BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JULY 27, 2001

IN RE:	)	
	)	
UNIVERSAL SERVICE GENERIC CONTESTED CASE	)	**DOCKET NO. 97-00888**
	)	

THIRD INTERIM ORDER ON PHASE II AND FIRST INTERIM ORDER ON PHASE III

This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on May 15, 2001 to resolve certain issues raised by the Authority during the February 21, 2001 Authority Conference.[1]

I. Procedural History

The Authority convened the Universal Service Docket to establish an intrastate Universal Service funding mechanism pursuant to Tenn. Code Ann. § 65-5-207; Section 214 of the Telecommunications Act of 1996 (the "Act");[2] and Federal Communications Commission ("FCC") Order 97-157.[3] The Authority initially determined that it would divide the docket into two phases, but later added a third phase to address rate rebalancing.

In Phase I, the Authority defined the general parameters for "determining the appropriate size of the intrastate [fund]" and recognized that "the size of the fund could have a significant

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[1] The Authority set forth the specific issues and due dates for briefs in the *Second Interim Order on Phase II* issued May 22, 2001.

[2] *See* 47 U.S.C. § 214 (Supp. 2000)

[3] *See In re Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 97-157, 12 FCC Rcd. 8776 (May 8, 1997) (Report and Order).

impact upon competition."[4] The Authority determined that the intrastate Universal Service fund will provide support to carriers offering discounted educational lines to schools and libraries and to carriers serving low-income customers.[5] Further, the Authority concluded that the intrastate Universal Service fund would support high-cost areas upon a finding by the Authority that high-cost areas exist.[6] To calculate the amount necessary to support high-cost areas, the Authority defined the revenue benchmark to be used in calculating support at the wire center level and then determined that the cost studies for each wire center should reflect the forward-looking cost of providing the services included in the revenue benchmark.[7]

In Phase II, the Authority addressed the level of cost for use in calculating the support for BellSouth Telecommunications, Inc. ("BellSouth") and United Telephone-Southeast, Inc. ("UTSE"). To estimate the cost, BellSouth and UTSE presented the Benchmark Cost Proxy Model ("BCPM") and AT&T Communications of the South Central States, Inc. ("AT&T") presented the HAI model. The Authority reviewed the models and ordered twenty-five (25) common adjustments.[8] After the parties submitted the amended cost models, the Authority adopted the HAI model.[9] The Authority also directed BellSouth and UTSE to revise their respective revenue benchmarks so that the benchmark calculations would be compliant with the methodologies adopted by the Authority for calculating the revenue benchmark.[10]

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[4] *Interim Order on Phase I of Universal Service*, p. 4 (May 20, 1998) (hereinafter *May 20, 1998 Order*).
[5] *See id.* at 43, 46-47.
[6] *See id.* at 32-34.
[7] *See id.* at 41.
[8] See *Interim Order on Phase II of Universal Service*, pp. 72-75 (Sept. 16, 1999). (hereinafter *September 16, 1999 Order*)
[9] *See Phase II Order Re: Determination of Cost Model and Revenue Benchmarks*, p. 5 (Sept. 22, 2000) (hereinafter *September 22, 2000 Order*).
[10] *See id* at p. 7, 9-10.

In accordance with the Authority's *September 22, 2000 Order*, BellSouth and UTSE submitted revised revenue benchmarks on October 24, 2000. On November 3, 2000, AT&T and the Tennessee Cable Television Association ("TCTA") filed comments on the October 24th filings.

At a regularly scheduled Authority Conference held on February 21, 2001, the Authority recognized that there were certain issues that required further briefing and discussion before Phase II could be concluded. Thus, the Authority ordered the parties to submit briefs and/or comments on the following issues by March 14, 2001: 1) how support received from the federal CALLS Plan[11] should be accounted for in establishing the intrastate Universal Service fund;[12] 2) whether the Authority should establish a mechanism to fund the Tennessee Relay Center ("TRC") through the Universal Service fund at this time;[13] 3) the deployment of advanced services in Tennessee, particularly the rural areas served by BellSouth and UTSE, how the Authority could use the Universal Service fund to accelerate the deployment of advanced services, and the availability of advanced services consistent with the Act;[14] and 4) whether the Universal Service fund should support secondary residential lines in high-cost areas, including an analysis of the relationship between secondary residential lines and advance services, and how line sharing could impact the need for the Universal Service fund to support secondary lines.[15] The Authority also ordered BellSouth and UTSE to submit the following information and data by March 7, 2001: 1) a schedule showing the amount of Universal Service support received from

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[11] CALLS is an acronym for Coalition for Affordable Local and Long Distance Service.
[12] *See Second Interim Order on Phase II*, p. 8 (May 22, 2001).
[13] *See id.* at p. 10.
[14] *See id.* at p. 11.
[15] *See id.* at p. 12. The Authority also ordered that parties could file reply briefs no later than March 28, 2001. *See id.* at 15.

the federal CALLS Plan in 2000 and anticipated in 2001 along with all supporting calculations;[16] 2) a schedule showing the amount of support necessary to fund their existing intrastate educational discount provided to schools and libraries along with supporting calculations based on data for the twelve (12) months ending August 2000;[17] 3) a summary sheet for each high-cost wire center including the revenue benchmark, cost per line, the number of initial residential lines, and the necessary Universal Service support;[18] and 4) a schedule showing the amount of support necessary to fund their respective intrastate Lifeline programs along with supporting calculations based on data for the twelve (12) months ended August 2000.[19] Moreover, the Directors unanimously approved the methodologies contained in the revenue benchmarks submitted by BellSouth and UTSE on October 24, 2000.[20] The Authority also modified the *May 20, 1998 Order* such that each Incumbent Local Exchange Carrier serves as the carrier of last resort in its service area when there is no designated intrastate eligible telecommunication carrier in that area.[21] Lastly, the Authority clarified its *May 20, 1998 Order* to specify that the intrastate Universal Service fund shall support educational discounts to schools and libraries through a specific fund within the overall intrastate Universal Service fund.[22]

On March 7, 2001, BellSouth and UTSE filed the requested information and data. On March 14, 2001, UTSE, BellSouth, AT&T, TCG MidSouth, Inc., and the Consumer Advocate and Protection Division of the Office of the Attorney General and Reporter ("Consumer

16 *See id.* at 8.
17 *See id.* at 13.
18 *See id.*
19 *See id.*
20 *See id.* at 7.
21 *See id.* at 9.
22 *See id.* at 12.

Advocate") filed briefs addressing the issues raised by the Authority at the February 21, 2001 Authority Conference. On March 28, 2001, BellSouth filed reply comments.

On April 3, 2001, the Pre-Hearing Officer convened a Pre-Hearing Conference to set a procedural schedule and define the issues for resolution by the Authority. After attending to some preliminary matters, the Pre-Hearing Officer turned to the issues the Authority had requested the parties brief. The Pre-Hearing Officer informed the parties that the Authority would address the following issues: 1) whether support received from the federal CALLS Plan should be included in the intrastate Universal Service fund; 2) whether the intrastate portion of TRC cost should be provided by the intrastate Universal Service fund at this time; 3) whether the intrastate Universal Service fund should support the acceleration of advance services; 4) whether the intrastate Universal Service fund should support secondary residential lines; and 5) what is the necessary support for Lifeline and educational discounts funding in light of the information provided by the parties as a result of the February 21, 2001 directive.[23] In addition, the Pre-Hearing Officer instructed the parties that the Directors would initiate Phase III by determining whether rate rebalancing should be based on the gross receipts of carriers or the net financial impact.[24]

On April 16, 2001, MCI WorldCom Communications, Inc. ("WorldCom"), XO Tennessee, Inc. ("XO"), and Time Warner Telecom of the Mid-South, LP ("Time Warner") filed a *Motion to Accept Late Filed Comments*. In the motion, the parties requested that the Authority consider their comments on the issues raised during the February 21, 2001 Authority

[23] *See Order Setting Procedural Schedule and Defining Issues for May 1, 2001 Authority Conference*, p. 5 (Apr. 30, 2001).
[24] *See id.*

Conference. On April 20, 2001, the Authority issued a *Notice Regarding Late-Filed Comments* stating that the Authority would place the comments in the official record.

II. Findings and Conclusions

At the May 15, 2001 Authority Conference, the Directors considered the issues articulated by the Pre-Hearing Officer during the April 3, 2001 Pre-Hearing Conference.

A. Inclusion of Support from the Federal CALLS Plan

The first issue addressed by the Authority during the May 15, 2001 Authority Conference was whether the Authority should include support received from the federal CALLS Plan in the intrastate Universal Service fund. The Authority had previously ordered that "the minimum amount of universal service support necessary for the high-cost areas is to be determined by summing the amounts by which costs exceed the revenue benchmark in all high-cost wire centers, then subtracting the amount of federal support."[25] In conjunction with this ruling, BellSouth and UTSE reduced their respective intrastate Universal Service fund contributions by the amount of interstate access support realized for their high-cost wire centers. Having taken into consideration the increases in subscriber line charges and decreases in access charges, the Authority must consider support received from the federal CALLS plan for high-cost wire centers in Tennessee. Thus, the Directors voted unanimously to include the amount of interstate access support received from the federal CALLS plan for high-cost wire centers in Tennessee in calculating the revenue benchmarks of BellSouth and UTSE. Specifically, the Directors agreed that BellSouth and UTSE should add the support received per line in each wire center to the previous revenue benchmark calculations.

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[25] *September 16, 1999 Order*, p. 8.

B. Funding for the Tennessee Relay Center ("TRC")

The Authority next considered funding for the TRC. To aid in achieving competitive neutrality between telecommunications service providers regardless of their size or service area, the Directors voted unanimously to include funding for the TRC in the intrastate Universal Service fund. They specified that the amount of support for the TRC shall be the annual contract amount as established by the provider of the TRC.

C. Funding for Lifeline and Educational Discounts

The Authority then turned to the matter of funding for Lifeline and educational discounts. In an Order entered November 7, 1997, the Authority affirmed the amount of intrastate Lifeline support in order to obtain the maximum federal support.[26] In the *May 20, 1998 Order*, the Authority determined that Lifeline shall be "funded though a separate, specific fund within the intrastate [Universal Service fund]."[27] The Authority also held in the *May 20, 1998 Order* that the intrastate Universal Service fund would provide support to carriers offering discounted telephone services to schools and libraries.[28] The Directors subsequently decided to obtain the information necessary to calculate the appropriate level of support for these services and, therefore, ordered BellSouth and UTSE to file schedules showing the amount of support needed to fund their respective intrastate Lifeline programs and their existing intrastate educational discounts.[29]

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[26] *See Order Establishing Procedures for Lifeline Consents Pursuant to Section 214(e) of the Telecommunications Act of 1996 and FCC Order 97-157*, p. 3 (November 7, 1997).
[27] *May 20, 1998 Order*, p. 13.
[28] *See id.* at 46-47.
[29] *See Second Interim Order on Phase II*, p. 13 (May 22, 2001).

BellSouth and UTSE filed such schedules on March 7, 2001. No party disputed the figures contained in the schedules. Thus, the Directors voted unanimously to adopt the figures filed by BellSouth and UTSE on March 7, 2001, relative to Lifeline and educational discounts.

D. Support for Secondary Lines

The Authority then considered whether support for secondary lines should be included in the intrastate Universal Service fund. The goal of the intrastate Universal Service fund is, in part, to maintain "residential basic local exchange service at affordable rates."[30] In addition, pursuant to Tenn. Code Ann. § 65-5-207(c), the intrastate Universal Service fund should operate to "prevent the unwarranted subsidization of any telecommunication service provider's rates by consumers or by another telecommunications service provider."[31] The Authority found that secondary lines should not be included within the goal of the intrastate Universal Service fund at this time. The subsidization of this service would burden users of unsupported telecommunications services with increased subsidy payments only to provide low-priced second telephone lines to households that already purchase telephone service. These increased payments could threaten Universal Service in unsupported areas without significantly promoting Universal Service in the supported areas. Thus, at this time, the subsidization of secondary lines is unwarranted for the purpose of maintaining Universal Service statewide and is prohibited by Tenn. Code Ann. § 65-5-207(c). The Authority also found that inclusion of secondary lines would unnecessarily increase the size of the fund, particularly in light of the Authority's efforts to encourage the development of line sharing technology. Based on these findings, a majority of

[30] Tenn. Code Ann. § 65-5-207(a) (Supp. 2000).
[31] *Id.* § 65-5-207(c).

the Directors determined that the intrastate Universal Service fund should not include support for secondary lines.[32]

E. Support for Advanced Services

The Directors next deliberated whether the intrastate Universal Services fund should be used to expand the deployment of advanced services.[33] AT&T, UTSE, BellSouth, WorldCom, XO, and Time Warner expressed disapproval of such expansion, while the Consumer Advocate maintained that 47 U.S.C. § 254(b)(2) supports the inclusion of advanced services in the intrastate Universal Services fund. Upon consideration of these comments and in light of pending FCC action on this issue, the Directors voted unanimously to exclude advanced services from the intrastate Universal Service fund at this time.

F. Rebalancing Methodology

The Authority voted unanimously to defer this matter, but instructed BellSouth and UTSE to refile their respective benchmark calculations consistent with the aforementioned decisions. The Authority also ordered BellSouth to file schedules showing their calculation of the high-cost portion of the fund by wire center no later than May 29, 2001.

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[32] Director Malone did not vote with the majority.

[33] The Act defines advanced services or advanced telecommunications capability as "high speed, switched broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, telecommunications using any technology." Pub. L. No. 104-104, Title VII, § 706(c), 110 Stat. 153 (1996) (reproduced in the notes under 47 U.S.C. § 157).

IT IS THEREFORE ORDERED THAT:

1. The amount of interstate access support resulting from the federal CALLS plan for high-cost wire centers in Tennessee shall be included in calculating the revenue benchmarks of BellSouth Telecommunications, Inc. and United Telephone-Southeast, Inc., and the support received per line in each high-cost wire center shall be added to their previous revenue benchmark calculations.

2. Funding for the Tennessee Relay Center shall be included in the intrastate Universal Service fund. The amount of support for the Tennessee Relay Center shall be the annual contract amount as established by the provider of the Tennessee Relay Center.

3. The amount of support necessary to fund Lifeline and educational discounts, as shown in the schedules filed by BellSouth Telecommunications, Inc. and United Telephone-Southeast, Inc. on March 7, 2001, are adopted.

4. Support for secondary lines shall not be included in the intrastate Universal Service fund at this time.

5. Support for advanced services shall not be included in the intrastate Universal Service fund at this time.

6. The issue of whether rate rebalancing should be based on the gross receipts of carriers or the net financial impact is deferred.

7. BellSouth Telecommunications, Inc. and United Telephone-Southeast, Inc. are ordered to refile their respective benchmark calculations consistent with the above stated decisions. BellSouth Telecommunications, Inc. is further ordered to file schedules showing its calculation of the high-cost portion of the fund by wire center. All filings shall be filed with the Authority **no later than Friday, May 29, 2001**.

8. Any party aggrieved with the Authority's decisions in this matter may file a Petition for Reconsideration with the Tennessee Regulatory Authority within fifteen (15) days from and after the date of this Order.

Sara Kyle, Chairman

H. Lynn Greer, Jr., Director

Melvin J. Malone, Director[34]

ATTEST:

K. David Waddell, Executive Secretary

[34] Director Malone did not vote to exclude support for secondary lines from the intrastate Universal Service fund.

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DISSENTING OPINION OF DIRECTOR MALONE IN THE THIRD INTERIM ORDER ON PHASE II AND FIRST INTERIM ORDER ON PHASE III ON THE ISSUE OF WHETHER TO INCLUDE SUPPORT FOR SECONDARY LINES IN THE INTRASTATE UNIVERSAL SERVICE FUND

After having initially voted with my colleagues to withhold intrastate universal service fund support for secondary residential lines[1], I am now, however, persuaded that such decision potentially endangers a regulatory symmetry necessary to further the dual goal of universal service and the development of competition, for residential service in particular. Accordingly, for the foregoing reasons, I must respectfully dissent on the issue of whether support for secondary lines should be included in the intrastate Universal Service Fund.

The Authority, in adopting a standard established by the federal Telecommunications Act of 1996, supported its February 3, 1998, decision to deny support for secondary lines based on the determination that penetration levels for secondary lines was not yet sufficiently invasive to warrant intrastate universal service support.[2] Although there then existed an intricacy of policy

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[1] *See Interim Order on Phase I of Universal Service*, TRA Docket No. 97-00888, p. 12 (May 20, 1998). The decisions memorialized in the May 20, 1998, Order were deliberated on February 3, 1998.

[2] *Id.* It is noteworthy, however, that the non-rural incumbent providers' current penetration level for secondary lines, currently at approximately 13%, is significantly greater than the current penetration level for any type of residential service provided by all Competitive Local Exchange Carriers combined, currently at approximately 2%, as reported

concerns underlying each universal service issue, that decision, nestled amongst approximately 51 other universal service decisions deliberated that day, to exclude secondary lines from receiving universal service support was, in my opinion, the optimal decision that could be made at that time.

In the ensuing twenty-eight (28) month period, beginning from the time of the Authority's February 3, 1998, decisions up until today, a definitive pattern of competitive development and a precise determination as to the eventual degree to which competitive infiltration becomes ensconced in Tennessee remain largely a tactical puzzle that is yet unsettled. It is within the Authority's ability, and is most certainly part of its duty, to cause or be caused, with strategic policy planning and action, if necessary, a solution to the puzzle that promotes competition and universal service while avoiding irreparable harm to either. Consequently, based on the seemingly undeniable dynamic that exists between competitive crusades and intrastate universal service fund effectiveness, the Authority undertook reconsideration of certain issues. It is my opinion, that foremost amongst the complexities visited during reconsideration is the Authority's unenviable dilemma of resolving the paradox between two (2) seemingly conflicting policy objectives: the promotion and attainment of competition in Tennessee for both residential and business customers and the maintenance and possible enrichment of universal service objectives.

While it may be true, as noted by the majority, that support for secondary lines increases subsidy payments, consideration must not begin and end without also addressing, in some manner, the potential consequences, including cost, of not funding secondary lines. In fact, the withholding of support for secondary lines results, in my opinion, in two major consequences. First, withholding support results in a net *decrease* in residential lines that received universal

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in the *Tennessee Regulatory Authority's Report on The Status of Telecommunications in Tennessee, 1999-2000*, p. 7 (May 2001) ("TRA Report").

service support prior to the enactment of Tennessee's Telecommunications Act of 1995 rather than a maintenance of such lines statewide.[3]

Prior to the passage of Tennessee's Telecommunications Act, *all* residential lines where the costs of providing the line were in excess of revenues generated from the line received subsidy support.[4] Keeping in mind that only *high cost* secondary lines are under consideration here, the majority's ruling has the effect of again submerging the subsidies associated with these lines and placing 100% of the support burden for these lines with the incumbent provider. Although not supported in this docket, this forced subsidy may also represent a financial disadvantage that threatens Universal Service in unsupported areas, but is, however, a disadvantage that has, without adequate reasoning, been served upon the incumbent.[5] There may exist compelling policy reasons, that I could possibly support, to require continuing asymmetrical funding of high cost residential service, but none, however, were given here.[6]

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[3] *See Third Interim Order on Phase II and First Interim Order on Phase III*, TRA Docket No. 97-00888, p. 8 (July 20, 2001).

[4] Prior to the passage of Tennessee's Telecommunications Act of 1995, residential service rates were set to affect, among other things, maximum penetration levels in the state. The resulting price points then established, through rate design, were ostensibly selected to accomplish the state's social policy objective of providing affordable service for every residential line without regard to individual income or the number of lines to which any one household subscribed. Since incumbents' rates were then set to recover overall costs, cost studies for individual services were generally not required, nor produced. The Authority has since concluded, based on the criteria established in this docket, that certain *existing* residential services produce revenues in excess of cost and certain others do not. It is also worth noting that the gradual introduction over the years of revenue enhancing services offered to residential customers that likely resulted in an increase in average revenues per residential line did not, prior to the enactment of Tennessee's Telecommunications Act of 1995, diminish the policy objective of maintaining affordable rates for *all* residential lines in Tennessee.

[5] Since the continuing exclusion of secondary residential lines from the definition of Universal Service does not in any manner alter their basic service designation, state statutory restrictions on potential rate rebalancing for these services are unlikely to produce revenues sufficiently high enough to eliminate the necessity for continuing support.

[6] The position that the development of line sharing technology somehow lessens the importance of the consideration of secondary lines in the fund at this time is unpersuasive. First, because there has not been any correlation established, in this docket, between the demand for advanced services and the demand for voice grade secondary lines. In fact, no evidence was presented identifying what percentage of secondary lines are subscribed to by those who would select an advanced service option, such as broadband. The fact of the matter is the agency is largely unaware of why secondary lines are chosen – teenagers, price, reliability, etc . . . The irony is that broadband capability over line sharing technology *is* available *today*, yet secondary line subscribers have chosen, for whatever reason, to forego subscriptions.

Second, very simply stated, failure to fund secondary lines all but ensures that competition for that segment of the residential market will not likely develop. It is highly unlikely, in my opinion, that a rational competitor would serve a two-line residential customer in a high cost wire center, but yet only be assured cost recovery on one line. In short, this decision on secondary lines may, unintentionally, seal the fate for competitive development in these wire centers where there exists two-line households. Given the anemic development of competitive residential alternatives to date, the residential environment can ill-afford decisions that further discourage competitive entry.[7] Perhaps competitors will eventually migrate to the less lucrative residential arena, but after five (5) years of varying levels of competitive activity in Tennessee, that goal, absent policy-driven incentives, is unlikely.

Respectfully submitted,

DIRECTOR MELVIN MALONE

ATTEST:

David Waddell, Executive Secretary

[7] According to the TRA, "the State's nineteen (19) incumbent telephone companies provide service to 92% of the 3.7 million telephone lines in Tennessee." *TRA Report*, p.5. The report provides that, as of December 31, 2000, competing providers serve only 2% of the State's residential customers in non-rural areas. *TRA Report*, p. 7.