BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Regarding Revisions to the California High Cost Fund B Program.	Rulemaking _____

ORDER INSTITUTING RULEMAKING ON REFORMS TO THE CALIFORNIA HIGH COST FUND B PROGRAM

1. Summary

We hereby institute a new rulemaking to address important reforms to the state's California High Cost Fund B (B-Fund) program, as discussed below. The B-Fund program was designed to ensure that basic telephone service remains affordable in high cost areas served by the major incumbent local exchange carriers (ILECs). This will be a successor proceeding to Rulemaking (R.) 06-06-028, as previously instituted to review and reform the B-Fund program. Given the passage of time since the B-Fund program began back in the mid 1990s, R.06-06-028 was instituted as a forum for much-needed reform and updating of the program in view of changes in markets and technologies.

Although R.06-06-028 has made important progress in reforming the B-Fund program, important issues still remain unresolved. For purposes of resolving these remaining issues, we consider it appropriate to open a new successor proceeding, as outlined below. In a separate order, we will close R.06-06-028 so that any subsequent B-Fund reform measures will be considered exclusively in this new rulemaking.

2. Background

In June 2006, the Commission opened R.06-06-028, to review and implement reforms to the B-Fund program. Pursuant to Public Utilities Code § 739.3, the B-Fund program was established as part of a broader policy framework to meet universal telephone service goals. Through various decisions and rulings in R.06-06-028, we adopted measures to reform the B-Fund program. In particular, Decision (D.) 07-09-020 resolved a number of issues to reform the B-Fund, significantly reducing the overall magnitude of subsidized support. Beginning July 1, 2009, high-cost support will be limited to basic access lines in areas with a proxy cost above $36. Although raising the high cost benchmark to $36 per line will significantly reduce the number of lines receiving B-Fund support, a number of "areas" still qualify for support based on cost proxy data currently in use.

In R.06-06-028, the Commission also issued D.08-09-042, establishing a two-year transition period leading to full pricing flexibility in retail rates for "basic telephone service" by January 1, 2011, in regions not supported by the B-Fund. D.08-09-042 also provided for an interim increase in the California LifeLine Telephone Program (LifeLine) basic service rate cap from January 1, 2009 through December 31, 2010 of 25% of the rate cap increment authorized in that decision.

In addition to these reform measures that have already been implemented, however, additional tasks remain to be completed. In particular, these tasks involve reforming the process for selecting carriers of last resort (COLRs) and determining the amount of high-cost B-Fund support to be disbursed in a technologically neutral and cost-efficient manner. We also intend to make the processing of B-Fund payment claims more streamlined and automated. To

accomplish these tasks, we hereby open a new rulemaking to resolve the remaining issues relating to reform of the B-Fund program. [1]

3. Preliminary Scoping Memo

The scope of this new rulemaking will address unresolved issues, as previously identified in R.06-06-028, necessary to reform the B-Fund program. In particular, an updated process is needed to select COLRs and adjust support payments to reflect current market conditions, ensuring the program is competitively neutral. We also intend to implement reform measures to make the current administration of the B-Fund program more efficient.

3.1. Implementing a Reverse Auction Process

As noted in D.07-09-020, the cost proxy data utilized to determine B-Fund support is extremely outdated. In D.96-10-066, we defined high costs on a "Census Block Group" (CBG) basis where the cost of basic telephone service exceeded the system average in the territories of the state's large and mid-sized LECs. Since the adoption of cost proxies over a decade ago, the state's population demographics, technology and costs of providing service have changed considerably. As a result, the applicable cost proxies used in the B-Fund support calculations have grown increasingly outdated.

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[1] R.06-06-028 has also been a forum to encourage greater deployment of advanced communications services through broadband. We intend to open a separate rulemaking for purposes of continuing to promote greater access to advanced communications services through the deployment of broadband. Because this goal involves issues that are separate and distinct from the provision of a carrier of last resort to offer basic service, a separate rulemaking is the most appropriate procedural vehicle to pursue broadband issues.

As a basis for continuing to provide support in high cost areas going forward, we recognized in D.07-09-020 that a new approach is needed to determine what constitutes "high cost" for purposes of supporting the provision of basic service as a COLR.

In D.07-09-020, we recognized that relying on updated cost modeling to serve as the basis for B-Fund support levels has significant limitations and caveats. Not only is cost modeling time consuming and resource intensive, but it also requires the selection of a particular technology to be modeled. In the last decade, advances in communications technology have brought consumers many choices of voice providers using different technologies. Rather than relying on one technology-specific cost proxy as a basis to determine high cost funding levels, we concluded in D.07-09-020 that the superior solution is to move toward market-based approaches that are not biased toward a particular carrier or technology. We expressed our intent in R.06-06-028 to implement a new process to determine high-cost COLR support through a reverse auction.

Providing for competitive bids through a reverse auction will offer greater assurance that support is limited to reasonable levels needed to meet the goal of universal service. Accordingly, we expressed our intention to pursue a reverse auction as a means of selecting COLRs and determining the amount of high cost support to meet universal service goals. A reverse auction will solicit bids for the minimum level of subsidy required as condition of offering residential basic service as a COLR within a designated high-cost region.

Pursuant to D.08-09-042, as modified by D.08-10-040, full ILEC pricing flexibility will take effect for stand-alone basic service within regions not subject to the B-Fund support after January 1, 2011. The ILECs will be free thereafter to adjust residential basic rates in areas not subject to Lifeline subsidy or B-fund,

based on competitive market forces. Remaining work needs to be done, however, to determine what sorts of conditions on basic rates should apply to prospective COLRs bidding for B-Fund support in a reverse auction.

Although we began considering the design of a reverse auction in R.06-06-028, additional important work remains to be done. We find it appropriate to address this issue within the new rulemaking instituted today as a successor to R.06-06-028. We take official notice of the record developed in R.06-06-028 regarding the design and implementation of a reverse auction. We shall utilize this record as a starting point in this new rulemaking for making further progress. Initial comments on reverse auction design issues were filed in R.06-06-028 on November 9, 2007, with reply comments on November 28, 2007. By ruling dated December 13, 2007, Working Groups were established to formulate recommendations on the design and implementation of a reverse auction process.[2] The Working Groups issued progress reports on February 21, 2008, and May 1, 2008.

The Working Groups reached limited consensus on certain issues, but remained in dispute on other issues. The Working Groups requested Commission guidance on certain threshold issues relating to reverse auction design before attempting further discussions on secondary issues. Opening and reply comments on the threshold issues were filed on June 24, 2008, and July 15, 2008, respectively. We hereby incorporate the progress reports and comments on reverse auction threshold issues into the record of this proceeding.

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[2] One Working Group focused on design issues relating to carrier eligibility for participation and selection as a Carrier of Last Resort, while a second Working Group focused on design issues relating to bidding protocols.

As the basis for further work on the design of reverse auction protocols, the assigned Commissioner will issue a Proposed Decision providing guidance on the threshold issues involved in the design of a reverse auction process. The assigned Commissioner will also by separate ruling establish a schedule for the remainder of the proceeding. The Working Groups will then be directed to resume discussions to address the remaining auction design issues in accordance with the guidance provided on the threshold issues. We expect that this rulemaking proceeding will conclude within 18 months of the effective date of this order.

3.2. Program Administration Issues

In 1999, the Legislature created the CHCF-B Administrative Committee Fund within the State Treasury.[3] This legislation provided that the funding would be in rates, while the funds collection would be submitted first to the Commission, and then deposited with the Controller for deposit in the California High Cost Fund-B Administrative Committee Fund.[4] The COLR's claims are paid after being reviewed by Commission staff.

In 2001, the Legislature allowed funds to be transferred between various telephone funds in the annual budget act.[5] The Legislature also expressed its concern with stale data underlying the B-Fund. Section 270(b) restricted the transfer of funds until the service costs from the Commission's 1996 decision

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[3] Government Code Section 270(a)(2), pursuant to SB 669.

[4] Government Code Section 276(b).

[5] Pub. Util. Code § 276, pursuant to Section 20 of SB 742 (2001), as amended by Stats. 2001, Ch. 903 § 5.

were recalculated.[6] Subsequently, the Budget Act of 2002 transferred nearly $251 million of High Cost Fund-B money to the state general fund.[7]

In 2004, Pub. Util. Code § 739.3 was further amended to: (a) provide that money in Commission-regulated telecommunications related funds are the proceeds of rates, and therefore, are held in trust for the benefit of ratepayers and to compensate telephone corporations for their costs of providing universal service; (b) extend funding for the various universal service programs including the B-Fund program until January 1, 2009;[8] and (c) further require the Commission to conduct by January 1, 2006, a review of the B-Fund.[9] The purpose of the review was "to accomplish an adjustment of subsidy payments to reflect updated operating costs and an evaluation of whether subsidy levels can be reduced while maintaining the goals of the program."[10]

We solicited comments in R.06-06-028 on B-Fund program implementation issues associated with an automated claims process.[11] Two parties presented proposals regarding program processing issues. Cox suggested an automated claims review that would include electronic submission of monthly claims via secured connection, standardization of a monthly claims format for all carriers,

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[6] Pub. Util. Code § 270(b)(2), pursuant to AB 140 (Statutes of 2001). The Legislature restricted fund transfers from the B-Fund to the other high cost fund until statewide data was recalculated.

[7] AB 425 Provision 8660-011-047.0 (Stats. 2002, Ch. 379).

[8] Pub. Util. Code § 739.3, pursuant to SB 1276 (Stats. 2004, Ch. 847, enrolled September 28, 2004).

[9] SB 1276 § 4 (Stats. 2004, Ch. 847).

[10] *Ibid*.

[11] OIR at 47.

electronic notification with a date that the monthly claim was submitted, and the opportunity for all carriers to elect to receive payments via an automatic clearinghouse.[12] AT&T recommended that the Commission employ a Third-Party Administrator that would be responsible for processing new participant applications, processing claims for compensation from the fund, distributing subsidies from the fund, and provide staff support to the CHCF-B Administrative Committee, including preparation of financial statements and management reports. If such a Third-Party Administrator were employed, the Commission's role would be reduced to drafting the annual budget, overseeing audits of program, and periodically setting the level of the CHCF-B surcharge.[13]

DRA expressed concerned that these proposals lack specificity, and provide no supporting data as to the likely cost of such programs. AT&T provided no basis – such as an undue burden on the Commission – for the management of the fund to be outsourced to a Third-Party Administrator. DRA argues that Third-Party Administrators can add an unnecessary layer of expense and administrative complexity for programs such as the CHCF-B. DRA recommends that, if the Commission elects not to eliminate the B fund, workshops should be held to determine the need for and cost of program implementation changes, with evidence (including evidence of anticipated costs) provided by those claiming needed changes.

We shall consider within this new proceeding how B-Fund program administration can be improved, automated, and streamlined. The assigned

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[12] Cox Opening Comments at 15.

[13] AT&T Opening Comments at 26-27.

Commissioner will issue a subsequent ruling to set a schedule for addressing this issue.

4. Category of Proceeding

The Commission's Rules of Practice and Procedure require that an order instituting rulemaking preliminarily determine the category of the proceeding and the need for hearing.[14] As a preliminary matter, we determine that this proceeding is quasi-legislative as defined by Rule 1.3(d). It is preliminarily determined also that hearings are not necessary. As provided in Rule 6(c)(2), any person who objects to the preliminary categorization of this rulemaking or to the preliminary hearing determination, shall file and serve its objections within 10 business days of the issuance of this OIR.

5. Schedule

Pursuant to Pub Util. Code § 1701.4(a), it is anticipated that this proceeding will be concluded within 18 months of the issuance of this OIR. The assigned Commissioner will issue a subsequent ruling to establish a more specific schedule to resolve the issues in this proceeding. We delegate to the assigned Commissioner and the ALJ the authority to set other dates in the proceeding or modify those below as necessary. This proceeding will conform to the statutory case management deadline for ratesetting matters set forth in Pub. Util. Code § 1701.5.

6. Parties and Service List

We will serve this order by electronic mail on all telecommunications carriers, the B-Fund Administrative Committee and parties on the service list of

[14] Rule 6(c)(2).

R.06-06-028. The initial service list for this proceeding shall be established utilizing the service list in R.06-06-028. Parties of record in R.06-06-028 will automatically be made parties in this new proceeding, and need take no further action in that regard. Any additional persons or representative of entities seeking to become a party to this new rulemaking that are not already a party to R.06-06-028 should send a request to the Commission's Process Office, State Office Building, 505 Van Ness Avenue, San Francisco, California 94102 (or Process_Office@cpuc.ca.gov) to be placed on the official service list for appearances in this proceeding. Individuals seeking only to monitor the proceeding, but not to participate as an active party may request to be added to the "Information Only" section of the service list. The service list will be posted on the Commission's website: www.cpuc.ca.gov.

Any party interested in participating in this rulemaking who is unfamiliar with the Commission's procedures should contact the Commission's Public Advisor in Los Angeles at (213) 649-4782 or in San Francisco at (415) 703-7074, (866) 836-7875 (TTY – toll free) or (415) 703-5282 (TTY), or send an e-mail to public.advisor@cpuc.ca.gov.

7. Requirements for the Filing and Service of Documents

There are different types of documents participants may prepare in this proceeding. Each type of document involves different obligations with respect to filing and service. Parties must file certain documents as required by the Rules or in response to rulings by the assigned Commissioner and/or the ALJ.

All formally filed documents must be filed with the Commission's Docket Office and served on the service list for the proceeding. Article 1 of the Rules contains the Commission's filing requirements. The Commission rules for the electronic service of documents related to its proceedings are set forth in

Commission Rule 2.3.1, available on our web site at http://www.cpuc.ca.gov/PUBLISHED/RULES_PRAC_PROC/44887.htm. All parties shall comply with the requirements of these rules.

Resolution ALJ-188 sets forth the interim rules for electronic filing, which replaces only the filing requirements, not the service requirements. Parties are encouraged to file electronically whenever possible as it speeds processing of the filings and allows them to be posted on the Commission's website. More information about electronic filing is available at http://www.cpuc.ca.gov/efile/static.htm.

Other documents, including prepared testimony, if any, are served on the service list but not filed with the Docket Office. We will follow the electronic service protocols adopted by the Commission in Rule 1.10 of the Commission's Rules of Practice and Procedure for all documents, whether formally filed or just served. This Rule provides for electronic service of documents, in a searchable format, unless the appearance or state service list member did not provide an e-mail address. If no e-mail address was provided, service should be made by United States mail. In this proceeding, e-mail service shall be made concurrently on ALL persons on the service list for whom an e-mail address is available, including those listed under "Information Only." Parties are expected to provide paper copies of served documents upon request.

Any e-mail communications about this proceeding should include a brief description of the topic of the communication. Paper format copies, in addition to electronic copies, shall be served on the Assigned Commissioner and the ALJ.

8. Ex Parte Communications

The Commission's *ex parte* communication rules set forth in Rule 8.2(a) shall apply in this proceeding.

IT IS ORDERED that:

1. The Commission hereby institutes this rulemaking on its own motion to develop measures to review and reform the California High Cost Fund–B Program.

2. The issues to be considered in this proceeding are set forth in the Preliminary Scoping Memo.

3. The Executive Director shall cause this Order Instituting Rulemaking to be served on all telecommunications carriers, the B-Fund Administrative Committee and parties on the service list of R.06-06-028.

4. The service list for R.06-06-028 shall be used to establish an initial service list for this proceeding. If a party is already on the service list in R.06-06-028, that party automatically will appear as a party on the service list in this proceeding with no further action required.

5. Any person or representative of an entity interested in becoming a party to this proceeding who is not on the service list in R.06-06-028, should contact the Commission's Process Office, 505 Van Ness Avenue, San Francisco, California, 94102 (or Process_Office@cpuc.ca.gov) requesting to be placed on the service list for this proceeding.

6. Individuals interested only in monitoring the proceeding may request to be placed on the "Information Only" section of the service list. This service list will be posted on the Commission's website, www.cpuc.ca.gov.

7. The category of this rulemaking is preliminarily determined to be quasi-legislative as defined in Rule 1.3(d) of the Commission's Rules of Practice and Procedure. Ex parte communications are allowed pursuant to Rule 8.2(a). Pursuant to Rule 7.6, any party may file and serve an appeal of categorization no later than 10 days from the effective date of this OIR.

8. All parties shall abide by the Commission's electronic service rules contained in Rule 2.3.1 of the Commission's Rules of Practice and Procedure.

9. We hereby incorporate into the record of this new proceeding the progress reports and comments previously filed in R.06-06-028, as summarized in the dicta of this order, regarding threshold issues in the design of a reverse auction mechanism for selection of carrier of last resort and for setting the level of B-Fund support in designated high-cost areas.

10. The Working Groups that were previously formed in R.06-06-028 to develop proposals for a reverse auction mechanism are authorized to continue under the new proceeding. Based on the record that was developed in R.06-06-028 and which is incorporated into this proceeding, a Proposed Decision will be issued providing guidance on the disposition of threshold issues in the design of a reverse auction mechanism. Based on the disposition of these issues in the Proposed Decision, the Working Group will receive further direction to resume discussion of remaining reverse auction issues to be addressed.

11. The assigned Commissioner and Administrative Law Judge will set the schedule for this proceeding by subsequent rulings, as warranted, to develop the record and to bring this rulemaking to a conclusion.

This order is effective today.

Dated _____, at San Francisco, California.