

PROJECT NO. 24526

RULEMAKING TO AMEND USF	§	PUBLIC UTILITY COMMISSION
RULES REGARDING UNBUNDLED	§	
NETWORK ELEMENT SHARING	§	OF TEXAS
MECHANISM	§	

ORDER ADOPTING AMENDMENTS TO §26.403 AS APPROVED AT THE JULY 11, 2002, OPEN MEETING

The Public Utility Commission of Texas (commission) adopts amendments to §26.403, relating to the Texas High Cost Universal Service Plan (THCUSP) with no changes to the proposed text as published in the February 8, 2002 *Texas Register* (27 TexReg 851). These amendments concern the adjustment for basic local telecommunications service provided solely and partially through the purchase of unbundled network elements (UNEs). The amendments to §26.403(e)(3)(C)(i) and (ii) and new subsections (e)(3)(C)(iii) and (iv) are adopted under Project Number 24526.

The commission has the authority to approve procedures for the collection and disbursal of the revenue of the universal service fund (USF) under Public Utility Regulatory Act (PURA) §56.023(a)(5). The amendments implement part of Senate Bill 560 (SB 560), which was passed in 1999 (1999 Texas General Laws 4210). In SB 560, the legislature enacted Public Utility Regulatory Act (PURA) §56.026 to ensure that eligible telecommunications providers (ETPs) receive prompt and efficient disbursement for provisioning basic local telecommunications services in rural areas from the Texas Universal Service Fund (TUSF). Specifically, under PURA §56.026(c)(2), the legislature granted the commission the authority to

reduce an electing company's amount of TUSF disbursement if its local end-use customer switches to another local service provider that serves the customers solely or partially through the use of UNEs provided by the electing company only if the commission establishes an equitable allocation formula for the disbursement.

In the Final Order issued on January 14, 2000 in Docket Number 18515, *Compliance Proceeding for Implementation of the Texas High Cost Universal Service Proceeding (High Cost Proceeding)*, the commission implemented the THCUSP portion of the TUSF to establish financial assistance for ETPs that serve high cost areas in the state and to ensure that customers in high cost areas receive basic local telecommunication service at reasonable rates. The THCUSP provides a monthly, per-line support amount that is calculated by comparing the difference between the forward-looking economic cost (FLEC) amount of provisioning service in high cost rural areas and the revenue benchmark. The commission determined that a monthly, per-line support amount is available if the FLEC amount exceeds the revenue benchmark. In the *High Cost Proceeding*, the commission established an equitable allocation formula pursuant to PURA §56.026(c)(2) for the disbursement of monthly, per-line THCUSP support. After notice and comments from interested parties in Project Number 21163, *Rulemaking to Amend the Texas Universal Service Fund Rules to Comply with SB 560*, the commission adopted this allocation formula as Substantive Rule §26.403(e)(3)(C) of this title (relating to Texas High Cost Universal Service Plan (THCUSP)).

The current allocation formula provides an adjustment for the disbursement of monthly, per-line THCUSP support to ETP-competitive local exchange carriers (CLECs) that are provisioning basic local telecommunications service solely or partially through the purchase of UNEs. The current allocation formula determines the amount of monthly, per-line THCUSP support based on the following variables: (1) the USF cost figure derived from the Hatfield Associates, Inc. (HAI) model; (2) UNE rate based on a total long run incremental cost (TELRIC) model, (3) retail cost additive; and (4) revenue benchmark.

The retail cost additive represents the additional cost of retailing basic local telecommunications service to the end-use customer. The retail cost additive is derived by multiplying the incumbent local exchange carrier (ILEC)-specific wholesale discount percentage by the appropriate revenue benchmark. The commission established a retail cost additive of \$8.21 per month for residential customers and \$11.23 per month for business customers in the Final Order in the *High Cost Proceeding*.

The revenue benchmark represents the average amount of revenue that a basic local telecommunications service provider should receive from an end-use customer for basic and discretionary local telecommunications services and a reasonable portion of toll and access services. The commission established a \$38 residential statewide revenue benchmark and a \$52 single-line business statewide average revenue benchmark in the Final Order in the *High Cost Proceeding*.

In the cases where an ETP-CLEC provides service solely through UNEs, the current allocation formula addresses three scenarios for the allocation of THCUSP support. First, if the sum of the UNE rate and retail cost additive (UNE rate + R) exceed the revenue benchmark, the ILEC would receive the difference between the USF cost and the sum of the UNE rate and retail cost additive (UNE rate + R). The ETP-CLEC would then receive the difference between the sum of the UNE rate and retail cost additive (UNE rate + R) and the revenue benchmark. The commission found that splitting the THCUSP support in this manner would allow both the ILEC and ETP-CLEC to recover, on average, the costs of serving the end-use customer at rates consistent with the revenue benchmark. In addition, the commission found that the ILEC, as the carrier of last resort (COLR), would be in the same position whether it directly serves the average end-use customer and or indirectly serves the end-use customer through the sale of UNEs to a competing ETP. Secondly, if the revenue benchmark exceeds the sum of the UNE rate and retail cost additive (UNE rate + R), the ILEC would receive the difference between the USF cost and the revenue benchmark. The commission found that this allocation of THCUSP support would diminish the undue incentive for the ETP-CLEC to provide service through UNE resale and lessen the economic harm done to the ILEC. Thirdly, if the sum of the UNE rate and retail cost additive (UNE rate + R) exceeds the USF cost and revenue benchmark, the ETP-CLEC would receive the difference between the USF cost and the revenue benchmark.

If an ETP-CLEC provides service partially through UNEs, the current allocation formula divides the THCUSP support between the ETP-CLEC and the ILEC based on the percentage of total per-line costs that are self-provisioned by the ETP-CLEC. The commission found that the cost-category percentages for each wire center would be derived by adding the retail cost additive and the USF costs for the loop, line port, end-office usage, signaling, and transport.

Adopted changes to §26.403(e)(3)(C)

In the current proceeding, the commission adopts the proposed amendments to §26.403(e)(3)(C)(i) and (ii) and the proposed addition of clauses (iii) and (iv). The commission adopts amendments to §26.403 to establish a more equitable formula for the disbursement of THCUSP support to ETP-CLECs that are provisioning basic local telecommunications service solely and partially through the purchase of UNEs in high cost areas. The commission adopts these amendments to ensure that customers in high cost rural areas receive basic local telecommunications service at reasonable rates as required under PURA §56.021. The commission finds that the adopted amendments establish an equitable allocation formula that meets the requirements under PURA §56.026(c)(2). The commission further finds that the adopted amendments establish a competitively-neutral mechanism that is consistent with the stated purposes of the TUSF, set forth in PURA §56.021 and §26.401(a) of this title (relating to Texas Universal Service Fund (TUSF)).

§26.403(e)(3)(C)(i)

The commission adopts amendments to §26.403(e)(3)(C)(i) to provide an equitable allocation of THCUSP support in circumstances where the ETP-CLEC is provisioning service in high cost rural areas solely through UNEs. The commission finds that the adopted amendments to §26.403(e)(3)(C)(i) appropriately provide the ETP-CLEC that wins a customer from the underlying ILEC with the lesser of the available THCUSP support or the amount of the appropriate retail cost additive. The adopted amendments recognize that the underlying ILEC (the wholesaler), does not incur retailing costs when it provides UNEs to an ETP-CLEC (the retailer), which ultimately serves the end-use customer. The commission finds that an inherent avoided retail cost exists when the underlying ILEC assumes the role of the wholesaler providing UNEs to the ETP-CLEC. Therefore, if the retail additive is less than the available THCUSP support, the commission finds that the retail additive shall be distributed to the ETP-CLEC that wins the customer and, thus, incurs the additional costs of providing retail service to the end-use customer. The commission finds that allocating the THCUSP support in this manner would result in an equitable allocation of THCUSP support as required under PURA §56.026(c)(2). The commission finds that the adopted amendments are consistent with the FCC's goal of USF portability, which enables the carrier that wins the customer to be the recipient of a reasonable share of USF support while allowing the underlying ILEC to recover its costs.

§26.403(e)(3)(C)(ii)

The commission adopts amendments to §26.403(e)(3)(C)(ii) to provide an equitable allocation of THCUSP support if the ETP-CLEC is provisioning service in high cost rural areas partially through UNEs. The commission finds the adopted amendments to §26.403(e)(3)(C)(ii) appropriately provide the lesser of the available THCUSP support or the amount of the appropriate retail cost additive to the ETP-CLEC that wins the customer. In addition, the adopted amendments also provide an ETP-CLEC with a pro rata share of THCUSP support in excess of the retail cost additive. Specifically, the commission finds the adopted amendments appropriately afford an ETP-CLEC with THCUSP support relative to the percentage of the UNEs that it self-provisions. The adopted amendments provide that the THCUSP support shared between the ETP-CLEC and the underlying ILEC is based on a percentage of the total per-line cost that is self-provisioned by the ETP-CLEC. The commission finds that the adopted amendments take into account the UNE costs for each wire center, which are based on the HAI model costs for the loop, line port, end-office usage, signaling, and transport.

§26.403(e)(3)(C)(iii)

The commission adopts new §26.403(e)(3)(C)(iii) to provide an equitable allocation of THCUSP support to the underlying ILEC that provides UNEs to the ETP-CLEC, which is provisioning service solely or partially through UNEs in high cost rural areas. The commission

finds that adopted subsection (e)(3)(C)(iii) appropriately provide the underlying ILEC with the difference, if any, between the total available THCUSP support and the THCUSP support amount allocated to the ETP-CLEC serving the end-use customer. The commission finds that the adopted amendments shall make the underlying ILEC, as the COLR, indifferent between directly serving the average end-use customer and indirectly serving the end-use customer through the sale of UNEs to a competing ETP.

§26.403(e)(3)(C)(iv) Retail Cost Additive

The commission adopts new §26.403(e)(3)(C)(iv) to define the retail cost additive. The commission finds that adopted subsection (e)(3)(C)(iv) appropriately provides that the retail cost additive shall be derived by multiplying the ILEC-specific wholesale discount percentage by the appropriate residential or business revenue benchmark. The commission points out that this calculation of the retail cost additive was deemed reasonable in the *High Cost Proceeding*. The commission notes that the retail cost additive shall function as a cap on the THCUSP support provided to ETP-CLECs that provide basic local service solely or partially through UNEs.

The commission received written comments on the proposed amendments from the following parties: AT&T Communications of Texas (AT&T); Southwestern Bell Telephone Company (SWBT); Verizon Southwest (Verizon); WorldCom, Inc. (WCOM); Sage Telecom of Texas,

LP (Sage); State of Texas (State); VarTec Telecom, Inc. (Vartec); Office of Public Utility Counsel (OPC); and United Telephone Company of Texas, Inc., Central Telephone Company of Texas, and Sprint Communications Company, LP (collectively Sprint). Reply comments were received from AT&T, SWBT, WCOM, Verizon, Sage, and the State.

No public hearing was requested by the parties.

Only one party provided specific language changes to the proposed rule as published in the February 8, 2002 *Texas Register* (27 TexReg 851). Parties commented on general and specific legal and policy reasons why the proposed sections should or should not be adopted by the commission. Parties also responded to the specific question asked in the publication preamble and Sage and AT&T provided alternative proposals in their comments.

Parties' comments:

The commission's notice provided a "brief explanation" of the proposed rule.

SWBT asserted that the commission did not include a brief explanation of the specific proposed amendments in the notice for proposed change as required by the Administrative Procedure Act (APA), Texas Government Code Annotated §2001.024(a)(1).

The commission provided a legally sufficient explanation of the proposed rule. In the Proposal for Publication published in the *Texas Register* on February 8, 2002, the commission provided an explanation of the proposed rule change, as follows:

"The Public Utility Commission of Texas (commission) proposes amendments to §26.403, relating to the Texas High Cost Universal Service Plan (THCUSP), as it concerns the adjustment for basic local telecommunications service provided solely and partially through the purchase of unbundled network elements (UNEs). In 1999, as part of Senate Bill 560 (SB 560), the legislature enacted Public Utility Regulatory Act (PURA) §56.026 to ensure that eligible telecommunications providers (ETPs) receive prompt and efficient disbursement for provisioning basic local telecommunications services in rural areas from the universal service fund (USF). Specifically, under PURA §56.026(c)(2), the legislature granted the commission the authority to reduce an electing company's amount of disbursement if its local end-user customer switches to another local service provider that serves the customers solely or partially through the use of UNEs provided by the electing company. The commission is required to establish an equitable allocation formula for this disbursement. Accordingly, the commission initiates this rulemaking proceeding to establish an equitable formula to ensure that all residents within the state have access to affordable basic local telecommunications service. The proposed amendments are comprised of substantive revisions to §26.403(e)(3)(C)."

The commission notes that this notice followed two previous notices that described the nature of the proposed rule change. In the October 12, 2001 *Texas Register* (26 TexReg 8241), the commission published a public notice of a workshop to be held to consider "amendments to the universal service fund (USF) rules regarding the unbundled network element (UNE) sharing mechanism." In the November 16, 2001 *Texas Register* (26 TexReg 9455), the commission published a public notice of an additional workshop that quoted the language quoted in the previous notice. Therefore, the commission finds that SWBT's concerns are without merit.

The commission's notice provided "reasoned justification" for the rule.

OPC contended that an agency rule must be supported by reasoned justification to be valid under the APA §2001.035. OPC asserted that the notice for proposed rulemaking did not contain an explanation of why the current rule needed to be amended.

The commission observes that **APA** §2001.035 derives its "reasoned justification" requirement from §2001.033(a)(1), which applies to a "State Agency Order Adopting Rule" and not to a rulemaking notice or public comments. The commission's "reasoned justification" is, therefore, provided in this order adopting amendments to the rule.

The commission has the authority to amend §26.403(e)(3)(C).

SWBT contended that the commission has already determined in the *High Cost Proceeding* that the current formula is appropriate, competitively neutral, equitable, and necessary to reduce undue incentives for uneconomic market entry in various proceedings. SWBT maintained that the commission cannot disregard or overturn these prior determinations absent a demonstration that there has been a change in circumstances sufficient to warrant their re-examination. SWBT asserted that the Proposal for Publication did not include any allegations that changed circumstances warrant the modification of the current allocation formula adopted in the Final Order in the *High Cost Proceeding*. SWBT argued that a commission decision in a contested case is final if a motion for rehearing is not timely filed on the expiration of the period for filing a motion for rehearing, as required under APA §2001.144 for a contested case proceeding. SWBT claimed that the commission cannot modify an order after it is administratively final, except as authorized by PURA. SWBT alleged that such an action would constitute an unlawful collateral attack.

In its reply comments, SWBT claimed that AT&T unequivocally represented to the commission in Project Number 20428, *Texas Universal Service Fund Rulemaking*, that if AT&T had any problem with the allocation formula adopted in the Final Order in the *High Cost Proceeding*, it would raise the issue in a motion for rehearing in that proceeding. SWBT pointed out that AT&T only contested the issue regarding the flow-through of access charge reductions by interexchange carriers (IXCs) in its motion for rehearing in the USF proceeding. SWBT argued that AT&T's failure to file such a motion for rehearing demonstrated that AT&T had no problem

with the existing allocation formula adopted by the commission in the *High Cost Proceeding*. SWBT claimed, therefore, that AT&T is launching an improper collateral attack on the commission's Final Order in the *High Cost Proceeding*, without providing the requisite evidence of changed circumstances.

SWBT further contended that AT&T was fully aware that the adopted formula would result in UNE-based CLECs being eligible for THCUSP support in only 16 exchanges out of 246 SWBT wire centers at the time motions for rehearing were due in the *High Cost Proceeding*. SWBT points out that the information was included in an attachment to a SWBT witness's testimony, as later confirmed in an AT&T brief, in the *High Cost Proceeding*. SWBT claimed that the commission was fully aware during the *High Cost Proceeding* that its allocation formula would result in ETP-CLECs receiving THCUSP support in only 16 of 246 eligible SWBT wire centers. In addition, SWBT maintained that the ban on excessive CLEC access rates under PURA §52.155 is not a changed circumstance, because it was enacted before the commission issued its Final Order in the *High Cost Proceeding*. SWBT also noted that §52.155 indicates that CLECs were not entitled to offset any switched access rate reductions with TUSF disbursements.

OPC asserted that its review of the parties' comments has not found proof of any changed circumstances since the promulgation of the current rule.

Sage argued that the commission has met the statutory provisions set forth in the APA relating to rulemaking proceedings. Sage asserted that the Government Code does not prohibit an agency from changing a rule that the agency deems to be no longer appropriate. Sage refuted SWBT and OPC's "changed circumstances" arguments by noting that the current proceeding is about the amendment of a rule regarding the current allocation formula, not the overturning of the Final Order in the *High Cost Proceeding*. Sage argued that the commission is exercising its authority under PURA §56.023(a)(5) and §56.026(c)(2) to review the current allocation formula in §26.403(e)(3)(C), and that such review is in conformity with the guidelines set forth in the APA §2001.033 and within the general objectives of PURA. Sage contended that the commission probably did not realize that the allocation formula in the *High Cost Proceeding* would result in ETP-CLECs being eligible for only a very small percentage of USF funds. Sage claimed that the commission also likely did not realize that the formula would discourage competition. Sage asserted that an additional "changed circumstance" was the adoption of §26.223 of this title (relating to Prohibition of Excessive COA/SPCOA Usage Sensitive Intrastate Switched Access Rates), which effectively required CLECs to reduce access charges to capped rates at or below that of the ILEC. Sage maintained that the commission has complete authority to review its rules and establish new and more appropriate rules as the facts dictate. Sage argued that the determination that the current allocation formula is valid does not prohibit the commission from developing a more equitable formula.

AT&T agreed with Sage's position. AT&T maintained that the current proceeding is a rulemaking proceeding, not a contested case proceeding.

In its reply comments, State disagreed with SWBT's argument relating to the commission's authority to change the rule in light of the Final Order in the *High Cost Proceeding*. State argued that the commission is amending its rules, not revisiting a prior contested case determination in the current proceeding. State noted that the rule amendment may indeed have some effects upon the perceived outcome of a previously settled or decided case. State argued, however, that these possible effects should not inhibit the ability of the commission to properly amend its rules within the established parameters of administrative procedure.

The commission finds that SWBT's references to the finality of a contested case order are misplaced, given that the current proceeding is a rulemaking proceeding to amend a rule that resulted from a prior rulemaking proceeding. Therefore, the commission finds no requirement to demonstrate "changed circumstances," as may be required before the commission revisits a Final Order in a prior contested case. The commission's action in the current proceeding is not the reconsideration of a Final Order from a prior contested case, but is instead the amendment of a rule, an action which is permitted by the APA. *See* Texas Government Code §2001.033(a)(1); Public Utility Regulatory Act, Texas Utilities Code Annotated §56.023(a)(5) and §56.026(c)(2).

The commission's consideration in the current rulemaking of the current allocation formula recognizes that the establishment of an equitable formula is a policy choice that may be improved by a legislative rulemaking process. The commission notes that it has re-visited the current allocation formula in two previous rulemaking proceedings. As noted by SWBT, the commission first revisited the support allocation formula in Project Number 21163. In Project Number 21163, the commission simply incorporated into §26.403 the same formula it determined on an ad hoc basis in the *High Cost Proceeding*. The commission again revisited the current allocation formula in Project Number 22472, *Rulemaking to Amend the Texas Universal Service Fund Rules*, but made no changes to the §26.403(e)(3)(C). It is noteworthy that SWBT failed to claim, in its comments in the two previous rulemaking proceedings, that the commission lacked authority to amend its prior determination in the *High Cost Proceeding* without a demonstration of "changed circumstances," even though possible revision of the current allocation formula was a major issue in Project Number 22472.

In light of the discussion above, the commission finds that it has the authority under PURA §56.023(a)(5) and §56.026(c)(2) to utilize APA rulemaking procedures to establish a more equitable allocation formula if warranted. The commission further finds that PURA §56.026(c)(2) does not require the demonstration of "changed circumstances" to justify a change to the current allocation formula in §26.403(e)(3)(C).

The commission finds that the demonstration of "changed circumstances" is not necessary in the current proceeding, because the current proceeding is an APA rulemaking proceeding. If, however, "changed circumstances" were required, the commission finds that the following constitute "changed circumstances:" as noted by Sage, the commission adopted §26.223, which effectively requires CLECs to reduce access charges to capped rates at or below that of the ILEC, after issuance of the commission's Final Order in *High Cost Proceeding*; the commission has developed a better understanding that CLECs have an opportunity to receive THCUSP support in only 16 of 246 eligible SWBT wire centers; and there is a smaller number of ETP-CLECs in high cost rural areas than anticipated, which has persuaded the commission that the current formula could be discouraging competition.

The commission finds that the IntraLATA toll and intrastate switched access rate reductions required in the *High Cost Proceeding* do not prohibit the modification of the current allocation formula. The commission points out that the ILEC's revenue-neutral, rate reductions required in the Final Order in the *High Cost Proceeding* were based on specific data for a specific time period, and that future circumstances, such as the inequitable disbursement of THCUSP support resulting from the discrepancy between the UNE cost and USF cost figures, could warrant an adjustment to the ILEC's THCUSP disbursement. Accordingly, the commission finds that the statutory flexibility in PURA §56.023(a)(5) and §56.026(c)(2) allows an ILEC's disbursement to be reduced if an equitable allocation formula is established. Moreover, the commission finds that SWBT's argument that AT&T may have agreed that ETP-CLECs would only receive

THCUSP support in only 16 of 246 SWBT wire centers is irrelevant. The commission finds that inequities resulting from the discrepancy between the USF cost and UNE cost figures is the central issue within the current rulemaking.

Preamble question

In addition to the general comments, the commission seeks comment on whether the proposed amendments to the UNE sharing mechanism in §26.403(e)(3)(C)(i)-(iv) are equitable. Specifically, are the proposed amendments competitively and technologically neutral?

Adequacy of current formula in §26.403(e)(3)(C)

SWBT argued that the commission should retain the existing formula. SWBT contended that the current rulemaking was initiated to modify the previously established allocation formula, which the commission has already determined to be equitable and in compliance with PURA §56.026(c)(2) in the *High Cost Proceeding*. SWBT argued that the proposed amendments would not comply with PURA §56.026(c)(2). Therefore, SWBT contended that the commission should not adopt the proposed amendments.

Sage disagreed with SWBT's position. Sage argued that all state agencies, including the commission, regularly change rules to achieve results that are more accurate and fair. Sage urged the commission to recognize that the current allocation formula no longer represents an equitable formula.

The commission finds that PURA §56.026(c)(2) grants it the authority to create a more equitable formula if warranted. The commission finds that it has the authority to reduce an electing company's TUSF disbursements if its local end-use customer switches to another local service provider that serves the customer solely or partially through the use of UNEs provided by the electing company under PURA §56.026(c)(2). The commission notes that what constitutes an equitable formula may change over time due to factors within the evolving basic local telecommunications market. Therefore, although the current allocation formula was deemed equitable in the *High Cost Proceeding*, the commission finds it has the authority to modify the current allocation formula in light of changes in the basic local telecommunications market.

SWBT contended that the commission determined that the current formula is competitively-neutral in that the ILEC, as the COLR, is indifferent between directly serving the average end-use customer and indirectly serving the end-use customer through the sale of the UNEs to a competitive ETP.

SWBT contended that, if the sum of UNE-Platform (UNE-P) rates and the retail cost additive (UNE rate + R) exceed the revenue benchmark, a UNE-based CLEC incurs high costs and is entitled to recover those high costs (*i.e.* the difference between these two costs and the revenue benchmark) from the TUSF. SWBT stated that the ILEC providing the UNE would then be entitled to receive any remaining high cost support to assist it in recovering the costs it incurred in providing and maintaining the underlying network facilities. SWBT claimed that the commission determined that splitting the USF support in this manner would allow both the ILEC and the ETP to recover, on average, the costs of serving the subscriber at rates consistent with the revenue benchmark in the *High Cost Proceeding*.

The commission finds that it is unable to determine, at this time, whether a UNE-based CLEC would break even by recovering the sum of the TELRIC-based, UNE rate and retail additive (UNE rate + R). Thus, the commission rejects SWBT's argument that UNE-based CLECs receive a built-in competitive advantage under the THCUSP.

AT&T asserted that the commission's current rule is inadequate because it allocates USF funds in an inequitable manner between ILECs and UNE-based CLECs. AT&T claimed that CLECs pay less than full cost in high cost exchanges. AT&T maintained that this UNE economics in rural Texas exchanges represents an impossible competitive situation because UNE rates are higher in more rural areas and CLECs must compete against significantly lower USF subsidized retail prices offered by SWBT in those areas. In addition, AT&T pointed out that the ILECs'

receipt of UNE rates from the UNE-based CLEC fully compensates the ILEC for its average forward-looking costs of the underlying network. Moreover, AT&T argued that SWBT incurs a statewide average cost of service equivalent to UNE rates, but receives the offsetting benefit of \$2.00 per month for every residential line in the state from the TUSF.

The commission notes that it is unable to determine, at this time, to what extent an ILEC's cost of provisioning service in high cost areas are recovered through TELRIC-based, UNE rates. AT&T's argument regarding the \$2.00 per month benefit SWBT receives for every residential line in the state does not directly result from the high cost lines in rural areas that constitute the fundamental premise of the TUSF, which is the central issue in the current rulemaking proceeding. Therefore, the commission finds that AT&T has not provided sufficient justification that an ILEC receives a windfall when it receives THCUSP support in addition to the UNE payment.

Sage disagreed with SWBT's argument that if the allocation of funding from the USF is decreased in any way, it will not be competitively-neutral. Sage contended that modifications to the existing rule should be made to create a competitively-neutral mechanism to share USF revenues.

Verizon claimed that the commission should maintain the current rule. Verizon argued that the commission has already engaged in a lengthy proceeding that considered many conflicting

proposals on the issues at stake in this project, and the resulting Final Order ensured the distribution of funds in a competitively-neutral manner.

Sprint asserted that no evidence was offered to prove that the current formula is not operating as intended.

The commission rejects SWBT and Verizon's position that the current formula in §26.403(e)(3)(C) should not be modified. The commission agrees with AT&T in that the differences between the UNE cost figures derived from a TELRIC model and the USF cost figures derived from the HAI model have resulted in inequitable TUSF disbursements under the current allocation formula. The commission has the authority to create a more equitable allocation formula under PURA §56.026(c)(2). The commission finds the adopted amendments to the current allocation formula are necessary for the creation of a competitively-neutral market in which a provider neither receives an unfair advantage or disadvantage over another provider based on THCUSP disbursements.

Allocation of THCUSP support in 246 SWBT high-cost wire centers

AT&T maintained that the current allocation formula leads to a competitive advantage for ILECs who, under the current allocation formula, receive the vast majority of USF support.

AT&T argued that CLECs would be eligible for TUSF support in only 16 out of 246 SWBT

exchanges. AT&T stated that SWBT's 246 exchanges include 878,000 residential and business lines. AT&T asserted that this result, which demonstrates the *de minimis* number of exchanges (and lines) for which UNE-based CLECs could receive USF support, was not part of the evidentiary record in the *High Cost Proceeding*. Moreover, AT&T pointed out that such an allocation forces CLECs to pursue facilities-based market entry. AT&T claimed that such a result has been a SWBT goal since before the Federal Communications Commission (FCC) preempted the Certificate of Operating Authority (COA) build-out requirements in PURA 95.

AT&T argued that paying average UNE rates means that they are, in fact, paying high costs. AT&T contended that UNE-based CLECs serving customers in SWBT's area pay the full TELRIC cost incurred by SWBT averaged across each zone. AT&T pointed out that SWBT's reference to a \$16.50 UNE-P rate in high cost areas is misleading. AT&T asserted that the lowest priced UNE-P cost is \$19.80.

SWBT contended that AT&T was fully aware that the adopted formula would result in UNE-based CLECs being eligible for high cost support in only 16 exchanges out of 246 SWBT wire centers at the time motions for rehearing were due in the *High Cost Proceeding*.

SWBT asserted that the fact that UNE-based CLECs are eligible for high cost support in relatively few wire centers is due solely to the low UNE rates that have been set for SWBT by

the commission; therefore, UNE-based CLECs do not need high cost support in order to compete in Texas. SWBT argued that the proposed amendments would provide extensive THCUSP support to CLECs in hundreds of high cost areas in which they do not incur high costs as defined by the commission.

SWBT pointed out that no carrier recovers its total costs via UNE-based pricing. SWBT claimed that a carrier only recovers its TELRIC costs, which are far less than its actual, total costs. Moreover, SWBT asserted that Sage demonstrates that UNE-based CLECs can profitably serve customers in high cost rural areas of Texas. SWBT maintained that the current allocation formula was initially proposed in the TUSF rules for publication in Project Number 14929, *Review of Universal Service Fund Pursuant to PURA 1995 (TUSF Restructuring Rulemaking Proceeding)*, in August 1997, which arose long before the *High Cost Proceeding*. In the *TUSF Restructuring Rulemaking Proceeding*, the commission adopted new rules to expand and restructure the TUSF in accordance with PURA Chapter 56, Federal Telecommunications Act (FTA) §251(b), and the FCC's order, *In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45*. The new rules replaced the commission's former universal service rules and complement the federal universal service rules.

Sage stated that under the current allocation formula UNE-P providers only qualify for a small percentage of available USF funds. Sage contended that CLEC ETPs can only qualify for funding in 16 of approximately 250 SWBT exchanges. Sage contended that it was highly

unlikely that the commission, and indeed many of the parties, realized that the current allocation would result in ETP-CLECs being eligible for an extremely small percentage of available USF funds. Sage asserted that the ILEC is clearly favored under the current formula.

The commission finds that the number of wire centers in which UNE-based CLECs are eligible to obtain THCUSP support is not necessarily determinative of the overall fairness of the current allocation formula. The commission agrees with AT&T in that the discrepancy between the UNE cost and USF cost figures that result in the current allocation of THCUSP disbursements is the main issue in the current rulemaking proceeding. The commission finds that there is insufficient information to determine whether UNE rates in high cost, rural areas justify an ETP-CLEC's receipt of THCUSP support. In addition, the commission finds that it has not been shown to what extent an ILEC recovers its actual, total costs through TELRIC-based, UNE rates paid by ETP-CLECs. The commission points out that the real issue in the current proceeding is the establishment of an equitable allocation formula. The commission notes that two varying models were utilized to obtain the USF cost figures and UNE cost figures. The commission finds that the adopted amendments are intended to reconcile the discrepancies between the two varying models to create an equitable allocation formula.

Modification of current formula to increase competition in high-cost rural areas

SWBT contended that the current allocation formula should not be modified to "jump-start" competition in rural Texas. SWBT argued that the proposed amendments result in a competitively, non-neutral device that provides an unfair competitive advantage to a selected group of providers. SWBT claimed that the commission should address any goals to further increase competition in proceedings brought under FTA §251 and §252. SWBT points out that the goals of universal service are set forth in §254 of the FTA. SWBT asserted that the FTA mandates that states may not adopt universal service regulations that are inconsistent with the federal universal service program, which is supposed to be competitively neutral. In addition, SWBT pointed out that the available data shows that UNE competition has been developing steadily and rapidly in rural Texas under the current formula. SWBT claimed that UNE-based CLECs already serve approximately 17% of the lines in SWBT's territory, or approximately 160,000 customers. SWBT alleged that the number of lines served by UNE-based CLECs in SWBT's territory has demonstrated a 533% increase since the implementation of the TUSF.

Sage argued that, while the purpose of USF rules may not be to encourage competition, it is important that the rules do not discourage competition. Sage pointed out that it is seeking modification of the existing rule to create a competitively-neutral mechanism to share USF revenues. Sage argued that the current rule discourages rural and residential competition for CLECs in that ETP-CLECs only qualify for an extremely small percentage of USF funds.

The commission disagrees with SWBT's position that the commission is seeking to increase competition with the modification of the current allocation formula in §26.403(e)(3)(C). The commission notes that, while the TUSF is not designed to increase competition, the allocation formula for the disbursement of THCUSP support should not discourage competition. The commission points out that it intends to promote the universal service principle of competitive-neutrality that has been adopted at both the federal and state level. The commission notes that it establishing a competitively-neutral mechanism in which a provider neither receives an unfair advantage or disadvantage in the allocation of THCUSP support. Therefore, the commission finds that the modification of the current allocation formula is consistent with the fundamental premise of the TUSF outlined in PURA §56.021 and §26.401(a) of this title.

IntraLATA toll and intrastate switched access rate reductions in the high cost proceeding

SWBT stated that ILECs that chose to participate in the THCUSP were required to implement substantial rate reductions equal to the amount they receive from the TUSF as required under §26.417(c)(2)(A) of this title (relating to Designation as Eligible Telecommunications Providers to Receive Texas Universal Service Funds [USF]). SWBT maintained this revenue-neutral rate reduction prevents any windfall, double recovery, or over-recovery by an ILEC.

AT&T disagreed with SWBT's position. AT&T pointed out that CLECs' access rates are capped without any corresponding USF support. AT&T asserted that the differing treatment of

ILECs and CLECs with respect to access revenues demonstrate that ILECs and CLECs are not in the same competitive posture relative to USF support. AT&T maintained that going forward from the implementation of the TUSF, all ILECs, even new CLECs, could be viewed as starting from the same place, because access rates for all carriers have been relatively equalized. Therefore, AT&T argued that an ILEC's entitlement to historic access revenues is no more justified than a CLEC's entitlement to the same revenues from the TUSF. AT&T contended that a local exchange carrier's (LEC's) entitlement to revenue/support for the USF is now a function of eligibility, which involves obtaining ETP certification and winning the local customer.

AT&T contended that providing ILECs with USF support based on HAI-determined costs, but providing CLECs with support based on UNE costs, produces a competitive advantage for the ILECs. AT&T claimed that when a UNE-P CLEC wins the end-use customer, either the ILEC's costs for TUSF support purposes should mirror the CLECs UNE costs, or the CLEC must share in the support that the ILEC receives based on HAI cost. AT&T claimed that such actions would treat the CLECs' costs as if they were the same as the ILECs' according to the HAI model.

Sage disagreed with SWBT that ILECs who elected to participate in the USF were required in the Final Order in the *High Cost Proceeding* to decrease their toll and switched access rates in an amount equal to their USF draw. Sage argued that such requirements were part of

negotiations in which SWBT fought strenuously to have the rate decrease applicable to both toll and switched access. Sage claimed that allowing SWBT to have USF funding for decreased access charges protects its revenue on the wholesale side of its business, while also allowing it to have fixed rates protected on the retail side of its toll business.

The commission finds that the IntraLATA toll and switched access rate reductions required in the *High Cost Proceeding* do not prohibit the modification of the current allocation formula. The ILEC's revenue-neutral, rate reductions required in the Final Order in the *High Cost Proceeding* were based on specific data for a specific time period, and that future circumstances, such as the inequitable disbursement of THCUSP support resulting from the discrepancy between the UNE cost and USF cost figures, could warrant an adjustment to the ILEC's THCUSP disbursement. Accordingly, the commission finds that PURA §56.026(c)(2) allows an ILEC's THCUSP disbursement to be reduced if an equitable formula is established.

Sage asserted the most significant effect of the *High Cost Proceeding* was that CLECs were required to decrease their access charges without receiving offsetting THCUSP support. Sage stated in Project Number 21174, *Rulemaking to address COA/SPCOA Switched Access Rates (COA/SPCOA Switched Access Rate Rulemaking Proceeding)*, that all CLECs were required by commission rule to decrease access charges on a de facto basis to a capped rate at or below that of the ILEC, and did not receive any offsetting USF support. In the *COA/SPCOA Switched Access Rate Rulemaking Proceeding*, the commission adopted

§26.223 to implement PURA §52.155; §26.223 addressed the statewide average, usage-sensitive switched access rates that can be charged by COA and SPCOA holders. Sage contended that SWBT's strong position on the toll allocation is due to the competitive benefit associated with the toll decreases and offsetting TUSF support paid for by other carriers.

SWBT responded that PURA §52.155, which prohibits excessive CLEC access charges, is irrelevant and does not constitute a change in circumstances. SWBT argued that PURA §52.155 was enacted as part of SB 560 in 1999, long before the Final Order was issued in the *High Cost Proceeding*.

SWBT claimed that CLEC access rates are not capped. SWBT stated that CLECs can raise their access rates at any time upon approval by the commission. SWBT claimed that CLECs with access rates higher than the statewide average voluntarily chose to reduce their rates as required under PURA §52.155. SWBT maintained that CLECs, unlike ILECs, are not required to reduce their rates in a revenue-neutral manner to offset TUSF high cost support. Therefore, SWBT contended that CLECs receive a competitive advantage over ILECs whenever they receive TUSF high cost support because it is not revenue-neutral support.

The commission disagrees with SWBT's position that UNE-based CLECs, which are not required to reduce their rates in a revenue-neutral manner to offset TUSF support, receive a competitive advantage over ILECs under the TUSF. The commission finds that the discrepancy

between the USF cost and UNE cost figures has resulted in an inequitable allocation of THCUSP disbursement among UNE-based CLECs under the current allocation formula. The commission finds that the adopted amendments shall, at this time, enable UNE-based CLECs to receive THCUSP support when they provide service in high cost rural areas within the state as outlined in PURA Chapter 56 and the commission's TUSF substantive rules.

The commission finds that the adopted amendments will not result in UNE discounts for UNE-based CLECs providing service in high cost rural areas. The commission points out that the UNE cost figure and retail cost additive are separate cost figures that result from different calculations. The commission notes that the retail cost additive is the additional cost a UNE-based CLEC incurs in retailing the service above and beyond the UNE rate. Therefore, the commission finds that the retail cost additive is not included in the UNE cost figure derived from the TELRIC model. Consequently, the commission finds that the adopted amendments will not result in a discount or reduction of the UNE rate.

Competitive-neutrality and revenue-neutrality

SWBT contended that the proposed amendments would inflict significant economic damage upon the ILEC providing and maintaining the wireline facilities that the UNE-based CLEC uses to serve the customer in the high cost area. SWBT claimed the proposed amendments would reduce its current THCUSP disbursement by approximately \$11 million annually. SWBT

contended that it would forfeit up to \$11.23 per/month for each of those lines. SWBT contended that the costs incurred by an ILEC would greatly exceed the revenues it would receive.

AT&T asserted that SWBT was only interested in revenue neutrality. AT&T argued that revenue neutrality is not a relevant basis on which to design USF rules.

Sage argued that competitive neutrality should not be defined as revenue neutrality for the ILECs. Sage contended that competitive neutrality means that all carriers would have an equal chance to draw from the fund an amount related to their cost of providing service in high cost areas. Sage maintained that federal and state law do not guarantee an ILEC a firm TUSF funding amount. Sage contended that there is no guarantee of revenue neutrality to any carrier with respect to universal service funding. Sage asserted the principle of USF portability that has been embraced both on the federal and state level enables the carrier winning the customer to be the recipient of a reasonable share of USF, while also enabling the underlying ILEC providing UNEs to recover its costs. Sage noted that it is unrealistic to assume that CLECs providing service via UNEs would suddenly win a large percentage of customers.

The commission agrees with AT&T and Sage's position that revenue neutrality is not a relevant basis on which to develop competitively-neutral TUSF rules. The commission disagrees with SWBT's argument that the adopted amendments would cause the ILEC's costs incurred to

greatly exceed its revenues, which, in turn, would not allow the ILEC to be "made whole." The commission notes that the universal service principle of competitive neutrality that has been adopted at both the federal and state level does not guarantee revenue neutrality in TUSF funding. The commission points out that competitive-neutrality enables all carriers to have an equal chance of receiving THCUSP support in relation to their cost of providing service in high cost areas. Therefore, the commission finds that due to competitive-neutrality, there is no guarantee that a carrier's revenue will be protected when it loses a customer to a competing ETP-CLEC.

The commission disagrees with SWBT's argument that the adopted amendments would erode its high cost support and reduce its local, toll, and switched access revenues as a result of increased customer loss. The commission points out that the fundamental premise underlying the TUSF, as set forth in PURA §56.021 and §26.401(a), does not address the protection of a carrier's revenue that is derived from the provisioning of service other than basic local telecommunications service. The commission notes that the portability of USF support enables the carrier winning the customer to be the recipient of a reasonable share of USF support and associated revenue.

Verizon argued that the proposed amendments are not competitively neutral. Verizon argued that the proposed amendments would enable a UNE-based CLEC to recover more than its costs, while an ILEC would recover less than its cost of providing service.

Verizon opposed the proposed amendments regarding the provisioning of service partially through UNEs. Verizon contended that the proposed amendments would break the link between cost and support by changing the basis of the sharing mechanism to a simple arithmetic percentage rather than a cost-weighted percentage of network elements that are self-provisioned. Verizon claimed that the loop cost is often 70% or more of total cost of service. However, Verizon maintained that the proposed amendments assume the loop, as one of five elements considered, accounts for only 20%, thus overly compensating the CLEC at the expense of the ILEC.

AT&T responded that Verizon's primary claim is that under the current allocation rule, many UNE-P CLECs stand to benefit more than under the commission's proposed amendments. AT&T argued that the main reason for such a result are the high UNE rates charged by Verizon. AT&T contended that neither Verizon nor Sprint have ever had final TELRIC-based UNE rates determined by the commission. AT&T thus contended that artificially inflated UNE rates are the primary reason for the extremely low incidence of competition in Verizon's territory. AT&T maintained that UNE-P CLECs have obviously made the decision not to provide service in Verizon's territory on wide-scale basis. Therefore, AT&T claimed that developing an allocation formula that addresses the problems in SWBT's territory makes the most sense at this time.

Sprint stated that while the proposed amendments would be easier to administer and understand than the current rule, no modifications to the current rule are necessary.

The commission disagrees with AT&T's position that the adopted amendments focus on the retailing costs avoided by an underlying ILEC that provides UNEs to a competing ETP-CLEC. The commission disagrees with Verizon's argument that the adopted amendments ignore the relationships between the cost of provisioning service, the cost of UNEs, and the revenue a company is expected to generate in providing service when UNE-based CLECs are providing service solely through UNEs. The commission points out that the USF framework adopted by the FCC requires that both the federal and state universal service mechanisms ensure competitive-neutrality, not revenue-neutrality. In addition, the commission finds that the PURA §56.026(c)(2) does not specifically delineate the components that an equitable allocation formula must take into account.

The commission rejects Verizon's position relating to the adopted amendments regarding UNE-based CLECs providing service partially through UNEs. The commission finds that the adopted amendments appropriately afford a UNE-based CLEC with THCUSP support in accordance with the relative percentage of self-provisioned UNEs. The commission finds that such an allocation is equitable and easy to administer.

Competition among UNE-based CLECs and facilities-based CLECs

SWBT asserted that the proposed amendments would increase a UNE-based CLEC's profit margin, which would result in a significant marketing advantage for the UNE-based CLEC over facilities-based CLECs. SWBT claimed that facilities-based CLECs would still need to recover the \$38 revenue benchmark from its end-use customers in high cost areas to be made whole, while the UNE-based CLEC would need to recover a lesser amount to be made whole.

No CLECs commented in reply to SWBT regarding this issue.

The commission disagrees with SWBT's position that the adopted amendments would favor UNE-based CLECs over facilities-based CLECs. The commission notes that a facilities-based CLEC is entitled to receive all available THCUSP support associated with provisioning basic local telecommunications service in high cost rural areas. Therefore, the commission finds that facilities-based CLECs are not disadvantaged by the adopted amendments. The commission notes that under the adopted amendments the UNE-based CLEC providing service solely or partially through UNEs could be required to share the THCUSP support with the underlying ILEC. The commission notes that UNE-based CLECs providing service solely through UNEs would receive the lesser of the available THCUSP support or the retail cost additive. The commission points out that UNE-based CLECs providing service partially through UNEs would provide a UNE-based CLEC with a pro rata share of THCUSP support in excess of the retail cost additive. The commission notes that the adopted amendments appropriately afford a

UNE-based CLEC with THCUSP support in accordance with the relative percentage of self-provisioned UNEs.

SWBT's Filing in Project Number 22472

AT&T noted that SWBT argued in its comments filed in Project Number 22472, *Rulemaking to Amend the Texas Universal Service Fund Rules*, that even if there is a discrepancy between what CLECs pay on average for UNEs and the HAI costs used for USF support, the net effect is that SWBT receives an underpayment from CLECs relative to HAI costs. AT&T cited SWBT's data filed in that proceeding in an attempt to support AT&T's contention that lines lost to CLECs actually reduce SWBT's retailing costs, and create a windfall to SWBT.

SWBT maintained that AT&T's attempt to rebut a filing SWBT made in Project Number 22472 is procedurally and substantively deficient.

The commission agrees that AT&T's rebuttal of SWBT's pleading in Project Number 22472 is untimely. The commission notes that, although the current rulemaking proceeding resulted from Project Number 22472, AT&T's rebuttal is untimely in that SWBT's pleading was filed in Project Number 22472 that was closed after the order adopting the amendments was filed on September 14, 2001.

SWBT's overearnings report

Sage contended that according to a memo filed by commission staff on February 21, 2002 in Project Number 23804, *2000 Telephone Utility Earnings Report Pursuant to PURA §26.73(b)*, SWBT is in a state of overearnings of between \$820 and \$862 million. Therefore, Sage maintained that it was disingenuous for a company in such a dramatic state of overearnings to be complaining about a potential decrease in funding lost to legitimate competition in the USF process.

In its response, SWBT stated that Sage's reference to the \$800+ million annual overearnings in its earning report should be disregarded. SWBT contended that PURA §58.025 clearly states that SWBT, as a Chapter 58 electing company, is not "under any circumstances" subject to a "determination" regarding the "reasonableness" of its overall revenues or net income.

The commission does not believe that Sage's reference to SWBT's overearnings is relevant or applicable to this matter. As a PURA Chapter 58 electing company, SWBT is not, under PURA §58.025, subject to a determination regarding the reasonableness of its overall revenue or net income. Furthermore, a LEC's eligibility for USF allocated funds is not dependent on its overall earnings.

Specific proposals by parties

WCOM's proposal

WCOM maintained that the commission should adopt the rule that Southwestern Bell Communications (SBC) agreed to in California, which allocates 100% of the state USF support to the retail provider. However, WCOM urged the commission to adopt one of the approaches proposed by AT&T, Sage, or commission staff if it elects not to adopt the approach that SBC agreed to in California.

The commission rejects WCOM's suggestion that rule adopted in California should be adopted within the current rulemaking proceeding at this time. The commission notes that such a proposal was not formally filed in the current rulemaking proceeding. The commission finds that there has been insufficient analysis conducted on this proposal. The commission finds that what other state commissions have accomplished or are attempting to accomplish within the USF arena may not be suitable or appropriate in Texas for several reasons related to such factors as geography, population density, cost models used, assumed revenue figures, and UNE rates and averaging methodologies. However, the commission notes that the proposal could be considered within the upcoming TUSF review beginning in September 2002.

SWBT's proposal

SWBT asserted that the proposed amendments, if adopted, should only apply to ETP-CLECs that switch to a UNE-based competitor after the effective date of the amendment. SWBT claimed that the existing formula should continue to apply to ETP-CLECs that switch to a UNE-based competitor prior to the adoption of the proposed amendments. SWBT alleged that such an approach would reduce the financial harm imposed on ILECs and reduce the competitive advantage that would be provided to the UNE-based CLECs. SWBT maintained that there is no point in providing an uneconomic subsidy for lines already served by UNE-based CLECs, since they have already captured the customer.

The commission disagrees with SWBT's suggestion that the proposed amendments, as adopted, should only apply to ETP-CLECs that switch to a UNE-based competitor after the effective date of the amendment, thereby allowing the existing formula to apply to ETP-CLECs that switch to a UNE-based competitor prior to the adoption of the proposed amendments. The commission notes the implementation of two formulas for the allocation of THCUSP support would create an administrative burden on the disbursement of THCUSP. The commission finds the utilization of one allocation formula will prevent possible gaming and regulatory uncertainty associated with the disbursement of THCUSP support. The commission points out that because the adopted amendments result in an equitable formula under PURA §56.026(c)(2) no uneconomic subsidy exists for lines already served by UNE-based CLECs. The commission notes that a formula that results in equitable THCUSP disbursement for future purposes would also result in equitable THCUSP disbursements under the current circumstances. The

commission also notes that comments regarding alleged financial harm to an ILEC resulting from loss of a customer and the corresponding loss of USF funding are irrelevant in the current proceeding.

OPC's proposal: delay until upcoming review of TUSF beginning in September 2002

OPC urged the commission to withdraw this proposed rulemaking and consider the allocation formula within the context of the upcoming review of the TUSF in September. OPC maintained that the differing cost measures relating to USF costs and UNE rates create difficulties in determining whether the current sharing of THCUSP between ILECs and resellers is fair.

Verizon contended the commission should reject the proposed amendments that would revise TUSF rules on a piecemeal basis. Verizon essentially agreed with OPC, and contended that the commission should review all TUSF rules simultaneously before considering any revisions.

Sprint opined that the proper way to develop this rule would be in a contested case proceeding in conjunction with an analysis of the entire TUSF, including the UNE sharing mechanism, in the proceeding scheduled to begin in September 2002.

AT&T asserted that the ongoing competitive advantage for ILECs as a result of USF support received on top of UNE revenues can and should be addressed without having to entirely "blow

up" the current funding mechanism and start from scratch. AT&T claimed that the history of that docket strongly suggests that any thorough re-examination of the commission's USF rules will be lengthy and contentious. AT&T argued that the commission should not delay addressing the current problem of the support allocation methodology.

The commission agrees with AT&T's position. The commission finds that modification of the current allocation formula in §26.403 is warranted at this time. The commission notes that the re-examination of the TUSF rules in the upcoming review, beginning in September 2002, will likely be a lengthy proceeding. Therefore, commission finds that the modification of the current formula within the current rulemaking proceeding is necessary to prevent further inequities in the disbursement of THCUSP support. The commission notes that the adopted amendments represent an interim solution to the inequitable THCUSP disbursements under the current allocation formula. The commission finds that, if necessary, the adopted amendments would be subject to further modification or improvement when it revisits the issues surrounding the allocation formula during the upcoming TUSF review beginning in September 2002.

OPC proposal: Withdraw proposed amendments pending deaveraging of UNE rates

OPC contended that the commission should withdraw the proposed amendments and republish them after the deaveraging of UNE rates has been addressed.

In response, AT&T agrees with OPC in that all ILEC's current UNE rates should be reviewed to determine if they are based on forward-looking costs. However, AT&T disagrees with OPC that deaveraging UNEs is the appropriate way to reconcile the discrepancy between UNE costs and HAI costs, both in terms of methodology and timing. AT&T pointed out that the commission has no current or planned proceeding to deaverage UNE rates. Moreover, AT&T maintained that it seems highly unlikely that UNE rates can be further deaveraged in the context of a USF proceeding.

The commission disagrees with OPC's position. The commission finds that the adopted amendments result in an equitable allocation formula for the disbursement of THCUSP support that alleviates some of the problems resulting from the discrepancy between UNE costs and HAI costs at this time. While the commission stated its intention to deaverage the UNE rates in the *High Cost Proceeding*, the commission notes that it does not have a current proceeding in which deaveraging of UNE rates has been proposed. The commission finds that the modification of the current allocation formula is necessary at this time to address the existing inequities in the disbursement of THCUSP support.

OPC proposal: Rule should include structural protections to protect consumers

OPC argued that any rule the commission adopts should include structural protections to ensure that the ultimate benefit is received by the consumer.

AT&T disagreed with OPC's position. AT&T contended the proposed benefit of the rule is that CLECs will be able to economically serve more rural customers, rather than to benefit a CLEC's existing customers. AT&T claimed that the current USF rules provide that no CLEC can obtain USF support unless it complies with eligibility requirements, such as quality of service and maximum pricing caps, which are outlined in §26.417(c). AT&T maintained that these eligibility requirements will ensure that customers will benefit from a more equitable allocation of USF support.

The commission agrees with AT&T's position. The commission finds that the adopted amendments shall enable ETP-CLECs to serve customers in high cost rural areas within the state more economically. The commission notes that the end-use customers would then benefit from the opportunity to obtain service from both ETP-CLECs and ILECs at reasonable rates. The commission finds that the adopted amendments result in an equitable allocation formula that enables residents throughout the state to have access to affordable basic local telecommunication service.

Sage's proposal

Sage proposed the following substitution for §26.403(e)(3)(C)(i):

"The basis for the calculation for the allocation of support between ETP/UNE providers and ILECs shall be as follows: The allocation ratio by eligible wire center will be the sum of CLEC UNE cost elements purchased divided by the sum of CLEC cost elements purchased and the THCUSP support. UNE cost elements included in this computation shall be loop, port, and local switching assuming 1700 minutes of use. The ETP/UNE purchaser support shall be determined by multiplying the THCUSP by the allocation ratio determined above. The ILEC shall receive the remaining THCUSP support."

Sage claimed that its proposal is a simple and direct means to apportion support between the entities providing the end-user service and the underlying UNEs, based on respective costs incurred by each entity. Sage argued the sum of UNE rates paid plus THCUSP support received should be considered the total cost of providing service in any given exchange. Sage asserted that UNE rates, which replaced the ILEC's retail revenues, were designed to fully recover the ILEC's average cost. Sage maintained that the CLEC should receive THCUSP support in that same proportion since it supports a portion of the total cost of service through the purchase of its UNEs. Therefore, Sage contended that CLECs would receive THCUSP support in proportion to the percentage it pays into the sum of the THCUSP plus the cost of the UNEs. Sage claimed that such an allocation would ensure that both carriers, the CLEC and ILEC, would receive funding equal to their share of overall costs.

Sage stated that its proposal would enable ETP and eligible telecommunications carrier (ETC) designated CLECs to qualify for additional funding. Sage asserted that its proposal would alleviate the concerns raised by SWBT that AT&T's proposal would allow CLECs to recover 100% of their UNE rates. However, Sage pointed out that SWBT would no longer be revenue neutral because it would no longer receive the vertical service revenue it might otherwise receive from the end-use customer.

SWBT responded that Sage's proposal would give UNE-based CLECs discounts of up to 90% of SWBT's existing UNE-P rates. SWBT contended that UNE-based CLECs, like ILECs, should not be entitled to receive high cost support when their costs do not exceed the revenue benchmark. SWBT claimed that Sage's proposal would violate the FTA by requiring the sale of UNEs at prices far below cost-based levels. SWBT asserted that Sage incorrectly alleged that ILECs gain a competitive advantage by receiving THCUSP support. SWBT claimed that Sage's proposal would result in millions of dollars in high cost funding being taken away from ILECs. Therefore, SWBT asserted that Sage did not present a reasoned justification for abandoning the current formula.

SWBT claimed that Sage admitted that its proposal was not revenue neutral for electing companies. Specifically, SWBT pointed out that Sage stated, "the proposals on the table will indeed result in less funding to SWBT, and potentially more funding to ETP-CLECs who qualify for funding."

AT&T preferred its own proposal, but maintained that Sage's proposal was a rational improvement to the current rule. AT&T concurred with Sage's reply comments to SWBT's initial comments. AT&T maintained that Sage's proposal would be more beneficial than the proposed amendments to CLECs in Verizon's territory. AT&T contended that Sage's proposal would have the advantage of not limiting UNE-P CLECs to a relatively low fixed dollar amount that is divorced from the current available support amounts to be allocated.

Verizon claimed that Sage's proposal was not competitively-neutral, because it compensates a CLEC even when its cost of service does not exceed the revenue benchmark.

State maintained that Sage's proposal would create a more equitable allocation formula than what currently exists. State argued that Sage's proposal takes into account the relative contributions of all ETPs to the provision of service and provides funding on a basis that is reflective of the ratio of service. State argued that Sage's proposal is the most competitively neutral because it provides USF support to the CLEC only to the extent that it is purchasing UNEs to provide the service.

VarTec concurred with Sage's proposal. VarTec asserted that Sage's proposal was a logical and simplified mechanism that would bring competition to high loop cost zones that currently have no competition.

The commission finds that it is not necessary to decide this issue at this time and therefore declines to adopt Sage's proposal. The commission finds that it is unable to determine, at this time, to what extent an ILEC's cost of provisioning service in high cost areas are recovered from UNE payments. Therefore, the commission finds that it is unclear whether an ILEC receives a windfall when it receives THCUSP support in addition to UNE payments. The commission notes that Sage's proposal could be reconsidered during the upcoming TUSF review beginning in September 2002.

AT&T's proposal

AT&T conceded that the proposed amendments are an improvement of the current rule. AT&T proposed, however, that the commission should adopt a variation of the FCC's rules for allocation of USF support between an ILEC and UNE-based CLEC. AT&T maintained that its proposal for service provided solely through UNEs is based on the FCC's rules in which a UNE-based CLEC would receive all of the THCUSP support on an eligible line, up to the amount of the cost of the UNEs used by the CLEC. AT&T attempted to meld the FCC's rules and the current allocation for service provided partially through UNEs in §26.403(e)(3)(C)(ii). AT&T claimed that its proposal would equitably allocate USF support, taking into account CLEC facility costs and UNE costs, when service is provided partially through UNEs. AT&T maintained that a CLEC would receive the lesser of the ILEC's support amount or an amount equal to the price of the UNEs purchased plus a proportionate amount to USF support as

defined under current §26.403(e)(3)(C)(ii). AT&T contended that the allocation of USF support is an issue of USF portability, which avoids discouraging CLECs from serving in high cost areas.

AT&T argued that its proposal is similar to the FCC's rules and that similar methodologies have been adopted by the Colorado and California commissions. AT&T further maintained that the Missouri commission's current rule also provides all of the available support to a UNE-based CLEC that serves an eligible line. AT&T claimed that the decisions made by the California, Missouri, and Colorado commissions represent appropriate sharing methodologies.

SWBT responded that AT&T's proposal would result in free UNE-P in 121 of SWBT's wire centers and discounts ranging from 50% to 94% in 63 of SWBT's wire centers. SWBT maintained that AT&T's proposal would immediately take away -- in a non-revenue neutral manner -- approximately \$21 million of its THCUSP support and could eventually take more than \$113 million of its THCUSP support. In addition, SWBT contended that AT&T's proposal violates the fundamental premise of THCUSP by allowing UNE-based CLECs to receive high cost support in situations where their costs do not exceed the revenue benchmark.

SWBT asserted that AT&T's references to other jurisdictions should be disregarded. SWBT stated that the Missouri rule specifically provides that each carrier, not only the ILEC, receiving high cost support must reduce other rates in an offsetting manner, which is different from the

TUSF. In addition, SWBT pointed out that the Settlement Agreement in California is an interim agreement that is expected to be superceded by California commission action. SWBT maintained that the geography and population densities in California's high cost areas are not similar to the high cost areas in Texas. SWBT asserted that the California commission has different CLEC pricing rules and provider-of-last resort (POLR) requirements. SWBT stated that it was unable within in the limited reply comment cycle to determine how the Colorado commission's USF rule would operate in practice.

Verizon disagreed with AT&T. First, Verizon claimed that the Missouri rule only states that a UNE-based CLEC is entitled to receive support. Verizon pointed out that the Missouri commission is currently conducting a proceeding to consider how much support a UNE-based CLEC should receive. Second, Verizon stated the California stipulation that awards all available support to the CLEC is distinguishable because it (1) does not apply to any other ILEC in California, (2) is valid only for an interim period, (3) is part of a broader settlement that includes other trade-offs, such as the adoption of Pacific Bell's UNE deaveraging proposal, and (4) relates to a state fund that is different in many ways, including a restriction to residential lines and a formula based on a cost benchmark rather than a revenue benchmark. Third, Verizon maintained that AT&T's citation to the Colorado commission's USF rule, which provides support to CLECs up to the cost of UNEs, is incomplete because it does not recognize that the Colorado commission's rules also appear to require evidence that CLEC revenues, as defined by a revenue benchmark, exceed the CLEC's cost of service.

Sage claimed that AT&T's proposal is virtually the same as the federal rules. Sage maintained that AT&T's proposal favors the entity that wins the customer. Sage also pointed out that both the California and Colorado commissions have adopted a funding allocation formula for UNE-P providers that would provide virtually all of the USF support to the CLEC, rather only a portion, as is proposed in Texas. Sage rebutted SWBT's argument that allocating additional funding to CLECs would effectively require SWBT to sell its UNEs at rates below cost. Sage asserted that ILECs still recover their costs when UNE-P providers receive a proportionate share of USF support.

AT&T responded that its proposal would be more beneficial to CLECs than either the proposed amendments or the current rule in cases where ILECs have high UNE rates relative to USF costs, as demonstrated in Verizon's comments. However, AT&T stated that simply providing the greatest benefit to CLECs is not the rationale for its proposal, which relies on the proposition that UNE rates fully compensate the ILEC.

The commission finds that it is not necessary to decide this issue at this time and therefore declines to adopt AT&T's proposal. The commission finds that it is currently uncertain whether AT&T's proposal represents an equitable formula for allocation of THCUSP support as required by PURA §56.026(c)(2). In addition, the commission finds that it is uncertain, at this time, to what extent an ILEC's cost of provisioning service in high cost areas are recovered

from UNE payments. However, the commission notes that AT&T's proposal could be reconsidered during the upcoming TUSF review in September 2002.

The commission finds that AT&T's reference to the USF rules in other jurisdictions, such as California, Missouri, and Colorado, is not relevant. These rules were not submitted as proposals in the current rulemaking proceeding, and the commission has not had the opportunity to properly analyze them. The commission notes that what other state commissions have accomplished or are attempting to accomplish within the USF arena may not be suitable or appropriate in Texas for several reasons related to such factors as geography, population density, cost models used, assumed revenue figures, and UNE rates and averaging methodologies.

These amendments are adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2002) (PURA), which provides the Public Utility Commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; specifically, PURA §56.021 which requires the commission to adopt and enforce rules requiring local exchange companies to establish a universal service fund; §56.023 which requires the commission to adopt rules for the administration of the universal service fund; and §56.026 which permits the commission to establish an equitable allocation formula for the disbursement of universal service funds if a local

end-user customer of an electing company switches to another local service provider that provisions service solely or partially through UNEs.

Cross Reference to Statutes: Public Utility Regulatory Act §§14.002, 56.021-56.028.

§26.403. Texas High Cost Universal Service Plan (THCUSP).

- (a) **Purpose.** This section establishes guidelines for financial assistance to eligible telecommunications providers (ETPs) that serve the high cost rural areas of the state, other than study areas of small and rural incumbent local exchange companies (ILECs), so that basic local telecommunications service may be provided at reasonable rates in a competitively neutral manner.
- (b) **Definitions.** The following words and terms when used in this section shall have the following meaning unless the context clearly indicates otherwise:
- (1) **Benchmark** — The per-line amount above which THCUSP support will be provided.
 - (2) **Business line** — The telecommunications facilities providing the communications channel that serves a single-line business customer's service address. For the purpose of this definition, a single-line business line is one to which multi-line hunting, trunking, or other special capabilities do not apply.
 - (3) **Eligible line** — A residential line and a single-line business line over which an ETP provides the service supported by the THCUSP through its own facilities, purchase of unbundled network elements (UNEs), or a combination of its own facilities and purchase of UNEs.

- (4) **Eligible telecommunications provider (ETP)** — A telecommunications provider designated by the commission pursuant to §26.417 of this title (relating to Designation as Eligible Telecommunications Providers to Receive Texas Universal Service Funds (TUSF)).
- (5) **Residential line** — The telecommunications facilities providing the communications channel that serves a residential customer's service address. For the purpose of this definition, a residential line is one to which multi-line hunting, trunking, or other special capabilities do not apply.
- (c) **Application.** This section applies to telecommunications providers that have been designated ETPs by the commission pursuant to §26.417 of this title.
- (d) **Service to be supported by the THCUSP.** The THCUSP shall support basic local telecommunications services provided by an ETP in high cost rural areas of the state and is limited to those services carried on all flat rate residential lines and the first five flat rate single-line business lines at a business customer's location. Local measured residential service, if chosen by the customer and offered by the ETP, shall also be supported.
- (1) **Initial determination of the definition of basic local telecommunications service.** Basic local telecommunications service shall consist of the following:

- (A) flat rate, single party residential and business local exchange telephone service, including primary directory listings;
 - (B) tone dialing service;
 - (C) access to operator services;
 - (D) access to directory assistance services;
 - (E) access to 911 service where provided by a local authority;
 - (F) telecommunications relay service;
 - (G) the ability to report service problems seven days a week;
 - (H) availability of an annual local directory;
 - (I) access to toll services; and
 - (J) lifeline and tel-assistance services.
- (2) **Subsequent determinations.**
- (A) Timing of subsequent determinations.
 - (i) The definition of the services to be supported by the THCUSP shall be reviewed by the commission every three years from September 1, 1999.
 - (ii) The commission may initiate a review of the definition of the services to be supported on its own motion at any time.
 - (B) Criteria to be considered in subsequent determinations. In evaluating whether services should be added to or deleted from the list of supported services, the commission may consider the following criteria:

- (i) the service is essential for participation in society;
 - (ii) a substantial majority, 75% of residential customers, subscribe to the service;
 - (iii) the benefits of adding the service outweigh the costs; and
 - (iv) the availability of the service, or subscription levels, would not increase without universal service support.
- (e) **Criteria for determining amount of support under THCUSP.** The TUSF administrator shall disburse monthly support payments to ETPs qualified to receive support pursuant to this section. The amount of support available to each ETP shall be calculated using the base support amount available as provided under paragraph (1) of this subsection and as adjusted by the requirements of paragraph (3) of this subsection.
- (1) **Determining base support amount available to ETPs.** The monthly per-line support amount available to each ETP shall be determined by comparing the forward-looking economic cost, computed pursuant to subparagraph (A) of this paragraph, to the applicable benchmark as determined pursuant to subparagraph (B) of this paragraph. The monthly base support amount is the sum of the monthly per-line support amounts for each eligible line served by the ETP, as required by subparagraph (C) of this paragraph.
- (A) Calculating the forward-looking economic cost of service. The monthly cost per-line of providing the basic local telecommunications services

and other services included in the benchmark shall be calculated using a forward-looking economic cost methodology.

(B) Determination of the benchmark. The commission shall establish two benchmarks for the state, one for residential service and one for single-line business service. The benchmarks for both residential and single-line businesses will be calculated using the statewide average revenue per line as described in clause (i) and (ii) of this subparagraph for all ETPs participating in the THCUSP.

(i) Residential revenues per line are the sum of the residential revenues generated by basic and discretionary local services, as well as a reasonable portion of toll and access services, for the year ending December 31, 1997, divided by the average number of residential lines served for the same period, divided by 12.

(ii) Business revenues per line are the sum of the business revenues generated by basic and discretionary local services for single-line business lines, as well as a reasonable portion of toll and access services for the year ending December 31, 1997, divided by the average number of single-line business lines served for the same period, divided by 12.

- (C) Support under the THCUSP is portable with the consumer. An ETP shall receive support for residential and the first five single-line business lines at the business customer's location that it is serving over eligible lines in such ETP's THCUSP service area.
- (2) **Proceedings to determine THCUSP base support.**
- (A) Timing of determinations.
- (i) The commission shall review the forward-looking cost methodology, the benchmark levels, and/or the base support amounts every three years from September 1, 1999.
- (ii) The commission may initiate a review of the forward-looking cost methodology, the benchmark levels, and/or the base support amounts on its own motion at any time.
- (B) Criteria to be considered in determinations. In considering the need to make appropriate adjustments to the forward-looking cost methodology, the benchmark levels, and/or the base support amount, the commission may consider current retail rates and revenues for basic local service, growth patterns, and income levels in low-density areas.
- (3) **Calculating amount of THCUSP support payments to individual ETPs.**
- After the monthly base support amount is determined, the TUSF administrator shall make the following adjustments each month in order to determine the actual support payment that each ETP may receive each month.

- (A) Access revenues adjustment. If an ETP is an ILEC that has not reduced its rates pursuant to §26.417 of this title, the base support amount that such ETP is eligible to receive shall be decreased by such ETP's carrier common line (CCL), residual interconnection charge (RIC), and toll revenues for the month.
- (B) Adjustment for federal USF support. The base support amount an ETP is eligible to receive shall be decreased by the amount of federal universal service high cost support received by the ETP.
- (C) Adjustment for service provided solely or partially through the purchase of unbundled network elements (UNEs). If an ETP provides supported services over an eligible line solely or partially through the purchase of UNEs, the THCUSP support for such eligible line may be allocated between the ETP providing service to the end-user and the ETP providing the UNEs according to the methods outlined below.
- (i) ETP provisioning service solely through UNEs. An ETP serving an end-user solely through UNEs purchased from another ETP shall receive the lesser of the available THCUSP support or the amount of the appropriate retail cost additive.
- (ii) ETP provisioning service partially through UNEs. An ETP serving an end-user partially through UNEs purchased from another ETP shall receive the lesser of the available THCUSP

support or the amount of the appropriate retail cost additive, plus a pro rata share of any THCUSP support in excess of the retail cost additive. THCUSP support in excess of the retail cost additive shall be apportioned to the ETP serving the end-user based upon the relative percentage of those UNEs that are self-provisioned. For purposes of this pro ration, the UNE costs for each wire center shall be based upon the HAI model costs for the following five UNEs: loop, line port, end-office usage, signaling, and transport.

- (iii) ETP providing UNEs. The ETP providing UNEs to another ETP shall receive the difference, if any, between the total available THCUSP support amount and the THCUSP support amount allocated to the ETP serving the end-user.
- (iv) ETP retail cost additive. For the purposes of clauses (i) and (ii) of this subparagraph, the ETP's retail cost additive shall be derived by multiplying the ILEC-specific wholesale discount percentage by the appropriate (residential or business) revenue benchmark.

- (f) **Reporting requirements.** An ETP eligible to receive support pursuant to this section shall report the following information to the commission or the TUSF administrator.

- (1) **Monthly reporting requirements.** An ETP shall report the following to the TUSF administrator on a monthly basis:
 - (A) information regarding the access lines on the ETP's network including:
 - (i) the total number of access lines on the ETP's network,
 - (ii) the total number of access lines sold as UNEs,
 - (iii) the total number of access lines sold for total service resale,
 - (iv) the total number of access lines serving end use customers, and
 - (v) the total number of eligible lines for which the ETP seeks TUSF support;
 - (B) the rate that the ETP is charging for residential and single-line business customers for the services described in subsection (d) of this section;
and
 - (C) a calculation of the base support computed in accordance with the requirements of subsection (e)(1) of this section showing the effects of the adjustments required by subsection (e)(3) of this section.
- (2) **Annual reporting requirements.** An ETP shall report annually to the TUSF administrator that it is qualified to participate in the THCUSP.
- (3) **Other reporting requirements.** An ETP shall report any other information that is required by the commission or the TUSF administrator, including any information necessary to assess contributions to and disbursements from the TUSF.

(g) **Review of THCUSP after implementation of federal universal service support.**

The commission shall initiate a project to review the THCUSP within 90 days of the Federal Communications Commission's adoption of an order implementing new or amended federal universal service support rules for rural, insular, and high cost areas.

This agency hereby certifies that the rule, as adopted, has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §26.403, relating to Texas High Cost Universal Service Plan (THCUSP), as it concerns the adjustment for basic local telecommunications service provided solely and partially through the purchase of unbundled network elements is hereby adopted with no changes to the text as proposed.

ISSUED IN AUSTIN, TEXAS ON THE 18th DAY OF JULY 2002.

PUBLIC UTILITY COMMISSION OF TEXAS

Rebecca Klein, Chairman

Brett A. Perlman, Commissioner