free calling area for customers served by the ILEC is the only area to which two-way EAS exists. Calling plans of CLECs are simply pricing options for one-way calling to an extended area and do not provide two-way toll free calling. Therefore, the basic flat-rate area of the ILEC should be used when determining if the calling areas subject to an EAS petition are contiguous.

c. Traffic Studies

The Ventura Administration believes that the current traffic study requirement and criteria used under the current EAS process are reasonable, fair, and have been easy to apply. This aspect of the current process should not be changed.

d. Balloting

If there are customers of one or more CLECs in an exchange, the question arises whether it is feasible for all customers in the exchange to receive a ballot to approve the proposed EAS route at the stated rate. If all customers in the exchange were to receive a ballot, the ballot would need to somehow reflect the impact to customers of CLECs. Moreover, under the current EAS process, only the petitioning exchange is allowed to vote on the issue. The MPUC's involvement has been purely ministerial enforcement of the procedures in the EAS Super Orders. There is no MPUC discretion to determine whether the EAS is in the public interest. In other words, persons in the petitioning exchanges are the only persons in the current EAS process that are allowed to determine whether a new EAS district is in the public interest.

The current process of approving or denying an EAS petition, based on the results of a balloting process, will not work efficiently in a market with multiple local service providers. Part of the problem with EAS has been that the EAS rate additives have been too high. As discussed, the high rates were the result of an arbitrary allocation of costs between the petitioning and petitioned areas, as well as the recovery of lost revenue streams. Because consumers were going to be subject to such significant rate increases, consumers were asked to vote on whether EAS should be implemented at the proposed rates. This made consumers responsible for the decision and absolved the MPUC of the responsibility.

The process of balloting consumers should be replaced by a process where the MPUC determines whether there is a community of interest between the petitioning and petitioned areas and that approval of the route is in the public interest. The rates imposed on consumers of the ILEC will be significantly lower when they are cost based. Thus, the decision will not have as significant of an impact on those consumers that do not favor the installation of EAS. However, with lower rates, more consumers are likely to favor the installation of EAS. If the rates are low enough, consumers may favor the installation of EAS even if there is not a community of interest. Because a community of interest should exist if the MPUC approves an EAS route, whether approval of a route is in the public inter-

est should be determined by the MPUC, not by the consumers in the petitioning exchange.

Community of interest factors to be considered by the MPUC include the level of calling between communities; the location of government, commercial, employment and social centers for persons living within the petitioning exchange; the locations of schools and school districts serving the petitioning exchange; and the location of medical, emergency medical, law enforcement, and fire protection services serving the petitioning exchange.

6. Rate additives developed under the EAS Super Orders need to be corrected if the law is changed as proposed by the Ventura Administration.

Many of the EAS rate additives approved in the past have been set using a methodology that is not fair to consumers and is not competitively neutral. The EAS rate additives approved by the MPUC have included lost access contribution and were established to achieve a revenue target based on an arbitrary allocation of responsibility between the petitioning and petitioned exchanges. This resulted in the MPUC approving high rates additives for EAS. However, rates of nearly \$60 for residence local service, when including the EAS rate additive, cannot be considered fair and reasonable. In the interest of fairness, many of the previous EAS rates that were established should be reevaluated using a process that sets rates based on the cost to provide the service, plus a fair contribution to common overhead and profit.

Because there are many EAS routes that exist in Minnesota, it would be an overwhelming task to reevaluate each and every EAS rate. To correct the current unfairness in a manageable way, the payments that currently occur between companies should be eliminated. The EAS rates of each company could then be adjusted to reflect the elimination of each such transfer. All rate adjustments would be analyzed by the MDOC and provided to the MPUC for approval. Any rate increases would need to be supported by showing that the resulting rates are priced at cost with a fair contribution toward common overhead and profit. Rates that do not fall below some threshold, such as \$10, could be reviewed for reasonableness. Rates that fall below the threshold could be accepted as being reasonable. However, such rates should be examined for reasonableness whenever the company's rates are reviewed in the context of an earnings proceeding or in the context of a rate restructuring.

D. Recommendations

1. State law should eliminate the arbitrary, anti-competitive and unfair implicit subsidies that flow between companies due to the current EAS process.
2. EAS pricing should not guarantee income neutrality for telephone companies by allowing the recovery of lost access charge contribution when a toll route is converted to EAS.
3. LECs should not be allowed under law to recover lost access charge revenue through EAS rate additives.
4. The Legislature should establish a new process and criteria for establishing EAS communities.
5. The basic flat-rate area of the ILEC should be used when determining if the calling areas subject to an EAS petition are contiguous.

6. The procedural requirement of a traffic study and the criteria used to determine whether there is enough toll traffic to justify conversion to an EAS should be maintained.
7. The process of balloting consumers to decide if an EAS route should be approved should be replaced by a process where the MPUC determines whether there is a community of interest between the petitioning and petitioned areas and that approval of the route is in the public interest.
8. Rate additives developed under the EAS Super Orders need to be corrected if the law is changed as proposed by the Ventura Administration.

IX. AREA CODE EXHAUST/NUMBER CONSERVATION

A. Background

The 612 area code has required area code relief 3 times since 1996. The 612 area code was split into the 612 and 320 area codes in 1996. In 1998, it was split a second time into the 612 and 651 area codes. The 612 area code is again to be split into the 612, 952 and 763 area codes in February of 2000. With 5 area codes, there will be approximately 40,000,000 numbers to serve the area previously served by a single area code. One area code has approximately 7,920,000 numbers available for assignment.

While the demand for telephone numbers has grown, the primary reason for the need for additional area codes to be assigned is the inefficient use of numbers. Telephone numbers have been assigned to local exchange service and wireless service providers in blocks of 10,000 numbers, which is the entire prefix of numbers. Further, numbers were assigned to small areas known as rate centers, which often were the same size as the local exchange boundary. Local competition has also caused large numbers of prefixes to be assigned, because each competitor is assigned a separate prefix for each rate center where they are to provide service.

The FCC is actively looking at number conservation measures as they are predicting that the North American Numbering Plan will exhaust within ten years if such measures are not implemented or are not effective. A former employee of the North American Numbering Plan Administration group indicated that Y2K issues are minor compared to the complexities associated with the exhaust of the North American Numbering Plan.

There are significant costs associated with adding additional area codes, many of which cannot be quantified. There are telephone company conversion costs, as well as costs to consumers to change stationary, business cards, and everything containing their telephone number. If businesses are assigned to the new area code, they may lose revenue or incur added expense and marketing materials that have been distributed will become obsolete.

Societal costs that are more difficult to quantify include confusion over which area code to dial and whether dialing ten digits is necessary. There may be greater confusion among the elderly and young children. Although there have been massive consumer education efforts undertaken, all such efforts are imperfect.

B. Federal Law

Section 251(e)(1) of the 1996 Act grants the FCC plenary jurisdiction over numbering issues that pertain to the United States. Specifically, the 1996 Act directs the FCC to create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. This section also gives the FCC the authority to delegate to states any portion of its jurisdiction over numbering administration. The FCC argues that it retains jurisdiction over all matters it does not specifically delegate. On July 2, 1999, the FCC opened a rulemaking on numbering resource optimization. The MDOC filed comments with the FCC on July 30, 1999.²⁷⁵ The MDOC recommended that the states should be delegated the authority to deploy number conservation measures where state specific facts are important in determining how a

²⁷⁵ Comments of MDPS in re Notice of Proposed Rulemaking on Numbering Resource Optimization, CC Docket No. 99-200 (FCC July 2, 1999).

measure is deployed or where states can be more effective than the FCC in conserving numbering resources. The MDOC also opposed mandatory ten-digit dialing for all consumers as it is unnecessary and burdensome.

C. State Law

There are no state laws concerning telephone number assignments and number conservation. While Minnesota does not have state laws on the use of numbering resources, the FCC has delegated the authority to the State to decide the method of area code relief to be adopted when such relief is needed. The decisions to be made by the State include whether an area code split, the overlay method or a boundary realignment should be used to achieve area code relief. If a split or realignment is selected, decisions must be made on where the area code boundaries are located. Implementation issues are also to be handled by the states.

D. Analysis

1. Minnesota must wait until the FCC delegates authority to the state before taking any steps to require number conservation measures.

The implementation of local number portability has created the technical ability to assign numbers in smaller blocks. Together with consolidating rate centers, and making sure that requests for number assignments are legitimate, there are opportunities to conserve telephone numbers to avoid any future need for area code relief. There is also a methodology called unassigned number porting that would make efficient use of numbers that have already been assigned to a carrier but are unassigned to customers. When and if the FCC delegates authority to the State to implement number conservation methods, the law should require the MPUC to identify telecommunications service providers who are the greatest users of telephone numbers. The MPUC should then be required to complete a proceeding that studies all known methods of number conservation. The MPUC shall have the authority to order such providers to implement all number conservation methods deemed by the MPUC to be in the public interest.

The FCC must delegate authority to implement number conservation measures before any action is taken in Minnesota. The FCC is expected to issue its rules regarding number conservation within the next six months. The FCC has already issued state specific delegations of authority to a few states allowing states to implement number conservation measures. The Ventura Administration will assume an active role in securing such authority for the State.

2. When and if the FCC delegates authority to the states to implement number conservation methods, state law should, to the extent allowed by federal law, require ILECs to implement number conservation measures within two years after the State secures authority from the FCC to implement such measures.

Telephone companies are hoarding telephone numbers, which is causing number exhaust. Number exhaust has serious financial repercussions because it ultimately forces more area code splits, and ultimately may require the Nation to reconfigure its telephone numbering system. Within two years after receiving authority from the FCC to implement number conservation measures, the MPUC should do so.

3. The Legislature should implement a charge on using phone numbers as a way of deferring number hoarding. The Legislature should specifically direct that all revenue

derived from number charges be used to subsidize essential telecommunications services for rural small businesses.

A charge on telephone numbers will deter telephone companies from hoarding numbers which results in millions of dollars in needless expenses due to the need to change area codes. Telephone companies would not be allowed to pass through this charge to consumers unless the number is activated for use by a customer. Any revenue derived from this number charge should be used to subsidize rural business rates.²⁷⁶

E. Recommendations

1. The Ventura Administration shall actively secure FCC authority to implement number conservation methods for the State.
2. The Legislature should require the MPUC to implement number conservation methods within two years after the State secures such measures.
3. The Legislature should implement a charge on using phone numbers as a way of deferring number hoarding. The Legislature should specifically direct that all revenue derived from number charges be used to subsidize essential telecommunications services for rural small businesses.

²⁷⁶ See discussion at p. 62.

X. LONG DISTANCE REGULATION

A. Background

Long distance service (also called toll call, trunk call, or interexchange service) refers to any telephone call to a location outside the local service area. The MPUC adopted a policy allowing interLATA and intraLATA competition for interexchange services provided in the State of Minnesota in 1985.²⁷⁷ At that time, equal access was not generally available, so only one interexchange carrier could receive superior toll access with 1 plus dialing (also called 1+ presubscription). Under the MFJ, toll calls dialed with 1+ service were routed to AT&T if the call terminated in an interLATA location and to Northwestern Bell if the call terminated in an intraLATA location.

Along with adopting a policy of allowing competition for interexchange services in its 1985 Order, the MPUC granted AT&T an extension of its certificate of authority allowing the company to provide intraLATA telecommunications services within Minnesota. In addition, the MPUC granted certificates of authority to MCI and GTE/Sprint allowing these carriers to provide intraLATA and interLATA telecommunications services to customers in Minnesota. In its 1985 Order, the MPUC directed other companies wishing to provide interexchange services to first apply for and to receive a certificate of public convenience and necessity prior to commencement of offering toll service. Among the other policy directives in the 1985 Order, the MPUC stated that “no interexchange carrier . . . shall implement rates or tariffs that deaverage toll rates based on the basis of geographic location or that discriminate in the terms and conditions under which services will be made available on the basis of geographic location without the express approval of the Commission.”²⁷⁸ This policy prohibiting geographic deaveraging generally required long distance companies to average their rates to eliminate rate structures where the price of a call would differ depending upon whether the call terminated at an interLATA or an intraLATA location.

Subsequent to adopting a policy of allowing interexchange competition in 1985, the MPUC has issued numerous other decisions regulating the provision of interexchange services in Minnesota, including decisions to require equal access, preventing unreasonable discrimination between long distance business and residential customers, and enforcing the state law requiring long distance carriers to geographically average long distance rates in Minnesota.²⁷⁹

A significant shift in the market for long distance services has taken place over the past 15 years. An FCC staff report entitled “Long Distance Market Shares: Fourth Quarter 1998,” which was issued on March 31, 1999, reveals the extent of the shift in the market for long distance services. According to the FCC report, AT&T’s toll revenues accounted for 90.1% of the revenues received by all long distance carriers in the year 1984. In the same year, MCI received 4.5% and Sprint received 2.7% of all the revenues received by

²⁷⁷ See FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER, MPUC Docket No. P442, 443, 444, 421, 433/NA-84-212 (October 15, 1985).

²⁷⁸ *Id.*

²⁷⁹ See 582 Docket; Order Approving Short-Term and Intermediate Infrastructure Recommendations as Modified and Establishing a Comment Period, MPUC Docket No. P999/CI-93-1176 (May 19, 1994); Order Setting Implementation Guidelines for IntraLATA 1+ Presubscription, MPUC Docket No. P999/CI-87-697 (July 21, 1994); Order Rejecting Differential Between Basic Business and Basic Residential Rates, P442/TC-95-419 (October 14, 1996); Order Requiring Revisions to Tariffs, MPUC Docket No. P466/C-97-1550 (February 5, 1998).

long distance carriers. By 1997, AT&T's revenues accounted for 44.5% of all long distance revenues, MCI accounted for 19.5%, Sprint accounted for 9.7%, and Worldcom accounted for 6.7%. All other long distance carriers made up the 19.8% balance of long distance revenues. Including the long distance revenues collected by local exchange companies, the following changes in market share have taken place:

<i>Year</i>	<i>AT&T</i>	<i>MCI</i>	<i>Sprint</i>	<i>All Other Toll Carriers</i>
1984	90.1%	4.5%	9.7%	2.7%
1997	44.5%	19.5%	9.7%	19.8%

Table 19 - Market Share Based on Total Operating Revenue of Long Distance Carriers and Total Toll Revenues for Local Exchange Carriers

Between the years 1984 and 1997, the overall market for long distance service in the U.S. has increased significantly from \$51,156,000,000 in 1984 to \$98,569,000,000 in 1997. The breakdown of the market for long distance services has shifted as follows:

<i>Year</i>	<i>Intrastate</i>	<i>Interstate</i>	<i>International</i>
1984	40.8%	51.8%	7.4%
1997	32.6%	46.8%	20.6%

Table 20 - Percentage of Total Toll Revenues Domestic

B. Federal Law

The 1996 Act states as follows:

Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including *interexchange services* and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. (Emphasis added).²⁸⁰

It is important to note that while long distance companies are required to contribute to the federal universal service fund, they will not receive any direct benefit from the universal service fund. Long distance carriers will realize indirect benefits through access charge reform and the replacement of implicit subsidies to ILECs with explicit subsidies from the federal and state universal service funds.²⁸¹

C. State Law

Minnesota Statutes section 237.01, Subd. 6 defines long distance service providers as "telecommunications carriers." Minnesota Statutes section 237.035 requires that "telecommunications carriers" comply with sections 237.121, 237.16, subdivisions 8 and 9,

²⁸⁰ See 47 U.S.C. §254(b)(3).

²⁸¹ See pp. 56-59 of this Plan.

and 237.74 and exempts such companies from all other sections of Minnesota Statutes Chapter 237.

Minnesota Statutes section 237.16, Subds. 8 and 9 require telecommunications carriers to comply with the MPUC's policies relating to the universal service fund and to obtain certificates of authority from the MPUC before providing regulated telecommunications services in Minnesota.

Minnesota Statutes section 237.74 establishes a detailed framework for the regulation of telecommunications carriers and covers the following subject areas:

- Filing requirements
- Discriminatory practices that are prohibited
- Special pricing arrangements
- Investigations, hearings, orders and appeals of orders
- Extensions of communication facilities
- Tariff or price list changes
- Occasional use of telecommunications services
- Uniform rules applicable to telecommunications carriers
- Discontinuance of service by a telecommunications carrier of the service of another telecommunications carrier or telephone company
- Assessment of regulatory expenses
- MPUC enforcement methods such as penalties and remedies
- Certification requirements
- International call blocking.

The current regulatory framework places numerous regulatory obligations upon interexchange carriers. Those companies must file a detailed application and obtain a certificate of authority before beginning to provide telecommunications services. The application for a certificate of authority must contain the detailed list of information, which is enumerated in the MPUC's rules.²⁸² After obtaining their certificates of authority and beginning to operate, interexchange carriers must maintain a tariff or price list and they are bound by all of the MPUC's rules and individual orders. Interexchange carriers may decrease rates without giving notice to customers. Long distance companies often limit their liability to consumers in tariffs unbeknownst to consumers. They may also increase rates, offer new services, and make changes in the terms and conditions of service any time after providing notice to customers. MPUC approval is required before an interexchange carrier discontinues a service provided to another telephone company or telecommunications carrier if end users would be deprived of service, because of the discontinuance. Interexchange carriers are currently prohibited from offering telecommunications services upon terms or rates that are unreasonably discriminatory. Minnesota law currently prevents an interexchange carrier from using geographically deaveraged pricing structures except with respect to promotions. Interexchange carriers may offer volume or term discounts and may offer unique pricing arrangements to certain customers where such pricing is justified by either market conditions or by differences in the cost of serving one customer or a group of customers. Minnesota law prohibits interexchange carriers from unreasonably limiting their service offerings to particular areas unless the facilities necessary for the service are not available and cannot be made available at reasonable costs.

²⁸² See Minn. Rules pt. 7812.0300, 7812.0350, and 7812.0400.

D. Analysis

1. The Legislature should take further moderate steps to deregulate the intrastate long distance business in Minnesota.

With the passage of Minnesota Statutes section 237.74 in 1993, the Legislature took a significant step in the direction of deregulating long distance services. Currently, the regulatory burdens of interexchange carriers are limited in comparison to other types of services regulated by the MPUC. Furthermore, the MPUC has attempted to interpret Minnesota Statutes section 237.74 to provide interexchange carriers with a significant amount of flexibility in establishing the rates, terms, and conditions relating to the provision of long distance services.

A further reduction in the level of regulation of interexchange carriers would fulfill the goals of the Ventura Administration by streamlining the regulatory process and aiding the transition from the non-competitive regulatory environment, that interexchange carriers faced in the past, a truly competitive environment where the burden of performance in the marketplace shifts from regulators to competitive service providers.

2. Geographic deaveraging of long distance rates in Minnesota should not be allowed until access charge reform is complete in Minnesota, and then only to the extent the Legislature is assured that rates for intrastate long distance service in rural Minnesota will remain comparable to rates in urban areas of the State.

In Minnesota, the level of competition in the market for long distance services varies among different parts of the State. While several hundred long distance companies currently hold certificates of authority, many carriers do not operate in the sparsely populated rural exchanges, because they do not have billing and collection agreements in place with the small, independent local exchange companies. With a small potential market, many competitive interexchange carriers do not feel that the potential to sign-up a few new customers justifies the expense of forming a contract for billing and collection services. Moreover, high access charges of most ILECs used to subsidize the cost of local service deter companies from competing in some rural areas. For this reason, customers served by the large local exchange companies tend to have more interexchange carriers to choose from than do customers served by small local exchange companies. In addition, the level of competition for toll services varies throughout Minnesota depending upon the concentration of residential customers in a given market. The FCC report of March 31, 1999 on "Long Distance Market Shares" clearly shows that the forces of competition have had a much greater impact on business customers than on residential customers. In Minnesota, there is a significantly greater concentration of residential customers in the small rural exchanges than in the major population centers, such as the inner rings of the Minneapolis/St. Paul Metropolitan Calling Area. A greater level of long distance competition is expected in urban compared to rural areas of the State. Without access charge reform, long distance competitors will have a disincentive to enter new markets in Minnesota. If allowed to geographically deaverage rates before access charge reforms are implemented, long distance carriers would have an incentive to "cherry pick" markets by pricing themselves out of higher cost areas. For these reasons, the Ventura Administration does not recommend that the Legislature permit geographically deaveraged rates in the long distance market.

3. The Legislature should replace the certification requirement for long distance carrier market entry with a simple registration procedure.

The existing certification process is time consuming and cumbersome, has not been changed since competition was first allowed in 1985, and does not recognize the changes that have taken place and the significant level of competition currently in the marketplace. With competition in the toll market, the current certification process does not serve to protect consumers over and above the protections that would continue to exist with a much simpler registration process. Under a simplified registration process, carriers could begin operating in Minnesota in a much shorter time frame than would be possible under the existing certification process. In turn, consumers would benefit from having a greater number of carriers to choose from. The registration would consist of a requirement to provide the name, address, telephone number of the company's agent in Minnesota. The Company's tariff would also be required. A bond would be required if the company were proposing to offer prepaid calling cards. Finally, the registration should include a list of all affiliates operating in the State.

4. The Legislature should increase the level of penalties that may be applied to long distance companies to be consistent with the penalties that may be applied to other telephone companies under Minnesota Statutes section 237.461.

Minnesota Statutes section 237.74, Subd. 11 states that "a person who knowingly and intentionally violates this section or a rule or order of the commission adopted or issued under this section shall forfeit and pay to the state a penalty, in an amount of at least \$100 and not more than \$1,000 for each day of each violation." Minnesota Statute section 237.461 contains similar language, but allows penalties of up to \$5,000, instead of \$1,000. For several reasons, the MDOC recommends increasing the maximum penalties that long distance carriers may face to \$5,000. With the reduced level of regulation being proposed for long distance carriers, the statutes and regulations that would continue to apply to long distance carriers are of critical importance. With the increased level of freedom to be given to long distance carriers, the carriers must likewise face an increased level of responsibility to operate fairly and honestly. An increase in the maximum penalty establishes the increase in responsibility in monetary terms that are easily understandable by the industry. Also, because many telephone companies offer both long distance and local exchange service, the application of a consistent maximum penalty avoids confusion on how to calculate the penalty in the case of a violation involving both long distance and local exchange services.

E. Recommendations

1. The Legislature should take further moderate steps to deregulate the intrastate long distance business in Minnesota.
2. Geographic deaveraging of long distance rates in Minnesota should not be permitted at least until access charge reform is complete in Minnesota, and then only to the extent the Legislature is assured that rates for intrastate long distance service in rural Minnesota will remain comparable to rates in urban areas of the State.
3. Long distance carriers should no longer be required to file tariffs with the MPUC.
4. The Legislature should replace the certification requirement for long distance carrier market entry with a simple registration procedure.

5. The Legislature should increase the level of penalties that may be applied to long distance companies to be consistent with the penalties that may be applied to other telephone companies under Minnesota Statutes section 237.461.

XI. REGULATION OF CABLE SERVICES

A. Background

1. Legislative History

Cable services are regulated much differently than telecommunications services. Before 1984, cable television services were regulated solely at the local governmental level. Generally, cable services are not regarded as essential services. However, “regulation” of cable arose because cable television operators needed franchises from local governments in order to use public right-of-way to access customers with cable plant and equipment. With no uniform standards governing how cable franchises were to be granted and the reasonableness of terms and conditions upon which cable franchises were granted, Congress decided in 1984 that it was necessary to “establish franchise procedures and standards which encourage the growth and development of cable systems and which assure that cable systems are responsive to the needs and interests of the local community.”²⁸³ Congress also felt it was necessary to adopt a national policy on cable regulation to protect cable operators from having unreasonable terms and conditions placed on the provision of cable services given the cable operator’s need to use public rights-of-way in order to do business.

In 1992, Congress overrode President Bush’s veto and adopted the Cable Television Consumer Protection and Competition Act of 1992.²⁸⁴ Congress adopted the 1992 Act based on several factors.²⁸⁵ First, Congress found that rates for cable television services had been deregulated in approximately 97% of all franchises since December 29, 1986. Since rate deregulation, monthly rates for the lowest priced basic cable service have increased by 40% or more for 28% of cable television subscribers. Although the average number of basic channels has increased from about 24 to 30, average monthly rates have increased by 29% during the same period. Congress found that between 1984 and 1992, the average monthly cable rate had increased almost 3 times as much as the Consumer Price Index. Congress also found that most cable television subscribers had no opportunity to select between competing cable systems. Consumers who subscribe to cable television often do so to obtain local broadcast signals which they otherwise would not be able to receive, or to obtain improved signals. Congress found that the result of this lack of competition was the cable operators’ undue market power in comparison to that of consumers and video programmers. In addition to the lack of competition for cable television services, Congress found a substantial increase in the penetration of cable television systems since 1984. By 1992, nearly 56,000,000 households, over 60% of the households with televisions, subscribed to cable television.

As a result of this growth, Congress found that the cable industry had become the dominant nationwide video medium. In addition, Congress found that the cable industry had become highly concentrated. The potential effects of such concentration, Congress found, were barriers to entry for new programmers and a reduction in the number of media voices available to consumers. Congress also found that the cable industry had become vertically integrated; cable operators and cable programmers often had common ownership. As a result, Congress found cable operators have the in-

²⁸³ 47 U.S.C. §521.

²⁸⁴ Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102-385, 106 Stat. 1460.

²⁸⁵ Pub. L. 102-385, Sec. 2(a), (b), Oct. 5, 1992, 106 Stat. 1460, 1463.

centive and ability to favor their affiliated programmers, making it more difficult for noncable-affiliated programmers to secure carriage on cable systems. Congress also found there to be a substantial governmental and First Amendment interest in promoting a diversity of views provided through multiple technology media and local origination broadcasting. Additionally, Congress found that franchising authorities were finding it difficult under the current regulatory scheme to deny renewals to cable systems that were not adequately serving cable subscribers.

Cable regulatory laws at the federal level were changed again by the 1996 Act. In the 1996 Act, Congress phased out some of the initiatives of the 1992 Act, including regulation of expanded tier cable rates and the three year holding requirement on cable television systems. The 1996 Act also clarified that local franchising authorities have no authority over telecommunications services provided by cable operators. The 1996 Act delineated the extent to which local franchising authorities could regulate cable and telecommunications companies through their authority to manage the use of public rights-of-way by such companies.

The Minnesota Legislature adopted a state cable television law in 1973. The State's cable law was amended several times between 1973 and 1985. In adopting the Minnesota Cable Act, the Legislature found that the provision of cable services in Minnesota required government oversight in order to protect cable operators from undue restraint and regulation by local franchising authorities.²⁸⁶ The Legislature also valued public, educational, and governmental (PEG) access programming and sought to promote the use of such programming in Minnesota. The Legislature also found that the cable industry was undergoing rapid growth and consolidation. The Legislature believed that cable industry consolidation should be discouraged when not in the public interest.

Based on these findings, the Legislature determined it was necessary to develop a state cable policy that is consistent with federal law. The Legislature believed that the law should promote and develop the cable industry in Minnesota, assure "adequate, economical, and efficient service," and promote the use of PEG access programming.²⁸⁷

2. Rates

The FCC has recently reported that there is a widening gap in average monthly rates between competitive and noncompetitive markets for cable services. The average monthly rate (for the basic service tier (BST), cable programming services tier (CPST), and related equipment) charged by cable operators facing effective competition was \$27.15 and \$28.71 as of July 1, 1997 and 1998, respectively, (55¢ and 57¢ on a per channel basis). For those not facing effective competition, the average monthly rate was \$28.56 and \$30.53, respectively, during the same time period (64¢ and 65¢ on a per channel basis). This represents a differential of 5.2% and 6.3%, respectively, in average monthly rates between competitive and noncompetitive areas. Further, the average monthly rates charged by systems facing head-to-head competition was 14% less than the average monthly rate charged by noncompetitive systems.

²⁸⁶ Minn. Stat. §238.01 et seq.

²⁸⁷ Id.

3. Cable Industry Performance²⁸⁸

The FCC reports that the number of households subscribing to cable continues to increase. The number of cable subscribers as a percentage of homes increased from 67.8% in 1996 to 68.8% in June 1998. The FCC also reports that 83% or more of all cable systems in the country are capable of providing more than 30 channels. 19% of the cable systems in the country have 54 channels or more of capacity. The FCC has no data on the total number of cable systems upgraded to 750 Mhz, the capacity needed to provide high-speed data and telephone services. The FCC has reported that the nation's largest cable operators invested \$4.3 billion in cable system upgrades in the United States in 1998.

a. Wireless Competition

Digital Broadcasting Service (DBS) is the biggest competitive threat to cable. DBS offers video programming and high-speed data transport via satellite direct to the home. High-speed data service can be offered, but the upstream signals are delivered through a telephone line. According to the FCC, DBS subscribership continues to show strong growth. DBS providers furnished programming to more than 7.2 million subscribers as of June 1998. This is an increase of more than 2.2 million subscribers since June 1997, or nearly 43%. In addition, industry reports state that 2.2 million of the 3.6 million net new video programming subscribers in 1998, or almost two thirds, are choosing DBS. The FCC reported that according to one analyst's projection, DBS subscribership will grow to 20 million by 2003, with its share of the multichannel video market growing to 25%.

Wireless cable, or Multichannel Multipoint Distribution Systems (MMDS) is a wireless broadband service that delivers addressable multichannel television programming, internet access, data transfer services, and other interactive services over a terrestrial microwave platform. MMDS serve 5 million customers in 90 nations, with over 1 million customers in some 250 U.S. systems.²⁸⁹ MMDS is a line-of-sight technology that works by broadcasting multiple channels of television or related services at microwave frequencies from an antenna located on a tower, tall building, or mountain. The signals are received by a small microwave dish typically about 16 x 20 inches in size, or perhaps larger in outlying areas.

Wireless cable, unlike traditional cable TV, requires no easements to operate and thus requires no franchise. Wireless cable, in contrast, is regulated by the Federal Communications Commission (FCC).

Recent technological advances have made feasible digital compression of video channels in the broadband communication industry. As one measure to foster competition, the FCC issued in July 1996 a declaratory ruling saying that wireless cable operators could digitize their MMDS channels as long as adjacent wireless cable systems experienced no interference from the process of the analog-to-digital conversion. With this FCC declaratory ruling and the advances in digital technology, wireless cable can now deliver between 100 and 200 virtual channels of video.

²⁸⁸ See generally, *Fifth Annual Report in re the Annual Assessment of Competition in the Markets for the Delivery of Video Programming*, CS Docket No. 98-102 (FCC December 23, 1998) (herein "*Fifth Annual Report*").

²⁸⁹ See Wireless Cable Association World Wide Web Site at <http://www.wcai.com/PDFfiles/fcc Aug. 27.pdf>.

In October 1996, the FCC cleared the way for wireless cable operators to use their spectrum for high-speed digital data applications, including internet access. The FCC also changed its rules last year to allow MMDS companies to offer two-way broadband services. In recent months MCIWorldCom and Sprint Communications Company, L.P. (Sprint) have taken advantage of this rule change and have spent collectively over \$1 billion to purchase several MMDS systems and plan to use these systems to offer broadband services directly to long-distance carriers' (IXC) networks, for they provide the last-mile connection to businesses and residences. Once the networks of MMDS and IXCs become fully integrated, the IXCs will have greater control of the end-to-end transmission and will be able to provide broadband services to subscribers more efficiently.

Teligent, Inc., Nextlink, and WinStar Communications Inc. also offer a variety of wireless broadband services to small- and medium-sized businesses in several metropolitan markets. Following are some of the cities that have systems offering high-speed access to the internet over wireless cable, including: Washington, DC; Las Vegas, NV; Lakeland, FL; Colorado Springs, CO; Santa Rosa, CA; and Nashua, NH.

b. Wireline Competition

The FCC reported that competing cable television franchises, or "overbuilds," have been awarded in 149 communities in the United States. These overbuilders have the potential to serve 7.2 million customers. However, many overbuilders are not yet operational due to the inherent difficulties in accessing customers through the overbuild strategy.

LECs do not yet represent a national presence in the video programming market. The competitive presence of LECs in the video market, however, is growing in some areas. The FCC took particular note of the efforts of Ameritech and Bell-South as cable system overbuilders.

4. Convergence

The cable industry is not just about MTV and ESPN anymore. Cable operators are continuing with the deployment of advanced technologies including digital video, internet access, and telephony services over their cable systems. In the last year, access to the internet over cable generally has become easier. As of August 31, 1998, the FCC reported that more than 15 million homes were passed by internet access service through cable modem technology. The FCC reported that there were approximately 300,000 subscribers.

Cable telephony requires expensive upgrades and presents a number of technical obstacles for potential competitors. The FCC reported that some cable operators have publicly expressed interest in Internet Protocol Telephony ("IP telephony") as a form of cable telephony.

In Minnesota, the deployment and advancement of cable television systems has progressed, but only in certain areas of the State. As discussed in section II of this Plan, of 855 communities surveyed in Minnesota, 700, or 82% reported that they have cable television service. This is well above the national average of 68% penetration. However, 155 cities (18%) reported that they had no cable television services at all. Cable system upgrades to provide advanced telecommunications services, expanded

video programming, and local telephone service have largely been an urban phenomenon.²⁹⁰

5. Industry Consolidation

Regulatory agencies cannot keep up fast enough to measure the level of consolidation in the cable and telecommunications industry. As discussed above, the lines are beginning to blur with respect to who is a telephone company and who is a cable company. The latest statistics available to the Ventura Administration on industry consolidation pre-date the acquisition of TCI by AT&T and the merger of AT&T and MediaOne.

Using the market shares for each video programming technology, the FCC's estimate of the HHI for the entire video programming market is 7015, a decrease from the HHI of 7567 for 1997. An HHI of 7015 remains several times greater than the 1800 threshold at which a market may be considered "highly concentrated."²⁹¹

Minnesota has not been immune from consolidation in the cable industry. A review of Appendix B, the data from the Ventura Administration's Cable System Inventory, shows that the Twin Cities cable market is dominated by just two companies: Paragon and MediaOne (soon to be AT&T).

Another phenomenon in the cable industry is vertical integration with suppliers of video programming. Of 245 national satellite-delivered video programming services identified by the FCC, 95 (39%) are vertically integrated with at least one major cable operator. In 1997, the FCC reported that, of the 172 national satellite-delivered video programming services identified, 68 (40%) were vertically integrated with cable operators. In 1998, 29 of the 50 most subscribed to video programming services were vertically integrated, according to the FCC. In addition, two other top 50 services (C-SPAN and C-SPAN2), while not directly owned by cable operators, were developed with significant involvement by the cable industry. In 1997, 26 of the 50 most subscribed to video programming services were vertically integrated.

6. PEG Access Programming and Facilities

With respect to PEG access and local origination programming and facilities, some cities have made the most of regulatory provisions requiring dedication of channel capacity, facilities, and financing for PEG access purposes. Others have not required the dedication of channel capacity, facilities, and financing above the extent required by federal and state law. Still others have required channel capacity, facilities, and financing and have not made the most efficient use of the resources for which they bargained. The relationship of PEG access viewership to the cost of programming in some communities in Minnesota indicates that cost/benefit analyses are not being performed or are not being performed objectively when decisions are made about PEG access related franchise requirements or funding. This point is supported by the following data collected by the Ventura Administration comparing the PEG access costs and benefits of two Minnesota cable franchise areas:

²⁹⁰ See Map 13.

²⁹¹ *Fifth Annual Report*, Table C-3. See p. 90 for explanation of the HHI index.

	<i>Community I</i>	<i>Community II</i>
PEG Fee	\$.38/sub/mo	\$2.52/sub/mo
Access Channel Viewership		
• Regional 6	<i>N/A</i>	<i>10% (freq or occ watch)</i>
• Government	<i>19%</i>	<i>12% (freq or occ watch)</i>
• Public	<i>18%</i>	<i>13% (freq or occ watch)</i>
• Educational	<i>16%</i>	<i>10-15% (freq or occ watch)</i>
• Local Origination	<i>42%</i>	<i>N/A</i>
Use of PEG access production facilities by public		
• Aware?	<i>61%</i>	<i>65%</i>
• Used?	<i>N/A</i>	<i>6%</i>
• Not Interested	<i>N/A</i>	<i>63%</i>

Table 21 - Comparison of PEG Access Costs and Benefits for Two Franchising Areas

B. Federal Law

1. Franchise Requirement and Allowed Conditions

Federal law requires cable operators to obtain a franchise from the local franchising authority (LFA) in order to provide cable service to a community.²⁹² As a condition for granting the franchise, LFAs may require cable operators to designate or allow the use of channel capacity for PEG access programming.²⁹³ LFAs may also require cable operators to designate or allow the use of cable system capacity for institutional networks for educational, or governmental use. An “institutional network” or “I-Net” is a communication network which is constructed or operated by the cable operator and which is generally available only to subscribers who are not residential subscribers. In practice, most institutional networks are dedicated to use by government institutions.

2. Franchise Renewal

Federal law also sets forth the procedures that must be followed by an LFA in renewing a cable television franchise. There are two alternative procedures that LFAs and cable operators must follow in renewing a franchise – an informal or formal renewal process. Most franchise renewals are handled through the informal franchise renewal process. The informal process generally leaves it up to the LFA and the cable operator to work cooperatively and bargain in good faith to arrive at a mutually satisfactory franchise renewal agreement.

Most LFAs follow the same approach in executing the informal renewal process. Many cities hire consultants to assist them in handling this process. First, the franchising authority typically goes through an information gathering (or discovery) stage in which data is collected from the cable operator about the system. Community surveys are conducted, the franchise is reviewed for compliance, a franchise fee audit is performed, and an independent technical audit is often conducted of the cable sys-

²⁹² 47 U.S.C. §541.

²⁹³ *Id.* §531.

tem. The LFA's staff or consultant synthesizes this information and usually issues a report to the decision-making authority and the public. A renewal proposal is then requested from the cable operator, negotiations ensue and either an agreement is reached or the parties reach an impasse.

If the informal process fails, the parties can revert to the formal process. The formal process is essentially a "mini" contested case hearing. The 1996 Act sets forth strict procedural time frames, requires an official record to be developed, and requires a final appealable order from the LFA, after consideration of the recommendation of the hearing official.

In *Union CATV, Inc. v. City of Sturgis*, the court affirmed a city's denial of a cable operator's franchise renewal proposal, and held that courts must defer to the judgment of the city in determining whether a franchise renewal proposal meets the needs of the community.²⁹⁴ The court also held that a franchising authority must balance the community's needs for franchised cable services against the cost of providing that service to determine whether the operator's proposal is reasonable.

3. Rate Regulation

LFAs may regulate BST rates and related equipment not subject to effective competition in accordance with FCC rules. LFA authority to regulate CPST rates expired on March 31, 1999. Small cable television operators are for all practical purposes exempt from BST rate regulation. The term "small cable operator" means a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1% of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed \$250,000,000.

4. Service Quality

Under section 632 (47 U.S.C. § 552) of the Cable Act, LFAs may enforce customer service standards relating to telephone answering, billing practices, installation times, and other consumer information. Most LFAs incorporate the FCC's minimum customer service standards into their franchises with cable operators. LFAs are not prohibited from adopting stricter standards and some LFAs have successfully negotiated stricter customer service standards.

5. Merger and Acquisition Reviews

Section 537 of the Cable Act allows an LFA to review the transfer of ownership of a cable franchise, if the LFA's franchise provides the right to do so. The Cable Act and FCC rules allow an LFA 120 days to review the financial, technical, and legal qualifications of the proposed buyer.

There has always been a question as to what the terms "financial, legal and technical" mean in reviewing cable television mergers. The federal act contains language which preserves the authority of an LFA regarding the public health, safety, and welfare to the extent consistent with the express provisions of the Cable Act.²⁹⁵ However, there is a question about what objective standard should be applied in reviewing mergers and acquisitions under federal law, and whether an LFA has the right to place conditions upon the transfer of a cable franchise while remaining consistent

²⁹⁴ 107 F.3d 434 (6th Cir. 1997).

²⁹⁵ 47 U.S.C. §556(a).

with the provision of the Cable Act that restricts an LFA's review to the legal, financial, and technical qualifications of the merger. LFAs often use transfer of ownership approval to "reopen" cable franchises, a power the Cable Act does not expressly provide to LFAs. Common issues raised on transfers are system upgrades and additional dedicated capacity for PEG purposes. In the City of Portland case, the lawsuit arose out of the City's decision to condition the transfer of the Portland franchise from TCI to AT&T on AT&T's agreement to provide an open cable modem platform. The City's authority to condition the transfer is one of the issues raised on appeal to the Ninth Circuit Court of Appeals.²⁹⁶

6. Regulation of Content.

Cable service providers enjoy First Amendment protection with respect to the video programming services offered over their systems.²⁹⁷ LFAs cannot dictate the channels or packages of channels that a cable operator provides to customers. The only control LFAs have over content is with respect to the messages that are sent over educational and government access channels.

Public access programming can present difficult First Amendment problems. Courts have ruled that once a public access channel is opened on a cable system, a public forum is created and government cannot restrict the content of the programming or discriminate with respect to which viewpoints it allows to be broadcast over the public access medium.²⁹⁸

C. State Law

1. Franchise Requirement and Allowed Conditions

Minnesota law requires all cable operators to obtain a franchise from the municipality governing the franchise area.²⁹⁹ Minnesota law also prohibits LFAs from granting competitive franchises on terms which are more favorable or less burdensome than granted to the incumbent with respect to the following issues: (i) franchise fees (ii) area served; and (iii) PEG channel requirements. Minnesota law also allows a municipality to own and operate a franchised cable system subject to Chapter 238.

State law requires that a franchise provide for the provision of at least one designated access channel. Exceptions to this requirement are provided for different categories of small cable operators (Class A, B, and C systems).³⁰⁰ Section 238.084 contains required provisions that must be included or addressed in every franchise granted in Minnesota, including a provision that requires rates to be available for public inspection, a provision that requires consumer grievance procedures to be set forth in the franchise, and a provision that requires certain customer service standards to be incorporated into the terms of a franchise.³⁰¹

2. Franchise Renewal

²⁹⁶ See pp. 31-35 of this Plan.

²⁹⁷ Turner Broadcasting v. FCC, 512 U.S. 622, (1994).

²⁹⁸ Denver Area Telecommunications Consortium v. FCC, 518 U.S. 727 (1996).

²⁹⁹ Minn. Stat. § 238.08.

³⁰⁰ Id. § 238.084(bb).

³⁰¹ Minn. Stat. § 238.084.

Minnesota law sets forth a detailed procedure that LFAs are required to follow in order to issue a franchise.³⁰² The requirements of this statute are much more stringent than that required under the federal Cable Act. These franchising procedures appear to have been drafted under the assumption that there would be vigorous competitive bidding for cable franchises in Minnesota. This assumption has not played out throughout the state, raising the question of the value of many of the state franchising procedures. A competitive bidding process also seems anti-thetical to promoting competition in the provision of cable services.

3. Transfers of Ownership

Minnesota law sets out different procedures, time lines, and standards for reviewing transfers of ownership of cable franchises than are provide under federal law. This often results in tensions between federal and state procedures. For example, federal law grants an LFA 120 days to review and approve a transfer of ownership of a cable system. The federal act does not spell out any other interim procedures. State law requires a decision on a proposed transfer within 30 days unless the city finds that the sale “could have an adverse impact on subscribers.”³⁰³ This finding of “adverse impact” has become a formality among those cities that actually review cable system mergers. After a finding of adverse impact, a city must hold a public hearing on the transfer within 30 days of the adverse impact finding. A decision must follow within 30 days of the hearing date. The maximum amount of time allowed under state law is 90 days. In practice, many communities negotiate waivers of the state law time line and take 120 days to review mergers and acquisitions under the federally prescribed time frame.

D. Analysis

1. Cable franchises, renewals, and mergers/acquisitions should be granted or approved at the state level so that a statewide cable communications policy can be implemented consistently throughout the state.

The cable infrastructure inventory conducted by the Ventura Administration indicates that there is a growing gap between urban and rural Minnesota with respect to cable infrastructure and services in Minnesota. Urban areas are all generally served by cable systems. However, 15% of the cities in Minnesota are not served by cable systems. All of these cities without cable are in Greater Minnesota. Moreover, most system upgrades are occurring in urban areas, not in Greater Minnesota.³⁰⁴ The Ventura Administration believes that this disparity is caused in large part by the lack of resources and bargaining power in small communities compared to larger communities. With the full panoply of state resources and bargaining leverage behind every community in Minnesota – no matter how small – the Ventura Administration believes it can narrow this gap of cable haves and cable have nots in Minnesota.

Today in Minnesota, there are approximately 600 different jurisdictions with regulatory authority over cable services. The Ventura Administration believes that vesting regulatory authority at the State level will in the long term save tax payer resources as a result of economies of scale achieved through state regulation. The MDOC and

³⁰² Minn. Stat. §238.081.

³⁰³ Minn. Stat. §238.083, Subd. 2.

³⁰⁴ See Map 13.

the MPUC will develop expertise in the area of cable regulation. As the regulatory structure is now, many cities have to relearn the learning curve every ten or fifteen years, or hire a consultant, if they want to match wits with the cable industry negotiators who earn their living negotiating cable deals. Moreover, the speed of merger approvals could be increased dramatically if cable were regulated at the state level. Today, in order to close a merger or an acquisition between a cable operator and another entity, each LFA served by that cable operator must independently analyze and pass on the approval or rejection of a merger. If regulated at the state level, this analysis would only have to occur once.

State cable regulation also eliminates bias or the appearance of bias in decision making at the local level. This is particularly true in the case of municipal cable systems. There are only two municipally owned cable systems in Minnesota, but others are contemplating constructing and operating broadband networks. In the municipal ownership situation, the same entity that operates a cable system should not be the entity regulating that system.

Even outside of the municipal franchising process, municipal officials responsible for negotiating cable franchises are often the same officials who operate or manage PEG access operations for the community. The Ventura Administration believes that one of the purposes of the federal Cable Act – to avoid unreasonable conditions being placed on cable operators in franchise negotiations – would be furthered by a state law that removes these sensitive decisions to the state level.

State regulation would also remove any competition between communities that may exist with respect to “who got what” in a cable franchise. Unlike a high school football rivalry, this kind of competition between communities can be harmful and can result in unnecessary franchise requirements, which ultimately are passed through to ratepayers.

State regulation of cable can also be easily accomplished while retaining local input into the decision making process. Most communities follow an identical informal franchise renewal process.³⁰⁵ The needs assessment process generally consists of surveys of interest groups in the community, focus group interviews, a cable system profile inquiry, franchise compliance reviews, and franchise fee audits. None of these exercises require a peculiarly local expertise. In fact, many communities in the state hire outside consultants to identify community needs. There is no reason the state cannot perform these functions – at much less cost to tax payers.³⁰⁶

The Ventura Administration proposes that decision making authority vest with the MPUC. The MDOC and OAG would be given the right to intervene just as is the case in any telephone docket.

2. Existing cable franchises granted by municipalities should be grandfathered under any cable regulatory reform legislation and remain effective until their stated expiration and treated as if granted by the State under the proposed new cable regulatory framework.

³⁰⁵ See pp. 139-140 of this Plan for a description of the informal renewal process.

³⁰⁶ A franchise renewal process in a Twin Cities community can cost a community over \$100,000 in consultant fees. Reviews of mergers can cost over \$10,000 per transaction.

Presumably each municipality in Minnesota has cable franchises which are currently in effect. State intervention and/or cancellation of these franchises would create great uncertainty with respect to the mutual rights and obligations of the cable operators and franchising authorities agreed to in those documents.

The Legislature should provide for a smooth transition of regulatory authority if it chooses to vest franchising authority at the State level.

The Ventura Administration recommends that any franchises existing on the effective date of any cable regulatory reform legislation be allowed to expire naturally, but the State would step into the shoes of the franchising authority as if the franchise had been granted directly by the State. Under the Ventura Administration's proposed framework, these franchises would continue to be locally enforced. However, the State would be responsible for administering the franchise renewal process, and negotiating and granting franchise renewals. The State would step into the municipality's shoes with respect to any decision making responsibilities (i.e., merger approvals) and any disputes arising out of the transition from municipal to state authority.

Cable operators should be allowed to petition the MPUC to modify their franchises to technically conform to the new state law. However, the Ventura Administration does not believe such modifications are necessary, and cable operators should not be allowed to use the change in regulatory structure as an opportunity to reopen substantive franchise terms negotiated and approved by municipalities under the current regulatory regime.

3. Cable franchise rights granted by the MPUC should be enforced, administered, and enjoyed at the local level.

While state decision making regarding cable issues presents economies of scale, it does not make sense for franchises and MPUC orders to be enforced at the state level. Just as the local police provide economies of scale with respect to enforcement of criminal statutes, the local government should also be responsible for monitoring compliance with franchises granted by the MPUC and taking enforcement action if necessary. Local city councils should have original jurisdiction over enforcement actions regarding cable regulatory issues, with the first level of appeal at the MPUC. This structure would provide communities the ability to handle and resolve enforcement problems themselves, but also provide appellate relief from an administrative agency with expertise in the field.

The Ventura Administration does not propose to take away any control over PEG access or local origination programming or production. These functions are best left to the community. Finally, as is discussed in further detail in Section XIV of this Plan, the Ventura Administration recommends that franchise fees continue to flow directly to the local governmental units. Also, to reiterate, cable operators providing telecommunications services will be subject to the same regulatory framework as other providers of telecommunications services.

4. Minnesota's cable laws need to be streamlined, standardized and generally updated to become consistent with federal law and eliminate outdated provisions.

Minnesota's state cable law is full of inconsistencies with federal statutes and rules and generally needs to be updated and standardized. Required franchising provisions should be reviewed and revised to create uniform franchising provisions. State fran-

chising procedures should be eliminated because they add no value to the federal renewal procedures that already adequately protect the interests of the public. Transfer of ownership review provisions should be revised to be consistent with federal law, eliminating tensions over review deadlines. A clear standard of review for mergers and acquisitions between providers of cable services should be developed which requires approval if it is demonstrated that the transaction will not harm the public interest. The FCC's minimum service quality standards should be incorporated by reference into state law.

Level playing field requirements under state law should be replaced with a provision that assures that, as a whole, a franchise will not be more burdensome or less favorable to incumbents than the franchise granted to a competitor. If a level playing field requirement is necessary it should be a uniform franchising provision under state law. Otherwise, these level playing field provisions serve only to deter potential competitors from overbuilding systems. Overbuilders do not want to provide a redundant set of services required under the franchise of the incumbent operator and automatically incorporated into the franchise of every competitor.

Finally, the small system statutes do not add value to the franchising process.³⁰⁷ No justification has been presented to the Ventura Administration for a different level of regulation of smaller cable television operators. These laws should also be eliminated.

5. Municipalities should be allowed to construct, acquire, own, and operate systems for the provision of cable services.

The Ventura Administration infrastructure inventory indicates that 15% of the state is not served by cable.³⁰⁸ Moreover, except for a few pockets and DBS providers, competition for cable services is non-existent in Minnesota. For these reasons, the Ventura Administration believes a community should be allowed to pool its resources and provide cable service to itself. A municipal cable system should be subject to the same laws and regulations as any other cable system.

6. Franchise requirements of a community, such as PEG access facilities and institutional networks should be granted only on the basis of demonstrated need by the community of interest.

Cable operators should not be required to dedicate PEG access channel capacity, facilities, and funding, or to provide institutional networks unless need is demonstrated by the community of interest. The Ventura Administration proposes that a minimum of one channel be dedicated for PEG access under every franchise. After that, it is the responsibility of the community to demonstrate that additional channels are necessary to further the public interest. The public interest can be met if the community demonstrates that the channel capacity, facilities or funding have an educational purpose (i.e. television production training), provide a valuable service to the community (i.e., cablecast of religious services for the disabled or elderly, or distance training provided over an institutional network), further the arts or provide an avenue for public expression (i.e., MTN's Artifacts program).

³⁰⁷ See Minn. Stat. §238.084, Subd. 2-6.

³⁰⁸ See Map 11.

The community of interest should also be required to develop a budget each year for PEG access operations to be approved by the MPUC and to be funded out of franchise fees. All communities receiving such funding should be required to submit an annual report of operations, including a review of the services provided over the year, financial statements of operations, and plans for the coming year. All capital expenditures sought by a community from a cable operator should be provided for in the franchise agreement itself. This allows an objective decision maker to evaluate the budget, and ensure accountability for how the rate payer's money is spent.

If a community fails to demonstrate in an annual report that it has utilized dedicated PEG access channel capacity, the MPUC should have the authority to order the channel to be returned to the cable operator.

The cable industry has been required to invest millions of dollars in PEG access channels, facilities, and funding. The Ventura Administration does not believe that communities are realizing the full value of this investment due to a lack of awareness about these public facilities in many communities throughout the State. The ability to insert locally originated television programming is a quality unique to the cable television industry. It is a capability that has not been adequately promoted by cable operators or communities. The Ventura Administration recommends that \$1 million per year be dedicated to a statewide multimedia campaign to promote PEG access programming and public access facilities to create awareness of this important educational and expressive tool. This promotional campaign should be funded out of franchise fees.

7. The state should promote competition in the cable industry by prohibiting suppliers of video programming from discriminating in the provision of such video programming services with respect to distributors of such video programming services.

Many large cable television companies enter into exclusive programming contracts with suppliers of the most popular video programmers, such as ESPN and CNN. These exclusive programming contracts sometimes prevent competitors, particularly overbuilders, from being able to offer customers the programming consumers desire most.

The Legislature should carefully consider banning exclusive programming contracts in Minnesota. The reason caution is advised is due to the probable legal challenges that might arise out of such legislation. Cable operators would likely challenge such a law. The Ventura Administration is unsure about whether such a challenge would prevail. The Ventura Administration will be studying this issue further before and during the legislative session. At the very least, it would be reasonable and prudent to require that such exclusive programming contracts be subject to periodic review by the MPUC for real or potential anti-competitive effects and a requirement that such contracts be of limited duration, so as to assure potential access by various competitors at the time of contract renewal.

8. The State should, to the extent it can, promote competition in the provision of video programming services in a technology neutral fashion. Initiatives to promote competition in the cable service industry in Minnesota are limited by technology, federal law, and private contract negotiated between parties. From a technical standpoint, a cable system cannot be unbundled like a telephone network, and federal law does not require cable system unbundling or resale with respect to the provision of cable services as it does of telephone networks. As the FCC has indicated in its competi-

tion reports, the promise of effective competition in the video programming delivery industry comes from wireless cable and overbuilders.

Also, if the Legislature decides that cable services are to be regulated at the state level, the Ventura Administration would take a much more active policy advocacy role with respect to the development of effective competition in the video programming services market.

E. Recommendations

1. Cable franchises, renewals, and mergers/acquisitions should be granted or approved at the state level so that a statewide cable communications policy can be implemented consistently throughout the state.
2. Cable franchise rights granted by the MPUC should be enforced, administered, and enjoyed at the local level.
3. Local city councils should have original jurisdiction over enforcement actions regarding cable regulatory issues, with the first level of appeal at the MPUC.
4. Control over PEG access or local origination programming or production are functions best left to the community.
5. Minnesota's cable laws need to be streamlined, standardized and generally updated to become consistent with federal law and eliminate outdated or unnecessary provisions.
6. Required franchising provisions should be reviewed and revised to create uniform franchising provisions.
7. State franchising procedures should be eliminated because they add no value to the federal renewal procedures that already adequately protect the interests of the public.
8. Transfer of ownership provisions should be revised to be consistent with federal law and eliminate tensions over review deadlines.
9. A clear standard of review for mergers and acquisitions between providers of cable services should be developed which requires approval if it is demonstrated that the transaction will not harm the public interest, and that the merged entity has the financial, technical, and managerial ability to uphold their franchise obligations.
10. The FCC's minimum service quality standards should be incorporated by reference into state law.
11. Level playing field requirements under state law should be replaced with a provision requiring that, on the whole, a franchise awarded to an incumbent will not be more burdensome or less favorable to a franchise awarded to a competitor.
12. Small system cable franchising regulations under state law which treat smaller cable systems differently than large cable systems should be eliminated.
13. Municipalities should be allowed to construct, acquire, own, and operate systems for the provision of cable services.
14. Franchise requirements of a community, such as PEG access facilities and institutional networks should be granted only on the basis of demonstrated need by the community of interest.

15. The community of interest should be required to develop a budget each year for PEG access operations to be approved by the MPUC and to be funded out of franchise fees.
16. If a community fails to demonstrate that it has utilized PEG access channel capacity, facilities, or funding, the MPUC will have the authority to order the dedicated channel capacity to be returned to the cable operator.
17. \$1 million per year should be dedicated to a statewide multimedia campaign to promote PEG access programming and the use of public access facilities to create awareness of these important educational, communicative and expressive tools.
18. The state should promote competition in the video programming service industry by prohibiting video programming suppliers from unreasonably discriminating in the provision of video programming with respect to distributors of such programming. In the alternative, exclusive programming contracts should be subject to MPUC review for real or potential anti-competitive effect, and limited in duration so as to permit access by competitors.
19. The State should advocate pro-competition policies at the federal regulatory level with respect to the provision of video programming services.

XII. TAXES AND FEES

A. Background

The telephone and cable industries in Minnesota are subject to a wide array of taxes, surcharges, fees, and assessments. Below, the Ventura Administration attempts to lay out this complicated tax and fee structure.

1. TAP and Lifeline

The Ventura Administration has already discussed the Telephone Assistance Program and the federal Lifeline assistance programs in section VII of this Plan. The Ventura Administration believes these charges are in essence taxes, but also believes that this subject is best dealt with in the context of the state's universal service plan due to the federal integration of the low-income assistance programs into the federal universal service program.

2. Telephone Access for Communications Impaired Persons (TACIP)

The TACIP surcharge went into effect in 1989. The current charge is \$.12 per access line per month. The statute allows the Commission to increase the charge to \$.20 if necessary. The TACIP fund supports the cost of the telecommunication relay service, which is a central statewide service through which a communication-impaired person, using a communication device, may send and receive messages to and from a non-communication-impaired person whose telephone is not equipped with a communication device and through which a non-communication-impaired person may, by using voice communication, send and receive messages to and from a communication-impaired person.

3. 911

The 911 surcharge was placed into effect on January 1, 1987 at a level of \$.14. The charge is currently \$.27. The Department of Administration handles the administration of the funds collected from the 911 surcharge. The Public Utilities Commission establishes the amount of the surcharge which has a \$.08 floor and a \$.30 cap under existing statutes.

4. Regulatory Assessments

Regulatory assessments are used to support the costs of the MPUC and the MDOC in those areas regulated by these agencies.³⁰⁹ Direct assessments are made on filings specific to a company. General assessments are made to all companies based on the agency costs allocated to telecommunications and are shared by all telephone companies and telecommunications carriers based on their intrastate revenues.

5. Sales Tax

The State levies a 6.5% sales tax on all providers of "local exchange telephone service, intrastate toll service, and interstate toll service, if that service originates from and is charged to a telephone located in this state."³¹⁰ Cable services are also subject

³⁰⁹ See Minn. Stat. §237.295.

³¹⁰ Minn. Stat. §297A.01(f). This section goes on to expressly include or exclude certain types of services from the definition of "telephone service." Minn. Stat. §297A.25, Subd. 36 exempts interstate WATS calls from the sales tax.

to the 6.5% sales tax.³¹¹ Under current law, telecommunications capital equipment purchased by telecommunications companies for use in Minnesota is subject to the 6.5% sales tax.

6. Franchise Fees

Federal and state law allow local franchising authorities to assess a franchise fee of up to 5% of the gross receipts derived from cable services provided within each franchising authority. Not all cities charge franchise fees to cable operators, and the amount of the charge varies from city to city.

In 1996 the then Department of Public Service presented a detailed report to the Legislature on franchise fees and PEG access programming in Minnesota. Without reiterating the entire report, some of the key findings in the report were:

- a. Local franchising authorities collected nearly \$9,000,000 in franchise fees from cable operators in 1994. The Minnesota League of Cities has recently estimated this number to be closer to \$20 million.³¹²
- b. Many local franchising authorities receive “in-kind” support from cable operators in the form of channels dedicated for PEG access, PEG access facilities and institutional networks. The estimated value of this in-kind compensation can be as high as \$11.7 million for a single community.³¹³

B. Analysis

1. The Legislature should establish a single uniform charge to carriers based on end-user revenue on all telecommunications services to fund the state universal service program (including the high cost fund and TAP), TACIP, and 911.

The Ventura Administration believes that all telecommunications related social goals should be funded through taxes or surcharges established by elected representatives. This approach is easy to levy and easy for consumers to understand (“It’s a tax”). The revenue would be collected by the Department of Administration, which is currently responsible for collecting and disbursing TAP and 911 surcharges, and distributed to the agency responsible for administering each program. The state universal service funds would be distributed by the MPUC as discussed in section VII of this Plan. TAP would continue to be administered and distributed by the Department of Human Services. 911 would be distributed by the Department of Administration. TACIP would continue to be distributed through a joint agreement between the Department of Commerce and DHS. These programs would all be budgeted biennially by the Legislature.

2. The exemption for capital equipment from the state sales tax should be extended to include telecommunications equipment purchased for use in providing advanced telecommunications services in Minnesota.

The current tax on this equipment is a disincentive for businesses to invest in capital equipment for use in Minnesota. For example, providers of satellite services are ex-

³¹¹ *Id.* §297A.01(g).

³¹² “Kelley’s Big Bill,” *City Pages* (November 17, 1999).

³¹³ Paragon Cable estimated this as the value of the in-kind compensation provided to the City of Minneapolis, which is entitled to 25% of the capacity on Paragon’s cable system under its franchise – the equivalent of approximately 30 analogue channels.

empt from the sales tax, while telephone companies are not. This violates basic principles of fairness. It violates the Ventura Administration’s principle of technology neutrality. It also creates a disincentive for telecommunications companies to locate advanced telecommunications facilities in the state. The Department of Revenue estimates that the state revenue loss from extending this exemption would be as follows:

FY 2000	\$41.5 million
FY 2001	46.8 million
Biennium	\$88.3 million
FY 2002	\$50.6 million
FY 2003	\$53.5 million
Biennium	\$104.1 million

Table 22 -- State Revenue from Sales Taxes on Telecommunications Capital Equipment

3. Taxes on telecommunications services and cable services in Minnesota should be based on the regulatory definitions of those terms as proposed by the Ventura Administration.

To achieve competitive and technology neutrality, all taxes levied on video programming and telecommunications services in the State should be based on the Ventura Administration’s proposed regulatory definitions. This creates a consistency in how the state regulates telecommunications services, will likely expand the tax base because the Ventura Administration’s definitions generally broaden the definitions of “telecommunications services.” These changes will also simplify the state tax code, which now contain somewhat tortured definitions of these services.

4. Franchise fees on cable services should continue to be paid directly to cities on the basis of gross receipts net of the value of any in-kind relief granted a municipality under a franchise.

One of the fundamental principles of the Ventura Administration is “never forget it’s the people’s money.” Franchise fees have always been intended to compensate local communities for the use of public rights-of-way by utilities and cable operators. Many communities have come to rely on these funds for a variety of purposes. Some franchise fees are allocated to the general fund for general operations. Other communities use franchise fees to fund PEG access facilities and institutional networks. After careful thought about how these funds should be collected, distributed, and used, the Ventura Administration believes that these decisions are best left at the local level, with two exceptions.

First, any “in-kind” compensation won by municipalities in franchise agreements granted by the MPUC should count against the 5% federal cap on franchise fees. Further, the MPUC should be required to assess the cost that, in the telephone world, would have been assessed to parties pursuant to Minnesota Statutes section 237.295, against franchise fees otherwise payable to the municipality.

The State should set a statewide franchise fee at 5%. This percentage can be revisited periodically. Moreover, the definition of gross receipts should also be defined by statute. These provisions go toward establishing a uniform franchising framework.

5. Total Funding Requirements and Proposed Surcharge Amounts

The table below summarizes the Ventura Administration’s estimates for tax or surcharge levels necessary to accomplish the goals of the 1996 Act and the Ventura Administration. This presumes that providers will pass through 100% of these surcharges to customers.

<i>Program</i>	<i>Surcharge Amount</i>
<i>Minnesota Universal Service Fund</i>	<i>30%</i>
<i>Franchise fees on cable service</i>	<i>5%</i>
<i>Sales tax</i>	<i>6.5%</i>

Table 23 -- Fee and Surcharge Amounts

C. Recommendations

1. The Legislature should establish a single uniform end user charge on all telecommunications services to fund the state universal service program (including the high cost fund and TAP), TACIP, and 911.
2. The exemption for capital equipment from the state sales tax should be extended to include telecommunications equipment purchased for use in providing telecommunications services in Minnesota.
3. Taxes on telecommunications services and cable services in Minnesota should be based on the regulatory definitions of those terms as proposed by the Ventura Administration.
4. Franchise fees on cable services should continue to be paid directly to cities on the basis of gross receipts net of the value of any in-kind relief granted a municipality under a franchise.
5. Any “in-kind” compensation won by municipalities in franchise agreements granted by the MPUC should count against the 5% federal cap on franchise fees.
6. The law should require the MPUC to assess agency regulatory costs against franchise fees.
7. The total cost of regulatory reform will seem expensive to consumers when it is itemized as a regulatory fee on a bill. As part of its consumer outreach campaign, the Ventura Administration would explain the changes and why change is necessary to give Minnesota the most competitive and advanced cable and telecommunications infrastructure on the planet.