

Rural Telephone Coalition

DOCKET FILE COPY ORIGINAL

RECEIVED

MAY - 7 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Federal-State Joint Board on
Universal Service

)
)
)
)
)

CC Docket No. 96-45

REPLY COMMENTS

of the

RURAL TELEPHONE COALITION

May 7, 1996

No. of Copies rec'd
List ABCDE

0+7

TABLE OF CONTENTS

SUMMARY	iii
I. THE COMMISSION AND JOINT BOARD MUST REJECT PROPOSALS NOT IN COMPLIANCE WITH THE 1996 ACT	1
A. THE CORE SET OF FEDERALLY DEFINED UNIVERSAL SERVICES IS AT THIS TIME ONLY A STARTING POINT IN A CONTINUING EVOLUTION	3
B. THE BENCHMARK RATE PROPOSALS DO NOT ASSURE REASONABLE AND COMPARABLE RATES	4
C. THE BENEFICIARIES OF THE NEW UNIVERSAL SERVICE MECHANISM ARE ALL USERS OF THE NETWORK	6
D. THE CONCEPT OF PORTABILITY OF UNIVERSAL SERVICE SUPPORT IS INCONSISTENT WITH THE ACT	7
E. THE BENCHMARK COSTING MODEL IN ITS CURRENT FORM WOULD BE HARMFUL TO UNIVERSAL SERVICE	8
F. INCREMENTAL COSTING AND PRICING THEORY HAS NO CONCEPTUALLY SOUND APPLICATION IN UNIVERSAL SERVICE MECHANISMS	11
G. INTEREXCHANGE SERVICES MUST CONTINUE TO BE RESPONSIBLE FOR AN APPROPRIATE PORTION OF NON-TRAFFIC SENSITIVE AND SWITCHING COSTS, AND IMPOSITION OF FULL SLCs CANNOT LEAD TO REASONABLE, AFFORDABLE, AND COMPARABLE RATES	15
II. RECOMMENDATION FOR SOUND POLICIES	18
A. CURRENT HIGH COST MECHANISMS CAN BE ACCOMMODATED WITHIN THE REQUIREMENTS OF THE ACT	19
B. THE NEED FOR A TRANSITION DEPENDS ON THE EFFECT OF THE NEW PROVISIONS ON RATEPAYERS, LECs AND UNIVERSAL SERVICE	22
III. CONCLUSION: THE COMMENTS DEMONSTRATE THE NEED FOR A MORE FOCUSED SET OF PROPOSALS	22

SUMMARY

The initial comments of the Rural Telephone Coalition, and many other parties, pointed out the major changes in approach to universal service issues required by the Telecommunications Act of 1996. Despite the specific requirements of the 1996 Act, however, many parties advocated approaches which would be inconsistent with the Act's requirements. The various proposals of these parties to limit support to low income or residential users, base support on some benchmark, to define cost by proxy and to impose substantial deaveraged increases in the Subscriber Line Charge do not meet the requirements for just, reasonable and affordable rates, comparability between urban and rural, and sufficient, predictable support mechanisms.

While LEC industry parties are in not in agreement, the better view is that the new support mechanisms required by the 1996 Act cannot be restricted to the amount allocated to the interstate jurisdiction by the current Part 36 separations rules, because the purposes of the Act are not so limited.

The attempts by some parties to restrict the scope of supported services is inconsistent with the objectives ensuring access to advanced telecommunications and information services. Following adoption of the core set of services, the Commission should commit to frequent review to ensure that the program stays current with respect to technology deployment.

The proposals of different parties to use "benchmarks" to determine support eligibility do not adequately addresses the requirement of comparability, either because they focus only on interstate allocated costs or because they make apples to oranges comparisons. These proposals do not reflect the substantially restricted calling scope which characterizes rural areas so that the typical monthly bill of the rural subscriber exceeds that of the urban because of toll charges to

reach essential locations within the community of interest.

Proposals to limit support to residential services, or to provide “portability” of support are also inconsistent with the 1996 Act.

The Benchmark Costing Model (BCM) while theoretically interesting, has not been shown to represent accurately the costs incurred in serving rural areas. Absent such a showing the Commission cannot find that it meets the 1996 Act’s requirements that support mechanisms be sufficient and predictable. Should the Commission decide to experiment with use of this model on large LECs, it must carefully isolate them from small companies so that inconsistent eligibility determinations do not result.

Several parties promote the use of incremental costing methodologies in an obvious effort to reduce their own support obligations or access charge bills. These recommendations, sounding in sophisticated economic theory, ignore the basic fact that somebody has to pay the embedded cost, and if that somebody is the basic local service subscriber, the result will be substantial increases inconsistent with the objectives of the 1996 Act. As the Washington Utilities and Transportation Commission recently observed, the local loop is required to provide all of the basic services, yet it is incremental to none of them.

In a similar vein, several parties suggest that interexchange carriers should not be required to pay a share of non-traffic sensitive cost when they use a LEC local loop to originate or terminate calls. Rather, the SLC charge should recover 100% of the loop cost, or at least the portion of the loop not recovered through the USF. The IXCs understandably want for free what in any other business they would have to pay for, but such free service is neither just nor reasonable. To the contrary, the result would be inconsistent with the universal service objectives

of the Act because of the shift of burden to local subscribers. The separate issues of the most appropriate rate structure to recover such cost and the proper balance between CCL and SLC charges can be readily dealt with, without causing large increases to subscribers. Similarly, the current cost allocation formula for traffic sensitive costs of small companies appropriately recognizes the additional costs of equipping a switch to handle non-local traffic and the higher costs of smaller switches.

In order to proceed with this Docket in a manner which meets the statutory timeline, there are several steps the Joint Board and Commission can take now without resolving all of the difficult questions presented by the new Act. First, there should be a recognition that the current high cost support mechanism can be readily integrated into the new rules. By building on the success of these rules, disruption of subscriber rates can be minimized, while a new recovery mechanism and newly eligible carriers can be accommodated. As the new rules begin to take shape, it will be more clear as to whether a transition mechanism is required.

The Commission can meet the Act's requirements by adopting the core set of services, directing recovery to be made on a retail revenue basis, and by adopting a timetable to fully implement Section 254. Administration should be conducted by NECA in a manner that avoids preventing it from performing its tariff and pooling functions on behalf of its members. To accomplish this, a more specific proposal should be issued promptly containing proposed rules and a proposed timetable. A specific issue in the timetable should be a plan for expanding universal service support to cover the costs of service to schools, libraries and health care providers.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Federal-State Joint Board on)	CC Docket No. 96-45
Universal Service)	

**REPLY COMMENTS
of the
RURAL TELEPHONE COALITION**

The Rural Telephone Coalition ("RTC") files these Reply Comments in response to the comments filed on April 12, 1996, in the above-captioned docket.¹ This proceeding is examining implementation of the universal service provisions contained predominantly, but not entirely, in Section 254 of the Telecommunications Act of 1996 ("Act").

The Commission and Joint Board should use this round of comments and replies as an opportunity to dismiss suggestions that are misplaced, harmful, or beyond any lawful implementation according to the direct requirements and time constraints of the Act. The reply comments below are intended to assist the Commission and Joint Board in two ways: to point out those suggestions which can be eliminated; and to provide a realistic set of suggested actions to be completed by May 1997 to implement the Act .

I. THE COMMISSION AND JOINT BOARD MUST REJECT PROPOSALS NOT IN COMPLIANCE WITH THE 1996 ACT.

The RTC explained in its initial comments the need for federal mechanisms that comply

¹ Unless otherwise indicated, citations herein refer to comments filed on April 12, 1996, in response to the *Notice of Proposed Rulemaking and Order Establishing Joint Board* released on March 8 in this docket ("*NPRM*"). The RTC is comprised of the National Rural Telecom Association ("NRTA"), the National Telephone Cooperative Association ("NTCA"), and the Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"). The RTC filed joint comments on April 12 in the first round of this proceeding.

with the 1996 Act and achieve the intentions of Congress. The comments, however, reflect diverse views that embrace several conceptual themes which must be rejected. These suggestions are either inconsistent with or counter-productive to the requirements of the Act. Moreover, many commenting parties suggest provisions that would act, if implemented, to limit severely the universal service mechanisms' effectiveness and the potential benefits Congress intended the Act to promote.²

The Commission and Joint Board should look to those experienced with rural conditions to help in universal service implementation. As one excellent example, the Eight Rural States: (1) realize that Congress has required "sufficient" high cost funding, rather than the curtailed funding pursued by the previous Joint Board proceeding;³ (2) recognize the need to determine rural and urban rate and service comparability;⁴ (3) state that high cost support and distribution must be based on actual costs unless the major shortcomings of the proxy approach can be solved and its reliability demonstrated;⁵ (4) support application of the new law's broad federal responsibility for universal service mechanisms and a limited, supplemental state role with respect

² The filing made by eight rural state commissions stands out in that it successfully, with but a few minor exceptions, meshes the new law with the different needs and characteristics of rural America that Congress meant to accommodate. See Comments of: The State of Maine Public Utilities Commission, the State of Montana Public Service Commission, the State of Nebraska Public Service Commission, the State of New Hampshire Public Utilities Commission, the State of New Mexico State Corporation Commission, the State of Utah Public Service Commission, the State of Vermont Department of Public Service and Public Service Board, and the Public Service Commission of West Virginia ("the Eight Rural States").

³ The Eight Rural States at 2-3; and the RTC at 6.

⁴ The Eight Rural States at 1-2.

⁵ *Id.* at 4-8; and RTC at 11-12.

to additional requirements;⁶ and (5) point out that interexchange carriers should pay a continuing share of loop costs because they require and use local distribution to obtain access to their customers.⁷

In sharp contrast, many other commenting parties fail to accept the Act's concern for adequate rural measures and other universal service policy directives. The Joint Board should listen carefully to those that oversee and provide universal service to rural America and implement sections 254 and 214 accordingly. Moreover, the Joint Board should reject the following misdirected proposals and presumptions to avoid wasting its limited time and resources.

A. THE CORE SET OF FEDERALLY DEFINED UNIVERSAL SERVICES IS AT THIS TIME ONLY A STARTING POINT IN A CONTINUING EVOLUTION.

Some commenting parties suggest that the list of defined and supported services be limited to minimum levels.⁸ These parties ignore the express statutory principles of "access to advanced telecommunications and information services." Minimum commitment will mean minimum result. The core set of defined services should only represent a starting point, at least as beneficial for customers as are the levels of services the nation's users enjoy today.

As the RTC Comments explained, Congress expects the Joint Board to encourage

⁶ The Eight Rural States at 14.

⁷ *Id.* at 15-20.

⁸ For example, US West advocates only a "deployment of a core set of basic telephony services." US West at 5. NYNEX at 1 suggests that "[t]he Commission should limit the size of the universal service fund to the minimum necessary. . . ." *See, also*, Bell Atlantic at 6-10. Other commenting parties would limit the mechanism in other ways. *See* all of the following sections in this part.

network advances and service availability in rural areas, based on urban market developments.⁹ However, the RTC also supports a pragmatic approach by the Joint Board to initiating the mandated evolution: first adopting the core set and then clearly committing to review, through a progressive definition process, immediately upon completion of the heavy implementation schedule next year.

B. THE BENCHMARK RATE PROPOSALS DO NOT ASSURE REASONABLE AND COMPARABLE RATES.

Some comments suggest satisfaction of the statutory principles requiring comparable, reasonable and affordable rates by setting "benchmark rates." There are several views on how to implement a benchmark system.

USTA proposes an "interstate affordability benchmark equal to the nationwide average loop cost."¹⁰ This proposal would, for other than rural telephone companies, limit the federal universal service funding mechanism to the amount by which the interstate portion of loop costs exceed the interstate benchmark.¹¹ The effect would be to create a different SLC for each LEC capped at its interstate benchmark rate. This plan would substantially undermine the

⁹ RTC at 2-3.

¹⁰ USTA at 15. The USTA plan apparently calls for: 1) carriers to allocate the full 25 percent interstate allocated common line cost to end user recovery; 2) an allowance for SLCs to "rebalance" to a local level based on areas smaller than study areas; and 3) users to be charged SLCs either (a) at the full 25 percent end user amount, if less than the interstate benchmark, or (b) the benchmark. *Id.* Of course, this full 25 percent allocation of common line costs to non-carrier common line ("CCL") recovery eliminates any recovery from long distance carriers and their customers for their use of common lines. *See I. G., infra.*

¹¹ Similarly, Frontier also urges substantial jurisdictional cost shifts, claiming that even the 25% gross allocator and DEM weighting mechanisms "unquestionably over allocate costs to the interstate jurisdiction." Frontier at 10.

comparability criterion and sufficiency requirements in the Act.

This approach, by focusing only on the interstate portion of loop costs, shifts much of the burden of high cost recovery onto the states, except for the small LECs which remain under the current Universal Service Fund (“USF”) and Dial Equipment Minutes (“DEM”) weighting rules. Intrastate rates would have to absorb the other 75 percent or so of costs and the responsibility to support comparability and reasonableness would be left to states to accommodate within this portion of cost recovery. As described by GTE, some states would be unable to fund their share of the universal service requirements if the Federal universal service support mechanism is limited to the portion of the 25 percent of loop costs above the interstate benchmark.¹² The Act’s expansive universal service mandate will not be satisfied if the interstate mechanisms are too limited.¹³

US West suggests a different “federal funding benchmark” of \$30 a month.¹⁴ Costs over that level would be recovered through a federal universal service fund, with any further high cost mechanism left to the states. While preferable in that it recognizes a greater federal mechanism role, US West’s plan, nevertheless, applies only an affordability test without consideration of comparability.

In addition, these approaches are too simplistic, because as pointed out in CC Docket No.

¹² GTE at 13.

¹³ Some carriers underestimate the importance of the mechanism and apparently want to limit the total industry contribution. Minimum commitment, almost without exception, leads to minimum result. If Congress meant to minimize this commitment, it would have left universal service goals out of the Act.

¹⁴ US West at 12.

80-286 and this proceeding, a single benchmark would completely disregard differences in levels and values of service.¹⁵

Benchmarks would need to incorporate comparability of price and adjustment for the recognition of different service levels to comply with the Act and the will of Congress. The RTC believes, as do others, that the use and comparison of rate levels presents difficulties that should be avoided at this time.¹⁶ Instead, the Joint Board should adopt the recommendation to use an actual cost-based mechanism designed to identify high-cost above an appropriate threshold of per-unit network costs, in order to monitor comparability and sufficiently address high costs.¹⁷

C. THE BENEFICIARIES OF THE NEW UNIVERSAL SERVICE MECHANISM ARE ALL USERS OF THE NETWORK

Some commenting parties incorrectly suggest that universal service support is to be limited to residential subscribers and then only to those who “need” the funding. For example, MCI states that support should be limited to residential customers because “[e]xtending support of universal service to business customers would greatly expand the scope. . . .”¹⁸ Sprint states that “[a]t this time only basic residential telephone services should be generally supported for residential subscribers.”¹⁹ Others would only provide universal service support for those

¹⁵ RTC at 3. The Act requires comparable rates for comparable services. Basic local service at \$15 a month allowing access to a few million other local users is not comparable to a typical rural rate which only provides local service access to a few hundred subscribers.

¹⁶ The Eight Rural States at 11-12.

¹⁷ *Id.* at 13-14.

¹⁸ MCI at 9.

¹⁹ Sprint at 6.

customers served who are “eligible for support.”²⁰

These commenting parties are mistaken in their beliefs about the new law. Congress did not intend that access to advanced services supported by universal service mechanisms be confined to one “type” of customer.²¹ Congress intended not only to support services to individuals who could not otherwise afford service, but to support services to all users located in rural, insular, and high-cost areas. The Act and the explanatory statement clearly indicate that Congress intended for the universal service provisions to ensure that more than “needy” or residential customers should be the beneficiaries of the supported services.²²

D. THE CONCEPT OF PORTABILITY OF UNIVERSAL SERVICE SUPPORT IS INCONSISTENT WITH THE ACT.

Some commenting parties suggest that funding should follow subscribers. i.e., that funding should be “portable.”²³ The Act does not contemplate a system in which individual ratepayers decide which carriers are eligible for universal service support. The states have the

²⁰ TCG at 15.

²¹ The Colorado PUC staff “believes that funding should be applied to all access lines (business and residential) in rural and high cost areas.” Colorado PUC staff at 6.

²² See 47 C.F.R. 254(b)(3). The inclusion of “low-income consumers” to the list was an addition made during the Joint Conference. Manager’s Explanation at p. 131. It was contemplated by both houses of Congress that rural and high cost areas would have access to services that were supported by universal service mechanisms. See S. 652 § 247(b)(1)(A) and H.R. 1555 § 246(b)(2). In fact, attempts made to limit the beneficiaries of geographically averaged rates in § 254(g) to residential customers were defeated.

²³ “These subsidies should be fully portable, so that when a customer selects a particular carrier, that carrier will then be eligible for universal service funding to help serve the customer.” LDDS Worldcomm at 6. See also MFS at 15; and Association for Local Telecommunications Services at 14.

authority to designate eligible carriers and only those so designated may receive support.²⁴

Moreover, the portability discussion may presume exclusive support based on customers served. However, Section 214(e) prescribes more than one eligible carrier in urban areas and allows more than one in rural areas. Nor do the conditions which must be met to be deemed eligible hinge on service to any particular customer, but instead look to a carrier's ability and willingness to provide the list of defined supported services in a particular area.²⁵ The "portability" suggestions simply are inapposite given the Act's prescription of the eligible carrier concept and state designation.²⁶

E. THE BENCHMARK COSTING MODEL IN ITS CURRENT FORM WOULD BE HARMFUL TO UNIVERSAL SERVICE.

There is still substantial concern regarding proxy models, even from their supporters. The concerns involve the need for further revision, improvement, and relevant testing of the validity of the results. Even MCI, one of the Benchmark Costing Model ("BCM") sponsors, points to improper assumptions used by the model.²⁷ AT&T, another apparent supporter of a modeling approach, nevertheless admits that enhancements will be necessary, including the recognition of business lines.²⁸ The Eight Rural States, while apparently open-minded at this point, will require

²⁴ 47 C.F.R. § 214(e)(1).

²⁵ 47 C.F.R. § 214(e)(1) and (5), and § 254(e). Universal service support will not promote ongoing network investment with evolving and advancing quality services if the support is put at risk among carriers based on customers served.

²⁶ The Senate defeated, by a margin of 82-18, an amendment that would have added a "customer voucher" approach to universal service. The portability discussion attempts to resurrect the voucher approach.

²⁷ "First, the BCM assumes that households are uniformly distributed throughout the CBG. This assumption is probably least true in the more rural areas." MCI at 11.

²⁸ AT&T at Appendix A, pp.1-2.

modifications and proof that “its results bear some relationship to the actual cost of providing service today.”²⁹

Even some large LECs which presumably would be more protected from serious errors under a proxy plan, do not now or in the future support a BCM approach. Ameritech wants to retain an actual cost approach and appears not to want to waste time on the BCM “[u]ntil that evaluation and review . . . can be completed.”³⁰ Southwestern Bell argues that “[a]dopting a demonstrably inaccurate proxy model to address the assumed unwillingness of new entrants to offer consistent, uniform, and actual data comparable to that supplied by an incumbent LEC is simply wrong.”³¹

The Eight Rural States take the view that “[i]f universal support mechanisms are to adequately address localized cost differences, ultimately they should base funding upon the costs of providing service . . .,” and a proxy approach should be accepted only if “reliable engineering and economic model can be developed”³² Most serious at this point of development is that the model authors have avoided disaggregation of their analysis and modeling in the range of density, which by mere common sense, is most likely to be the highest cost and most likely to

²⁹ The Eight Rural States at 6, and 5-8, generally. The Eight Rural States suggest modifications: 1) to include business lines; 2) to improve assumptions regarding population, switching cost, coverage design, assignment to wirecenters, and technology trade-offs; and 3) to include other variables such as terrain and remoteness. *Id.* at 6-7.

³⁰ Ameritech at 12.

³¹ SWBT at 16.

³² The Eight Rural States at 5.

present the most unique and difficult to model characteristics.³³

The RTC emphasizes that, despite the claims of the sponsors, the predictive value of the BCM from a quantitative standpoint has not changed since it was first described and proposed. The sponsors have made changes, but there is no logical proof whether the changes improve or worsen the result.³⁴ The authors have described the engineering judgements that went into their multiple assumptions, have described how the multiple assumptions have been combined into mathematical formulas, and have shown how the mathematical formulas can be calculated. No one has been able yet to determine whether the results of the mathematical calculations bear any reasonable comparison to network costs associated with even a representative sample of census block groups. This is because network cost by census block group is not known, not defined, and, except for the speculation and assumptions, has not been examined.³⁵ It also bears repeating

³³ The least dense range for modeling purposes has been designed around a zero to five households per square mile. *See, generally*, Joint Sponsors' Benchmark Costing Model. This lowest density modeling range is much too aggregated for the typical experience of high cost LECs with densities well below 1 subscriber per square mile. Cost modeling for all census block groups below 5 households per square mile is a gross simplification given that the predominance of high-cost occurs at this and less dense range levels. For a more complete discussion of the merits, or lack thereof, of the BCM, *see* NTCA Comments filed on October 10, 1995, at 73-90; and NTCA Reply Comments filed November 9, 1995, at 26-30, both in CC Docket 80-286.

³⁴ The model may produce mathematical results such that, for example, one census block group's per-unit cost is twice as much as a second. While experts may with common sense understand that the first is clearly higher cost than the second, they do not know how much greater. Is the real answer 1.5 times, 2 times, 5 times, or 50 times as costly? The exact answer is paramount to establishing the proper support level. Just recognizing that one is higher cost is not a sufficient mechanism.

³⁵ Some point out that census block groups are not the best "service block" because there is "no planned relationship to the actual physical telecommunications network and the associated costs." Alaska PUC at 13-14. "[T]he BCM will fail to provide appropriate support if applied to Alaska in the model's current form, leading to erosion of universal service." *Id.* at 14-15.

that the quantitative evaluations we do have, however inadequate they may be at this time, reveal that on a study area basis the model deviates from a realistic level of cost.³⁶ In any event, the model must be tested properly before any evaluation can be made.

As a matter of logic, it is not possible to prove that the sponsors will be unsuccessful in their efforts.³⁷ It is easy, however, to observe that success has not yet been achieved. Despite the extreme dangers and the serious legal impediments presented by an inaccurate proxy model, should the Joint Board and Commission decide to move forward, perhaps only with some segment of the industry, a bifurcated approach must be constructed carefully to isolate those experimenting with proxies.³⁸

F. INCREMENTAL COSTING AND PRICING THEORY HAS NO CONCEPTUALLY SOUND APPLICATION IN UNIVERSAL SERVICE MECHANISMS

Some commenting parties suggest mechanisms that in one way or another rely on incremental costing methodology to establish support levels for universal service.³⁹ These

³⁶ "Conversely, it may be difficult to create a model which provides a verifiable relationship between proxy results and actual costs." New York State Department of Public Service at 6.

³⁷ Even for those expecting to adopt a BCM approach, there is still doubt as to the ultimate form: "There is still unresolved issues remaining regarding the appropriate proxy model and inputs." Public Utilities Commission of the State of California at 11. These doubts leave questions about ultimate success.

³⁸ Even isolation of companies may not be enough to guard against wildly erroneous results leading to distorted pricing for otherwise comparable areas.

³⁹ For example, both AT&T and MCI, suggest similar mechanisms. AT&T recommends a plan that would provide cost recovery support "[t]o the extent that the [total service long run incremental cost ("TSLRIC")] of serving an area would require a local service rate that exceeds that affordable rate. . . ." AT&T at 14. MCI asks that the "subsidy" be calculated as "the difference between the [TSLRIC] of basic universal service, determined separately for different

(continued...)

suggestions and the results they would yield are inconsistent with the goals of the legislation and must be dismissed.

First, Congress did not intend to apply a minimizing cost recovery approach, as incremental costing theory would yield, to determine the sufficient levels necessary to achieve the goals outlined in the Act.⁴⁰ Carriers cannot make capital commitments to major network upgrades and maintain current facilities if they are to be subjected to cost recovery support based on the potentially minimum calculations.⁴¹ The parties suggesting this approach have not explained how “squeezing” cost recovery on all sides is going to lead to reasonable, affordable and comparable rates. Forms of incremental costing may be useful intellectual, analytical tools for establishing non-predatory pricing floors in a not yet fully competitive marketplace, but provide relatively little guidance to the real world practitioner trying to preserve and advance universal service.⁴² The Act explicitly requires that universal service be retained in a competitive,

³⁹(...continued)
geographic cost zones. . . , and the revenues generated by rates set at the current nationwide average.” MCI at ii.

⁴⁰ **The support must be specific, predictable, and sufficient and must be designed both to preserve and advance universal service. 47 C.F.R. § 254(b)(5).**

⁴¹ **Calculations which would be subject to extreme theoretical debate and fierce disagreement over their proper practical application would further burden universal service.**

⁴² **The Washington Utilities and Transportation Commission (“WUTC”) understands: “The Commission will use incremental cost studies primarily to establish price floors for individual services. . . . [I]t is important to ensure that the rates at least cover the incremental costs of providing that service. Guarding against cross-subsidy and predatory pricing is the primary function of the incremental cost studies.” Fifteenth Supplemental Order, Docket No. UT-950200, released by the WUTC on April 11, 1996 (“WUTC Order”) at p. 81. “No party has suggested any sort of mechanistic relationship between incremental costs and rates. . . . Neither are rates based on equal markup over incremental cost necessarily fair. An equally ‘fair’ rule, with potentially very different rates, would be to have equal discounts from the stand-alone cost of**

(continued...)

interconnecting environment. Basic "universal service" users should not be asked to pay for the remainder of cost after the incremental payers have had their way by squeezing the cost recovery of the class of carriers that most contribute to the goals.

Incremental costing theory is presented with a huge conceptual dilemma -- the treatment of joint and common costs in excess of incremental costs. The resolution of this dilemma is essential to the achievement of reasonable basic rate levels for high-cost, rural, sparsely populated areas because the portion of costs not clearly addressed by incremental theory constitutes a large percentage of the overall cost recovery burden. The Washington Utilities and Transportation Commission ("WUTC") recently concluded in addressing a rate case of US West that "[s]ince the loop is required if [US West] is to provide any one of toll service, access service, or local service, it is incremental to none of the services."⁴³ The WUTC also concludes that "local loop facilities are required for nearly every service provided by a [LEC] to a customer."⁴⁴ In contrast, the proponents of incremental costing techniques often conveniently conclude that 100 percent of the local loop distribution costs are incremental to services for which they hope to bear little or no recovery responsibility or risk.⁴⁵ Every service places cost recovery demands on LECs' local distribution and first point of switching networks. Theoretical long run incremental cost arguments work to establish minimal prices for those customers who successfully convince policy

⁴²(...continued)
each service." *Id.*

⁴³ WUTC Order at p. 83.

⁴⁴ *Id.*

⁴⁵ AT&T, MCI and others have perpetuated the argument that no portion of local loop costs should be borne by long distance services and that it follows that all of the local loop costs should be attributed incrementally to basic local service.

makers that their service should be incrementally priced leaving to all other customers the remaining non-incremental revenue requirements.⁴⁶

Additionally, AT&T wants, in determining an affordable benchmark rate, to presume that it includes an increase in the subscriber line charge to recover all of the joint cost of local loops.⁴⁷ Then, AT&T suggests the use of an as yet undeveloped model to determine a minimized incremental cost of universal service to be compared to a full-SLC “weighted average of . . . rates” to establish the level of support.⁴⁸ In other words, AT&T wants to squeeze universal service from both ends: minimize its theoretical cost calculation and then compare its cost to an arbitrarily maximized benchmark.⁴⁹ Even novice observers will wonder how such a system will achieve a beneficial result.

As most understand, if all telecommunications providers (or for that matter any other industry) set out to charge all their customers on some incremental cost basis, they would all go out of business. The Commission has previously recognized the huge issue of how to recover costs in excess of incremental costing when non-incremental dependent costs represent a large

⁴⁶ The WUTC also concludes that “[o]ther considerations . . . remain an important part of the rate-setting process.” *Id.* at p. 82. The WUTC cites: “1. Effectiveness in yielding total revenue requirements under the fair return standard; 2. Fairness in the apportionment of total costs of service among different consumers; and 3. Efficiency in discouraging wasteful use of services while promoting all justified types and amounts of use, in view of the relationships between costs incurred and benefits received.” *Id.* at n. 42.

⁴⁷ AT&T at iii. AT&T forgets that affordability is not the only criterion required by Congress. Comparability to urban areas’ rates is also required.

⁴⁸ *Id.*

⁴⁹ MCI approaches this question similarly, except that it proposes a benchmark rate of \$20 per month. MCI at ii.

portion of telecommunications networks.⁵⁰ Given this “in excess of incremental cost” component, the debate has more to do with the manner in which these costs are spread to prices than perhaps the manner in which theoretical incremental costing determinations are developed in the first place. This industry does not need to plunge into a incremental cost pricing scheme to promote universal service.

G. INTEREXCHANGE SERVICES MUST CONTINUE TO BE RESPONSIBLE FOR AN APPROPRIATE PORTION OF NON-TRAFFIC SENSITIVE AND SWITCHING COSTS, AND IMPOSITION OF FULL SLCs CANNOT LEAD TO REASONABLE, AFFORDABLE, AND COMPARABLE RATES.

It may be that some adjustment to the SLC could be shown to be reasonable and consistent with the comparability test in the Act. However, a continuing misleading theme found in the comments is that LEC access charges are set at levels that result in subsidy from interexchange carriers and their service users. Access charges including both common line IXC charges and traffic sensitive charges are neither set at subsidizing levels now nor were they ever constructed to yield universal service support.

The Commission and Joint Board should be wary of elevating the SLC for the sole purpose of lowering common line charges that IXCs should justifiably pay.⁵¹ Interstate access charges are set at reasonable levels that reflect a fair share assessment of IXCs’ use of local network plant. This relative share of use reflected in charges to IXCs results in their cost

⁵⁰ *Notice of Proposed Rulemaking*, CC Docket Nos. 95-185 and 94-54, released by the Commission on January 11, 1996, at paras. 49-55.

⁵¹ For example, AT&T argues “the SLC should be raised to recover fully the subscriber loop portion, or base factor portion, of the interstate common line; this will result in a SLC of approximately \$7.00 per subscriber (with offsetting reductions in the access charge component of toll rates).” AT&T at 16.

recovery responsibility for only a small percentage of local distribution and local switching costs nationwide. First, only 25 percent of common line costs are allocated to the interstate jurisdiction. The subscriber line charge for most LECs recovers the bulk of this 25 percent allocation. The remaining portion -- much less than 25 percent -- is recovered via IXCs and the rates they charge their long distance users.⁵² It is difficult to imagine how such a modest portion of costs represents a "subsidizing" level. Absent any artificial influence of others (such as regulation), IXCs would not expect to gain use of local networks for free. No one would expect local network providers to offer the use of their facilities for free. This result should not be imposed by regulatory fiat.⁵³

Moving to full SLCs and/or reducing the responsibility of IXC services to bear a reasonable percentage of local costs would be contrary to simulation of a competitive marketplace and would result in local network providers and their local services users subsidizing interexchange carriers and their long distance users.⁵⁴ More important, to make such a move

⁵² In addition to the 25 percent allocation, the Universal Service Fund allocates approximately 2 percent to the interstate jurisdiction.

⁵³ Now consider another illustrative example whereby two complete competing networks with redundant facilities, both capable of providing both local service and long distance service. If they were competing for customers to connect to their respective networks and buy their services, they would not seek to recover all local distribution, non-traffic sensitive costs in the form of full, recurring monthly charges. Competitive carriers would opt, at least for some portion of customers, to split the cost recovery between up-front recurring charges and volume service charges. Too high a recurring charge would not attract customers from a competitor or keep existing customers from moving to another competitor with a lower recurring charge.

⁵⁴ "[T]he Texas PUC reminds the Commission that the local loop is necessary for the provision of virtually all telecommunication services. . . . We therefore urge that the Commission not increase the interstate [SLC] at least until appropriate costs are developed, additional determinations are made regarding the assignment of joint and common costs, and the

(continued...)

would put upward pressure on the rates that universal service mechanisms are intended to support, thereby making these goals more difficult to achieve.⁵⁵ We should not transfer needlessly non-universal service cost recovery, properly addressed elsewhere, to the support mechanism. Therefore, the CCL portion of common line recovery should neither be moved to the new mechanisms under the guise of universal service support nor simply discontinued. The CCL remains a small portion of common line costs for which IXCs appropriately should remain responsible.

As has been submitted in this and the earlier CC Docket 80-286 proceeding, the special demands of long distance service are one reason that per-unit switching costs are higher than that attributable to local calling. The weighting of the interstate DEM by smaller LECs is a method intended both to recognize the higher toll costs of switching and the higher relative per-unit switching costs of smaller LECs with predominantly small offices.⁵⁶ Both purposes are reflected

⁵⁴(...continued)

components of the universal service funding program are in place.” Public Utility Commission of Texas at ii.

⁵⁵ “The SLC shifts costs from the interLATA user to all conventional users. This shift has a recognizable effect of hampering universal service goals.” South Dakota Public Utilities Commission at 2. “[T]he NYDPS opposes an increase in the federal [SLC] as a result of a decision to reduce the interstate carrier common line charge. It is our view that such action could jeopardize the continued provision of quality services at affordable rates and is counter to the goal of federal legislation that quality services be provided at affordable rates.” New York State Department of Public Service at 1-2.

⁵⁶ It is arguable that part of the DEM weighting mechanism is properly charged to IXCs for their use of switching given higher toll demands, and this portion is not a subsidy. Moreover, a DEM allocator for switching partially results in the subsidy of toll services by local services because intra switch local call minutes are counted twice, while toll and extended area service call minutes are only counted once, in arriving at the allocation factor. If the Commission and the Joint Board are to adjust interstate DEM weighting, then they should also adjust the hidden two-
(continued...)

in the weighting scheme. The portion that addresses higher toll service demands on switching, in general, and higher proportions for smaller offices, more specifically, still represents an appropriate share for toll service providers and their users to bear. Other portions intended solely to address high cost can be treated as such.⁵⁷

Instead, this discussion of the subsidy issue should be dropped and the concentration moved to the structure of the charges and recovery from users. Once an IXC's share of cost recovery responsibility for local distribution and switching plant is established, IXCs can then find ways in which to charge their customers for this responsibility. LECs should be allowed to structure the CCL charge in ways that do not accumulate per-minute charges that motivate IXCs to find ways to avoid the charges that correspond to high volume, individual customers. LECs are more concerned about the relative recovery of local distribution cost across all services than in determining the portion for any single customer.

II. RECOMMENDATION FOR SOUND POLICIES.

The record indicates that the Commission and Joint Board should build on the existing, successful mechanisms as a strong starting point to implement Section 254 of the Act.

There is no need to make any initial, disruptive changes, particularly those suggestions found in

⁵⁶(...continued)
times local weighting. For several years, the industry has been awaiting a resolution to the question of what the proper long term allocation should be. Many believe that the factor called the switched minutes of use ("SMOU") would be a more proper allocation factor. This factor removes the two-times weighting of local, intra switch usage.

⁵⁷ The RTC notes that some commenting parties suggest that, for treatment of high cost, TS and NTS costs should be examined in combination. The Eight Rural States at 10. This would not be appropriate since carriers face separate high cost recovery and rate problems for TS and NTS costs. Such a combination would, with unfair and unhealthy consequences, enable resellers and interconnectors to cherry-pick the system.

the comments that would be counter-productive to universal service. Accordingly, to reinforce and expand what works, the RTC offers the following recommendations.

A. CURRENT HIGH COST MECHANISMS CAN BE ACCOMMODATED WITHIN THE REQUIREMENTS OF THE ACT.

The current universal service mechanisms, in conjunction with new provisions, can be adjusted, without radical modifications, to fit the requirements of the Act.

1. Universal Service Fund (“USF”)

The need to address the high per-unit cost of local distribution loop plant will remain a primary goal under the Act. NTS plant costs vary most indirectly with density of customers from location to location and can potentially place the greatest demand on maintaining comparable rates. The current USF mechanism addresses recovery of costs in excess of national averages in a remarkably successful manner. This provision mitigates and limits costs that must be recovered elsewhere in rates. The provision should be paralleled in the new system by simply moving the allocation and recovery to the federal universal service mechanism as prescribed in the Act.⁵⁸

2. Treatment of New Eligible Telecommunications Carriers.

One necessary modification involves accommodation of support to newly eligible carriers who may not yet possess the necessary data to participate in the USF mechanism initially. The RTC has already explained why the public interest and the new law require that any support to new facilities-based eligible carriers must be based on an equivalent cost and achieved quality

⁵⁸ USTA, at 16, agrees that at least for rural LECs, the USF and DEM Weighting should be continued.

mechanism as applied to existing carriers.⁵⁹ The Commission should base the support level on the calculation of the actual costs for individual eligible carriers, and should not base it on the incumbent LECs' costs. This is a small burden for eligible carriers and the public to bear to be certain the goals of the Act are being carried out as intended.⁶⁰ Only through oversight that is dependent on accounting, costing and quality criteria will the results be known and the success guaranteed. The RTC also agrees with others that at least initially, support should be limited for newly eligible carriers to no higher than that of incumbent LECs.⁶¹ Should newly eligible carriers use some measure of support apart from actual cost and quality, it should be severely limited in scope, duration and be subject to an actual accounting at a later date.⁶²

3. Treatment of Resale.

In no case should resellers receive support for the portion of services they provide over the actual facilities of another carrier.⁶³ The mechanism must be structured to support the cost of facilities that provide the defined universal services, and only once.

4. Strong and effective anti-cream skimming provisions.

⁵⁹ RTC at 11-12.

⁶⁰ For those newly eligible carriers that argue that they are small and should not be required to shoulder these rules, it should be noted that hundreds of existing LECs are small entities and nevertheless comply with several sets of the Commission's rules.

⁶¹ USTA at 17; and NECA at 9-11.

⁶² RTC at 11-15.

⁶³ Similarly as "an entrant that merely resells a bundled retail service purchased at wholesale rates, would not receive the access revenues." *Notice of Proposed Rulemaking*, CC Docket No. 96-98, Implementation of the Local Competition Provisions in the Telecommunications Act, released by the Commission on April 19, 1996, at para.186. *See also* RTC at 9-10.