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FEDERAL COMMUNICATIONS COMMISSION
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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
UNITED STATES TELEPHONE ASSOCIATION

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May 7, 1996

No. of Copies rec'd 029
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SUMMARY

USTA proposes to replace implicit support with targeted, discrete support mechanisms funded in a competitively neutral manner based on contributions from the retail revenues of all interstate service providers. USTA's approach is conservative in that it seeks to ensure that a basic level of services are available thoughout the nation to meet the specific needs for support. USTA expects that each fund will evolve, consistent with the requirements of the Act, to continue to reflect the evolution of the market, technology and customer needs.

In order to establish specific, predictable and sufficient federal and state mechanisms to preserve and advance universal service, the Commission and the Joint Board should take the following steps: 1) Rely on the market wherever possible, to define and provide universal service at reasonable and affordable rates. Rate rebalancing is required in both the federal and state jurisdictions to ensure that exchange carrier rates are more economic and therefore more sustainable in a competitive environment. The Act requires that subsidies buried in exchange carrier rates be made explicit. Rate rebalancing should be accomplished in a revenue neutral manner by increasing rates for services provided below cost and decreasing rates for services provided above cost. 2) Establish discrete funds for the customers identified in the Act as requiring explicitly subsidized universal service: customers in high cost, rural, insular and unserved areas, although the actual support should be provided to the carrier serving those areas to ensure that facilities to provide universal service are built and maintained, qualified schools and libraries, rural health care providers and low income subscribers. Separate funds are required to meet the different needs and different statutory requirements for each identified group. 3) Ensure that rate rebalancing and the establishment of universal service support mechanisms occurs at the state level to achieve affordability of the customer's total service. States should develop intrastate mechanisms based

on the same concepts used to develop the interstate high cost support mechanism USTA proposed in its comments. 4) Concentrate, initially, on ensuring that the core set of services is available throughout the Nation before adding advanced services to the definition. 5) Target high cost support to smaller geographic areas.

USTA's proposed support mechanism for qualified schools and libraries has many advantages. It provides qualified schools and libraries flexibility to determine the specific services which each requires. It acknowledges that telecommunications services are only one part of a successful initiative to effectively incorporate Information Age technologies and functionalities into a school's curriculum or into a public library so that the full benefits of new technologies and capabilities are realized. It is based on a specific fund amount which will ensure that the mechanism is specific, predictable and sufficient to connect every qualified school and library to the Information Superhighway. It allows the states to be involved in approving the bona fide requests and in distributing funds to the schools. It allows the Commission and the Joint Board to be involved in establishing the criteria for the bona fide requests. It allows a national educational organization to be involved in establishing the criteria under which funds would be distributed to the states. It allows other telecommunications and information providers, equipment manufacturers, local governments and private citizens to be involved in providing all the components necessary for the bona fide request. It provides for what amounts to a discount of 100 percent of the requirements for connectivity as established in the KickStart Initiative's Lab Model.

USTA agrees that student head count should not be the sole determinant in distributing funding to the states. Non-telecommunications services, such as inside wire and on-line services, need not be funded as these are competitive services which the market will ensure are affordable.

Many parties supported USTA's proposal that an affordability benchmark be established as a maximum amount which reflects what customers reasonably expect to pay for universal service in high cost, rural, insular and unserved areas. An explicit funding mechanism would recover the costs of providing the core set of services above the benchmark.

USTA's proposed interstate benchmark would be equal to the nationwide average loop cost to replace the current EUCL caps. EUCL prices would be set at a level equal to interstate loop costs or the affordability benchmark, whichever is lower. In some service areas, the new EUCL price will be lower than the existing EUCL because current prices are based on study area average costs rather than targeted service area costs. In other areas, EUCL prices will increase to the affordability benchmark because current prices are far below costs. The Lifeline Assistance program should be expanded to cover any increased EUCL price to ensure affordability for low income customers. The record demonstrates that an increase in EUCL prices will not affect universal service.

Interstate high cost support per line would equal the difference between the amount of interstate loop costs per line for the service area and the benchmark level or the price, whichever is lower. Costs should be based on embedded costs to ensure that the full costs of providing universal service above the benchmark and a reasonable contribution toward shared and common costs can be recovered.

The current USF and weighted DEM support mechanisms would be continued, although only for rural telephone companies. This will ensure that high loop and switching costs for rural telephone companies will continue to be recovered in the interstate jurisdiction, thereby preventing a shift of current federal high cost support back to the states for recovery. Many parties support retention of these programs since they meet the requirements of the Act and will provide support in areas which are not likely to see any benefits from competition.

USTA strongly opposes using TSLRIC to set prices for services. TSLRIC will not recover the full costs of providing services. If all prices were set at TSLRIC, as some parties suggest, joint, common and shared costs could never be recovered and the carrier would eventually go out of business. TSLRIC imposes uniform prices which are antithetical to a competitive market. In addition, TSLRIC cannot serve as the basis for measuring universal service subsidies since TSLRIC ignores investment made to fulfill carrier of last resort requirements.

There is overwhelming evidence on the record in CC Docket No. 95-115 that the states and local exchange carriers have already instituted many of the proposals suggested by the Commission to assist customers in remaining on the network and to connect new customers. There is no need for federal mandates to accomplish what has already been implemented. Addressing the unique circumstances of the six percent of the population which currently does not have telephone service should be the responsibility of the states.

The public interest demands that the burden fall on those seeking to be exempt from funding universal service support mechanisms to prove that such an exemption will not harm the public interest. Funding should be based on annual interstate telecommunications revenues associated with retail transactions. This is consistent with the Act and is the most economically efficient way in which to assess the contribution. Collection of funds should be through a fixed surcharged applied to the retail transactions included in the funding base.

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REPLY COMMENTS
OF THE
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The United States Telephone Association respectfully submits its reply to the comments filed April 12, 1996 in the above-referenced proceeding.

In its comments, USTA presented proposals which will mold the guiding principles contained in the Telecommunications Act of 1996 [Act] into a coherent, reasonable universal service policy. In its reply, USTA will discuss several concerns raised in the comments, including the importance of targeting universal service into discrete, well-defined funds, encouraging state participation particularly in the establishment of support for high cost, rural, insular and unserved areas, and ensuring affordability. USTA will also oppose the adoption of pricing schemes, such as the use of total service long run incremental costs (TSLRIC) to price certain services as suggested by AT&T and MCI, which will only serve to inhibit competition contrary to the intent of the Act.

I. SPECIFIC, PREDICTABLE AND SUFFICIENT FEDERAL AND STATE MECHANISMS TO PRESERVE AND ADVANCE UNIVERSAL SERVICE.

In order to establish specific, predictable and sufficient federal and state mechanisms to preserve and advance universal service as required by the Act, the Commission and the Joint Board must take the following steps. First, the Commission and the Joint Board must rely on the market wherever possible, to define and provide universal service at reasonable and affordable rates. This step, therefore, requires the rebalancing of exchange carrier rates in both the federal and state jurisdictions to be more economic and therefore more sustainable in a competitive market.[1] As the Act requires, subsidies buried in current exchange carrier rates should be made explicit. Rate rebalancing should be accomplished in a revenue neutral manner by increasing rates for services provided below cost and decreasing rates for services provided above cost.[2]

This step alone will provide enormous benefits. Rate rebalancing is the most effective way to limit the size of universal service support mechanisms. It will promote efficient market entry by ensuring that all competitors are allowed to offer market based prices to customers. As a result, customers in areas with new entrants will receive the full benefits of competition i.e., lower prices and greater service choices. It will also reduce the cost burden borne by incumbent exchange carrier customers to fund current implicit universal service support.

However, the public interest requires, and the Act confirms, that the price of providing a certain level of service to particular subscribers be subsidized. This is necessary for a number of reasons. For example, competition will not develop in some areas to assure affordable prices. Certain areas are too costly to serve at affordable prices. For some customers, affordability simply cannot be achieved. Therefore, step two should be to establish discrete funds for the customers identified in the Act as requiring explicitly subsidized universal service: customers in high cost, rural, insular and unserved

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[1] U S WEST at 3, Ameritech at 4-5 and Frontier at 1-2.

[2] Under USTA's proposal to fund universal service support for high cost, rural, insular and unserved areas, prices would be increased to an affordability benchmark.

geographic areas,[3] qualified schools and libraries, rural health care providers and low income subscribers.

Separate funds are required to meet the different needs and different statutory requirements for each of the groups listed above and to further the general principle that the funding mechanisms be "specific, predictable and sufficient."[4] Separate funds are by definition specific. Defining each fund to meet a specified purpose will also assist in making the fund predictable. Targeting each fund will assist in determining that it is sufficient.[5] USTA's proposal replaces implicit support with targeted, discrete mechanisms funded in a competitively neutral manner based on contributions from the retail revenues of all interstate service providers. USTA's approach is conservative in that it seeks to ensure that a basic level of services are available throughout the nation to meet each specific need for support. Such a starting point will avoid creating and/or perpetuating telecommunications "haves" and "have nots". USTA expects that each fund will evolve, consistent with the requirements of the Act, to continue to reflect the evolution of the market, technology and customer needs.

Third, rate rebalancing to assist in the removal of implicit support and the establishment of universal service support mechanisms must occur at the state level. State commission development of compatible support mechanisms for high cost, rural, insular and unserved areas is necessary to achieve

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[3]Support for high cost, rural, insular and unserved areas should be provided to the eligible carrier servicing the geographic area. This type of support should be used to provide maintain and upgrade facilities to ensure affordable, high quality service is maintained. Provision of this type of support to customers will not ensure that the necessary facilities are built and maintained. See, Ardmore Telephone Co., at 4, Bledsoe Telephone Coop., at 4, Blountsville Telephone Co., at 4, Farmers Telephone Coop., at 4, Missouri PUC at 11, Mon-Cre Telephone Coop., at 4, New Hope Telephone Coop., at 4 and Ragland Telephone Coop., at 4.

[4]Even though the mechanisms should be separate, funding for each can be recovered through a surcharge based on interstate retail revenues.

[5]For example, costs above the benchmark would be targeted for the high cost mechanism.

affordability of the customer's total service in those areas. The comments reveal that some states have or are in the process of implementing universal service mechanisms.[6] Rather than interfere with those efforts, USTA recommends that states be encouraged to develop intrastate mechanisms based on the same concepts used to develop the interstate high cost support mechanism USTA proposed in its comments:

1). An affordability benchmark should be established to ensure that rates are affordable and comparable. The affordability benchmark must recognize that calling scope differences among rural and urban areas have an impact on the level of expenditures customers would consider to be affordable.

2). Smaller geographic areas should be established for non-rural telephone companies to target high cost areas.

3) High cost funding should be provided for costs above the affordability benchmark.[7]

4). Support should be explicit. Current implicit support should be removed from rates on a revenue neutral basis.

5). All telecommunications carriers operating within the state should contribute to the funding mechanisms.

6). Contributions should be based on retail revenues and recovered through a surcharge.

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[6]See, for example, Wisconsin PSC at 2, Colorado PUC at 2, Georgia PSC at 2, Kentucky PSC at 1-2, Oklahoma CC at 2, California PUC at 3, Texas PUC at 2, Rhode Island PUC at 1, Wyoming PSC at 2.

[7]Costs must exceed the affordability benchmark for a provider to be eligible for high cost assistance. An exchange carrier would receive universal service support when its costs for the core services exceed the affordability benchmark rate. The amount of support would be the difference between the benchmark rate and its actual cost for the core services or the actual rate and the actual cost for the core services, whichever is lower. This amount would be available to any eligible telecommunications carrier serving a non rural telephone company serving area. Eligible carriers serving rural telephone company serving areas would calculate their own support amount.

Fourth, the Commission and the Joint Board should concentrate, initially, on ensuring that the core set of services are available throughout the Nation before it starts to add advanced services to the definition. This will facilitate the predictability of the mechanisms and ensure that funding is sufficient to provide all customers access to the same core set of services at reasonable and affordable rates.

Finally, high cost support should be targeted to smaller geographic areas. Averaging prices across a study area causes prices for low cost areas to implicitly support high cost areas. Telephone companies should be permitted to rebalance prices over geographic areas smaller than a study area to remove implicit support.

II. THE UNIVERSAL SERVICE MECHANISM FOR QUALIFIED SCHOOLS AND LIBRARIES

The support mechanism proposed by USTA for qualified schools and libraries has many advantages.[8] First, it provides qualified schools and libraries with the flexibility to determine the specific services which each requires, rather than mandating services which may or may not be useful. Second, it acknowledges that telecommunications services are only one part of a successful initiative to effectively incorporate Information Age technologies and functionalities into a school's curriculum or into a public library so that the full benefits of new technologies and functionalities are realized. Third, it is based on a specific fund amount which will ensure that the mechanism is specific, predictable and sufficient to connect every qualified school and library to the Information Superhighway. The proposal is limited, yet it also limits the initial burden on consumers who ultimately will incur the costs of this initiative.[9] Fourth,

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[8]USTA at 6-10.

[9]Many commenters expressed support for a larger fund in order to connect every classroom in every school to the Information Superhighway. USTA'S plan could be viewed as an initial step to ensure that every qualified school and library in the Nation have at least the same initial level of technology and functionality before additional capabilities are included. In addition, several

the states would be involved in approving the bona fide requests and in distributing funds to the schools. Fifth, the Commission and the Joint Board would be involved in establishing the specific criteria for the bona fide requests. Sixth, a national educational organization would be involved in establishing the criteria under which funds are provided to each state. Seventh, various telecommunications and information providers, equipment manufacturers, local governments and private citizens will be involved in providing all the components of the bona fide request.

A concern has been raised regarding the equitable distribution of funds to the states. In particular, some have objected to using student head count as the sole factor in determining state funding amounts, as this would provide less funding to rural states. USTA shares this concern. While student head-count could be one factor, other factors should also be considered. For example, economic factors, such as average income levels and total population, and geography should also be considered in the distribution of funding to the states to ensure the equality of opportunities for all students. The objective should be, at least initially, to ensure that all qualified schools and libraries are connected to the Information Superhighway regardless of where they are located.

Including non-telecommunications services in the funding mechanism, as suggested by some parties,[10] will increase the size of the fund and, ultimately, the burden on consumers. Non-telecommunications services, such as inside wire and on-line services, are highly competitive, unregulated

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commenters sought to include other educational institutions, such as universities and day care centers. The Act is very specific as to which entities are "qualified" to receive discounted rates. Finally, the focus of this initiative should be to benefit the students. It is not clear how the provision of special services to the school office would be of benefit to students.

[10]American Association of Community Colleges at 6-7, Michigan Library Association at 5-7, ACE Coalition at 6-7.

services.[11] The market can be relied upon to ensure the affordability of non-telecommunications services. Such services will be included as part of the bona fide request.

The use of a fund to purchase tariffed state and interstate telecommunications services will equate to a discount of 100 percent of the requirements for connectivity as established in the KickStart Initiative's Lab Model for qualified schools and libraries. The use of TSLRIC to establish the discounted rate, as suggested by some commenting parties,[12] should be rejected. As will be discussed below, TSLRIC is not appropriate for pricing and is irrelevant to determine universal service support amounts.

Finally, as was recommended by the Aspen Institute,[13] the Commission and the Joint Board could establish an advisory committee, pursuant to the Federal Advisory Committee Act, to assist it in its deliberations. Under USTA's plan, such a group could provide the criteria for the bona fide requests and develop guidelines to ensure the equitable distribution of funding to each state.

III. UNIVERSAL SERVICE SUPPORT FOR RURAL HEALTH CARE PROVIDERS.

In its comments, USTA provided an expanded definition of "rural" in order to ensure that a greater number of rural health care providers are eligible for the reasonably comparable rates as specified in the Act. USTA also proposed that the statewide average rate be the rate which is charged to rural health care providers to ensure comparability with urban rates. Again, as discussed above, expansion of this mechanism to additional recipients will increase the difficulties in sizing the fund and, thus, the

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[11]Some of these services, such as inside wire, are provided by non-telecommunications providers. Inclusion of these services in the funding mechanism would require that the providers be included in the funding base to ensure that it is competitively neutral, as required by the Act.

[12]National School Boards Association, et.al., at 20-21, American Library Association at 2, Wisconsin Department of Public Instruction at 2 and American Federation of Teachers at 4.

[13]NYNEX at Exhibit C.

Commission's ability to make sure that it is specific, predictable and sufficient. Ultimately, expansion of the mechanism will increase the overall burden on consumers. Since the Commission has announced that it will form a Telemedicine Advisory Committee to assist in the implementation of the Act, USTA recommends that the Committee be charged with developing a recommendation similar to the "KickStart Initiative". The Committee should identify the costs of such a mechanism. Any recommendation made by the Committee should be subject to public notice and comment.

IV. UNIVERSAL SERVICE SUPPORT MECHANISM FOR RURAL, INSULAR AND UNSERVED AREAS.

A. The Core Services for the Preservation of Universal Service.

While the majority of commenters seemed to support the Commission's proposed definition of the core set of services which should be supported to preserve and advance universal service, there were proposals to include other services in the definition. USTA, for example, included white page directory listing and access to directory assistance within its definition. All of the proposals must be weighed against all four criteria specified in the Act. The addition of services will increase the cost of the mechanism and consequently the burden on all consumers.[14] The criteria provide a useful way to ensure that the societal cost of universal service is justified. This does not mean that additional services will never be supported. At issue now is the initial core set of services. The initial set of services will evolve over time to include other services as the needs of residential subscribers and technology changes. In addition, USTA recommended that states be allowed to add to the core set so long as the support for additional

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[14]Florida PSC at 6-7, Sprint at 7, LCI at 3 and the Michigan PSC at 1. AT&T, at 12, proposed that interexchange service not be included in the core set of services yet receive support. Such a proposal is not in accordance with the Act. In addition, AT&T included number portability in its definition. §251(e)(2) of the Act deals with number portability. Number portability is not a service which could be included in the core set of services for universal service.

services is provided at the state level. States should also be responsible for ensuring that the core services are provided in a high quality manner as recommended in USTA's comments.

B. Support Should Be Based on an Affordability Benchmark.

Many parties supported USTA's proposal to establish an affordability benchmark to set a maximum amount that reflects what customers reasonably expect to pay for universal service.[15] An explicit funding mechanism should be used to fund the costs of providing the core set of services above the benchmark level.

USTA proposed that the Commission and the Joint Board establish an interstate affordability benchmark equal to the nationwide average loop cost to replace the current EUCL caps.[16] EUCL prices would be set at a level equal to interstate loop costs or the affordability benchmark, whichever is lower. Rebalancing EUCL prices in this manner will assist in the removal of implicit support as noted above. In some service areas, the new EUCL price will be lower than the existing single line or multi-line EUCL prices because current prices are based upon study area average interstate loop costs rather than targeted service area costs. In other service areas, EUCL prices will increase to the affordability benchmark because current prices are far below costs.[17] The Lifeline assistance program should be expanded to cover any increased EUCL prices to ensure affordability for low income customers.

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[15]Michigan PSC at 2, Ameritech at 10-11, GTE at 7-8, Pacific Telesis at 17-19, Southwestern Bell at 17-19, AT&T at 15, and Sprint at 8.

[16]In accord, GVNW at 10, AT&T at 16, Florida PSC at 8, Southwestern Bell at 4, ITIC at 12, Time Warner at 20, Compuserve at 7, and MFS at 22.

[17]Some exchange carriers may not increase EUCL prices.

In its comments, GVNW provided a price out of a plan which is very similar to the USTA plan.[18] The average impact of the GVNW plan to the customer was an increase in monthly charges of $1.76 for 97 of its companies. The impact of eliminating the CCL was the removal of over $23 million from the CCL charges borne by interexchange carriers, which would result in savings for interexchange carrier customers.

As noted above, states would set their own affordability benchmark to establish intrastate high cost support mechanisms. USTA also recommended that the current USF and DEM weighting support mechanisms be continued, although only for rural telephone companies. This will ensure that high loop and switching costs for rural telephone companies will continue to be recovered in the interstate jurisdiction, thereby preventing a shift of current federal high cost support back to the states for recovery.

Many parties supported retention of the current USF and DEM weighting mechanisms.[19] Retention of these mechanisms for rural telephone companies is consistent with the intent of the Act to recognize the unique circumstances facing rural telephone companies and their customers.[20] While rate rebalancing could reduce the total telecommunications bill even for rural customers, maintaining these programs is necessary in order to ensure affordability. For example, Keystone-Arthur Telephone Co. explains that rural customers in Nebraska realize a benefit of approximately $50.52 per month from the

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[18]GVNW at Appendices 1-5.

[19]GVNW at 10, Ardmore Telephone Co. at 4, Bledsoe Telephone Coop. at 1, Blountsville Telephone Co. at 1, Evans Telephone Co., et.al. at 2, Farmers Telephone Coop at 1, Fort Mojave Telecom. at 2, Mon-Cre Telephone Coop at 1, New Hope Telephone Coop at 1, Ragland Telephone at 1, United Utilities at 3, Minnesota Telephone Association at 1, Texas PUC at 8, People for the American Way at 2, and Rural Telephone Finance Coop at 2.

[20]See, Century and TDS at 2 listing provisions of the Act to protect the interests of rural telephone companies.

existing USF and DEM weighting mechanisms.[21] If bulk-billed, these mechanisms are explicit, specific, predictable and sufficient.[22] They provide support in areas which are not likely to realize the benefits of competition for a long time, if ever, due to the limited revenues which can be realized given the costs of serving sparsely populated areas.[23] These mechanisms should be retained for rural telephone companies as defined by the Act. In addition, USTA recommended that the current USF mechanism be maintained without the current cap.[24]

Although not supported by any empirical evidence, several parties stated that any increase in EUCL prices would have an adverse impact on universal service.[25] In a paper prepared by Dr. Kenneth Gordon and Dr. William E. Taylor of the National Economic Research Associates (NERA) and appended to the comments of BellSouth, the rebalancing of EUCL prices as recommended by USTA is determined to pose no threat to universal service and to be entirely consistent with the 1996 Telecommunications Act.[26] Drs. Gordon and Taylor explain that in order to apply the principles of the Act to replace implicit support:

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[21]Keystone-Arthur Telephone Co. at 4.

[22]MCI claims (at 16) that these mechanisms provide funding to exchange carriers without requiring that exchange carriers modify their networks. This statement is untrue. Exchange carriers must incur the cost of providing a loop before that cost can be recovered through the support mechanism. In addition, contrary to the assertion of LDDS (at 11), the underlying cost of providing universal service is based on actual cost under these mechanisms.

[23]Century and TDS at Appendix A.

[24]In accord, Century and TDS at 6-7, U.S. Small Business Administration at 4, GVNW at 14, and Pennsylvania PUC at 21.

[25]AARP at 14-16 and NASUCA at 16-17.

[26]Kenneth Gordon and William E. Taylor, "Comments on Universal Service", Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996. [NERA].

> First, we should minimize the necessary support. That is we should resume the FCC policies of the mid-1980s to move rates closer to costs. The rate structure should recover as much of the NTS costs as possible from the services that cause those costs, i.e., from basic access service, by means of flat NTS prices such as SLCs. Economic efficiency requires recovering costs of all services--including universal services--from the causers of those costs to the greatest extent possible. Second, the remaining interstate revenue requirement--that not recovered through SLCs--could be recovered indirectly from those who use access lines to originate and terminate interstate calls by assessing a competitively neutral charge to all providers of interstate services. More specifically, we recommend that contributions be based on the end-user interstate revenues of those service providers. This allocation would avoid (i) the pricing distortions caused by per-minute or usage-based charges, (ii) the need to come up with arbitrary "equivalency ratios" for calculating contributions owed by providers...that were not sold on a per-line or per-minute basis ..., and (iii) the need to determine how much an interexchange carrier should contribute per line. Using revenues from sales of interstate services to end-users would also avoid unnecessarily taxing providers of universal service who are the intended recipients of the support.[27]

Drs. Gordon and Taylor also provide empirical evidence that higher flat rate charges for subscription will not retard universal service. First, they demonstrate that the phasing-in of EUCL charges and the reduction in toll rates in the 1980s had no impact on telephone subscription, even for households below the poverty level. To the contrary, subscription rose during this period. Second, they explain that residential demand for telephone access service is related to real (i.e., inflation adjusted) prices for flat-rated and measured service, connection charges, toll rates, income and other demographics, the uses to which telephone service can be put, and prices of complementary and competing services. They cite another study which suggests that rate rebalancing (i.e., lowering toll rates and increasing flat-rate charges) will in fact stimulate demand for telephone access service.[28] Finally, they

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[27] Id. at 8-9.

[28] Jerry Hausman, Timothy Tardiff and Alexander Belinfante, "The Effects of the Breakup of AT&T on Telephone Penetration in the United States, American Economic Review, 83, 1993 at 178-179 as cited by NERA at p. 20.

provide evidence that rebalancing EUCL prices today will have even less impact than in the 1980s. The concerns regarding the impact of increased EUCL prices can be addressed by increasing the amount of Lifeline assistance available to low income customers to equal the increased EUCL amount.

Finally, some parties stated that loop costs are joint and common costs which should not be recovered entirely from subscribers.[29] This contention is incorrect. Loop costs, the costs of the physical facilities which connect a customer's premises to a serving central office, are not shared or common costs to the exchange carrier. They are directly attributable to the services and customers that cause them (i.e., private line, special access, Centrex and the subscriber access component of basic local exchange service).[30] Customers may use the loop for many purposes, such as to complete a toll call, but that use does not create additional loop costs to the exchange carrier.[31] As the Commission has stated, "[t]he cost of a common line is attributable to the user who has that line, which is dedicated to his use and which remains available for his exclusive use in sending or receiving any telecommunication that can be transmitted through the local dial switch."[32] Further, loop costs are caused by the requirement to have facilities in place to provide universal service to customers. They are legitimate costs of universal service

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[29]AARP at 15 and NASUCA at 23.

[30]See, Alfred Kahn and William Shew, "Current Issues in Telecommunications Regulation: Pricing, 4 Yale Journal on Regulation (1987); Steve G. Parsons, "Seven Years After Kahn and Shew: Lingering Myths on Costs and Pricing Telephone Service, 11 Yale Journal on Regulation at 149 (1994) and Testimony of Dr. Richard D. Emmerson before the Georgia Public Service Commission, In Re: Universal Access Fund, Docket No. 5825-U, March 18, 1996.

[31]Under current separations rules, costs are allocated based on use. Thus, a portion of loop costs are allocated to the interstate jurisdiction to reflect interstate usage and a portion is allocated to the intrastate jurisdiction to reflect intrastate usage.

[32]Memorandum Opinion and Order, CC Docket No. 78-72, Phase I, released August 22, 1983, ¶10.

and are contained in the Commission's core definition. Loop costs which are above the affordability benchmark should be recovered from an explicit universal service mechanism.[33]

C. Calculating High Cost Support.

Under USTA's plan, interstate high cost support per line would equal the difference between the amount of interstate loop costs per line for the service area and the benchmark level or the price, whichever is less. Both residential and business loops would be included.[34] Costs would be based on Part 36 and 69 embedded costs, regardless of whether actual or proxy costs are developed.[35] The use of embedded costs will ensure that the full costs of providing universal service above a benchmark level and a reasonable contribution toward the shared and common costs of the providers can be recovered.[36] Contrary to the assertions of several parties,[37] shared and common costs are legitimate costs of doing business and should be included in the determination of universal service costs. The inclusion of such

[33]In 1983, the Commission observed that the "concept that users of the local telephone network should be responsible for the costs they actually cause is sound from a public policy perspective and rings of fundamental fairness. It assures that ratepayers will be able to make rational choices in their use of telephone service, and it allows the burgeoning telecommunications industry to develop in a way that best serves the needs of the country." Id. at ¶7.

[34]In accord, LDDS at 10. Some parties insist that only one residential line be included, AT&T at 13 and Sprint at 4,6. However if would be difficult and impractical for eligible carriers to make such a determination.

[35]Because a proxy is a hypothetical cost model, it should not be used to set prices since it does not represent the actual cost of providing service. In addition, since it produces relative costs, a proxy should not be used to determine the size of the high cost funding mechanism. The current Benchmark Cost Model should not be required for rate of return regulated exchange carriers.

[36]NERA provides various examples which demonstrate that setting the initial level of support in relation to the incumbent's embedded costs and then relying upon competition and the market mechanism for subsequent fine-tuning is economically efficient and will ensure that the market will be served by the least-cost provider. NERA at 9-16.

[37]MCI at 10-12 and AT&T at 14-15.

costs will ensure that the funding mechanism is sufficient, as is required by the Act.[38]

In addition, two commenters suggest that universal service support be "de-linked" from revenue requirement.[39] In rural and other high cost areas, there is no indication that competition will provide the necessary incentives to ensure that the infrastructure necessary to provide universal service will be deployed. The market presumes that competitors will invest in areas where they can realize a reasonable return on their investment. The prior regulatory regime has resulted in significant revenue requirement related to facilities which are currently providing universal service. Any "de-linking" would be confiscatory for rate of return companies.

Finally, pursuant to USTA's proposal, for non-rural telephone companies the interstate high cost support per line would be calculated at implementation and then would be frozen. Any eligible carrier would receive this amount for each customer served. In a rural telephone company serving area, each eligible carrier would calculate the interstate high cost support per line on an annual basis.[40]

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[38]Sprint at 14.

[39]MCI at 3, and LDDS at 3.

[40]Incumbent exchange carriers have a significant reserve deficiency on their regulatory books. The deficiency reflects the under-depreciation of their embedded plant. (See, USTA Reply Comments, CC Docket No. 94-1, March 1, 1994 at Attachment D, Table 2). As many parties pointed out in their comments, incumbent exchange carriers are entitled to fully recover this plant, since it was deployed by these exchange carriers to further universal service and fulfill carrier of last resort obligations in the past. There is more than one way the recovery of this embedded plant can be addressed. Some parties have proposed that recovery be achieved through an explicit, non-portable support mechanism in conjunction with universal service. Others have proposed price restructuring and/or flexibility. Whatever method(s) are accepted, the Commission must allow incumbent exchange carriers to recover this investment.

Some commenters propose that the prices for all access services be set at TSLRIC.[41] Such a proposal must be rejected. TSLRIC will not recover all of the costs of providing access services. There are shared and common costs incurred by exchange carriers which are not incremental to any one service. These costs are not included in the TSLRIC measure. A carrier's prices must be set to achieve revenues which recover its costs if it is to remain viable. Therefore, some, if not all, prices must exceed incremental cost if the carrier is to remain in business. If all of a carrier's prices were set at TSLRIC, joint, common and shared costs could never be recovered and the carrier would eventually go out of business. TSLIRC imposes uniform prices across all services which are antithetical to a competitive market. For example, volume discounts and prices responsive to individual customer needs would be precluded by TSLRIC, despite the fact that such pricing is economically efficient. Finally, TSLRIC cannot serve as the basis for measuring universal service subsidies since TSLRIC ignores investment made to fulfill carrier of last resort requirements.

Given the restrictive pricing implications of TSLRIC, it would be contrary to the intent of the Act to use this methodology to establish prices, since the Act mandates competition. Every service should provide contribution toward shared and common costs based on market conditions.

Finally, at least one commenter recommends perpetuating implicit subsidies by imputing non-universal service revenues to cover the costs of universal service.[42] In a competitive environment, implicit subsidy is not sustainable. The Act recognizes this fact and requires subsidies to be explicit. This suggestion is contrary to the requirements of the Act and should be rejected.

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[41]AT&T at 7,12, Sprint at 14, Ad Hoc at 13, Pennsylvania PUC at 17-19, American Library Association at 13 and LDDS at 23.

[42]AARP at 18-20.

D. A Transition Period Should be Implemented.

USTA recommended a four year transition period to implement its interstate high cost funding mechanism. As EUCL prices are rebalanced over the four year period, interstate CCL prices would be adjusted to recover the difference between the EUCL price and the benchmark. LTS will also decrease as EUCL prices are rebalanced and CCL decreases. Many parties agreed that a transition would be required to avoid rate shock.[43] USTA's transition plan should be adopted.[44]

E. Eligibility for High Cost Support.

As noted above, universal service support should be provided to the eligible carriers which are investing in the infrastructure necessary to provide universal service. Support should not be provided to customers.[45] Customers cannot ensure that the necessary infrastructure will be built and maintained to provide high quality service. Further, providing "phone stamps" or vouchers to customers would pose administrative and added cost burdens to the funding mechanism. Only eligible carriers, as specified in the Act should receive universal service support.[46]

V. THE FUNDING MECHANISM TO PROVIDE UNIVERSAL SERVICE TO LOW INCOME CUSTOMERS.

At the federal level, the core set of services included in the definition of universal service will be more than adequate to meet the needs of low income customers, particularly if USTA's proposed

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[43]Washington UTC at 12, Oregon PUC at 7, Florida PSC at 10, NARUC at 12 and Missouri PUC at 8.

[44]USF and weighted DEM for non-rural telephone companies would be frozen over the four year period and then eliminated.

[45]Citizens for a Sound Economy at 12-13, and AT&T at 10.

[46]Time Warner suggests that only one carrier of last resort receive support. The Act requires multiple eligible carriers in non-rural telephone company service areas.

definition which includes access to directory assistance is adopted. This would be prudent given the lack of data regarding the cost of providing additional services to low income customers. In addition, USTA strongly recommends the expansion of the federal Lifeline program to include other eligible carriers and their low income customers and to increase the amount of the credit to equal the rebalanced interstate EUCL price. Eligibility requirements for participation in Lifeline should be left to the states. No other federal intervention is required at this time. As the definition of universal service evolves over time, additional services may be included in the definition provided that they meet the four criteria established by the Act.

The record in CC Docket No. 95-115 provides overwhelming evidence that the states and local exchange carriers have already instituted many of the proposals suggested by the Commission to assist current customers in staying on the public switched network and to connect new customers. There is no need for federal mandates to accomplish what has already been implemented. Addressing the problems of the remaining six percent of the population which does not have telephone service should be the responsibility of the states. It is not evident that a new federal requirement will even address the unique subscribership issues within a state. The states should be charged with the responsibility of determining how to resolve these issues in order to increase subscribership within their borders in conjunction with the carriers operating within their borders.

Of course, any new requirements adopted by a state must be applied uniformly among all service providers and should be economically and technically feasible. There should be an objective, critical analysis of the perceived social benefits and the social costs before any such requirements are adopted. For example, the policy adopted in Pennsylvania to prohibit exchange carriers from disconnecting for nonpayment of toll and to require multiple balance billing have had some unintended adverse consequences.[47] Exchange carriers in Pennsylvania have experienced an increase of approximately 300 percent in uncollectible debt since that policy was implemented. These losses are shared by the entire customer base. The complexity of the multiple balance billing system generates substantial customer confusion and requires extensive time to explain to customers. It has also caused exchange carriers to incur substantial implementation and ongoing administrative costs. These additional administrative costs are borne by the entire customer base. In a competitive market, competitors able to avoid incurring such costs will have a distinct advantage over those who are subject to any such requirements. Therefore, any requirement must be applied to all providers.

VI. FUNDING THE UNIVERSAL SERVICE SUPPORT MECHANISMS.

The Act clearly states that all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service. USTA strongly agrees that a broad funding base recognizes the truly public benefit of universal service and ensures competitive neutrality. Therefore, the burden should be on those providers which are already seeking an exemption from contributing to the preservation of universal service to prove that to exempt them will not harm the public interest.[48] While the Act permits an exemption in cases where the contribution would be deminimus, the burden should be on the provider to prove that the contribution would not serve the public interest.[49]

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[47]Statement of David E. Freet, Vice President, Pennsylvania Telephone Association, Federal-State Joint Board, Low Income Panel Presentation, April 12, 1996.

[48]Comsat at 9-13, CTIA at 5-7, Telecommunications Resellers Association at 19-20 (seeking an exemption from funding, but asserting that resellers be permitted to receive support).

[49]The fund established to recover the costs of interstate TRS calls requires payments from all common carriers subject to the Americans with Disabilities Act. As of November 1995, there are