

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of)
)
Federal-State Joint Board)
on Universal Service)

CC Docket No. 96-45

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GTE's REPLY COMMENTS

GTE Service Corporation and its affiliated domestic
telephone operating companies

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SUMMARY

There is broad agreement that, to meet the mandate of the '96 Act and satisfy its own objectives, the Joint Board/FCC must undertake a fundamental reform of the mechanism for assuring universal service. Similarly, there is broad agreement on the principles that should govern adoption of a Federal universal service plan. These principles include: (1) the spirit of all regulatory efforts should be pro-competitive; (2) where regulations are needed, the scope of the activity subject to regulation should be as narrow as possible; (3) support should be limited to those necessary to enable users to purchase essential services that are beyond their economic means.

GTE urges the Joint Board/FCC not to even consider taking the supposedly easy way out -- patching together once again an obsolete system and burying the results in complexity so no one will know how bad it is. Over the past twenty years, government, industry and the public have all had to make do with improvisations that do not address the fundamental issues. Following the mandate of Congress and its own best judgment -- as reflected in the *NPRM*-- the Joint Board/FCC must not let this opportunity slip.

To have any hope of success, the plan adopted by the Joint Board/FCC must be grounded in symmetrical treatment of all Carriers of Last Resort. All service standards that apply to incumbent LECs should apply to all local service providers that seek universal service support as a condition of receiving that support.

GTE's plan, which offers a sound basis for carrying out the statutory mandate and addressing constructively and realistically the essential underlying issues provides as follows:

1. It avoids the "laundry list" approach and defines "core" service in accordance with Section 54(c) of the '96 Act and the broad consensus of parties filing comments.
2. It funds universal service in a competitively neutral manner through an explicit surcharge applicable to all interstate and intrastate end user retail revenues.
3. It includes an affordability threshold that would bring the Federal universal service fund into play when costs cause prices for core service to exceed a certain threshold.

4. It provides explicit, necessary and appropriate support to telecommunications carriers that are found to be *Elte/s* and that preserve and advance the universal service principle of the '96 Act.
5. It initially establishes the core service cost based upon estimates derived from a cost model.
6. It replaces the estimates derived from the cost model with a bidding mechanism that would allow the market to determine the level of universal service support.
7. It rebalances ILEC prices on a revenue neutral basis.

GTE urges the Joint Board/FCC to give careful consideration to the foregoing plan, which would carry out the intent of the '96 Act as well as long-established FCC policy in a practical and efficient way, avoiding the endless morass of argument and counter-argument by challenging all participants to act in accordance with their economic interests.

The importance of telecommunications to educational and rural health care entities is well documented, and the Joint Board/FCC plan must reasonably provide for discounted telecommunications.

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GTE's REPLY COMMENTS

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE"), in response to the FCC's Notice of Proposed Rulemaking and Order Establishing Joint Board (the "*NPRM*") and comments filed thereon with reference to the Telecommunications Act of 1996 (the "'96 Act") and the universal service requirements embodied in Section 254¹ thereof, submit the following.

DISCUSSION

- I. THERE IS BROAD AGREEMENT THAT, TO MEET THE MANDATE OF THE '96 ACT AND SATISFY ITS OWN OBJECTIVES, THE JOINT BOARD/FCC MUST UNDERTAKE A FUNDAMENTAL REFORM OF THE MECHANISM FOR ASSURING UNIVERSAL SERVICE.

Parties filing comments arrange themselves into rough groupings that are not unexpected in view of their perceived and often-expressed interests. The states are concerned about the role they will be expected to play and the impact of the Joint Board/FCC plan on service to their citizens. Smaller Incumbent Local Exchange Carriers ("ILECs"), that principally serve rural areas, express concern with maintaining the support they are presently receiving.² Interexchange Carriers ("IXCs") and Competitive Access Providers ("CAPs") recognize -- as do various state commissions -- that there is an urgent need for replacement of the current system and indeed that this replacement is mandated by the '96 Act.

US WEST, Southwestern Bell, BellSouth and GTE, urge the Joint Board/FCC to broadly reform the entire process in order to reflect (i) the reality of competition as well as the mandate of the '96 Act, and (ii)

¹ Unless otherwise stated, all section references are to 47 U.S.C.

² *See, for example*, comments of the ICORE companies.

the continuing burden placed on ILECs required to serve as Carriers of Last Resort ("COLRs")³ for areas that are costly to serve because of thin population density, geographic characteristics, or other reasons, often at rates set well below the levels that would prevail in a competitive market.

The current system -- where the support mechanism is largely implicit so the public has no notion of what it is being required to support and why -- relies primarily on support provided through the rates charged for other ILEC services. A small proportion of universal service support comes today from mechanisms such as the Universal Service Fund ("USF"), which is not competitively neutral, or related to the size of the market intervention imposed on the ILECs as COLRs. Moreover, because of the arbitrary operation of that system, many ILECs serve high cost areas but receive no support. The '96 Act, in §254(b)(5), §254(d) and §254(e) rules out arbitrary and insufficient mechanisms of this kind;⁴ it calls for creation of an explicit and sufficient mechanism to support universal service nationwide. Plainly, Congress has mandated not a "quick fix" but fundamental reform.

II. THERE IS BROAD AGREEMENT ON THE PRINCIPLES THAT SHOULD GOVERN ADOPTION OF A FEDERAL UNIVERSAL SERVICE PLAN.

A great many parties would agree with the following suggestion by the Washington Utilities and Transportation Commission ("WUTC") (at 2):

[W]e urge the Joint Board and the FCC to look to a market-driven approach to meeting universal service goals, with an emphasis on market transformation and consumer education, rather than subsidies, as the best means to achieve these goals.

Indeed, there is a remarkable degree of agreement from a broad range of perspectives on what should be the objectives of the Joint Board/FCC universal service plan. For example, from the ILEC perspective, the seven principles suggested by US WEST (at 3) parallel GTE's recommendations (at iii-iv). Viewing these issues from the perspective of the consumer, the California Department of Consumer Affairs

³ GTE defines the term COLR to mean an Eligible Telecommunications Company ("*Elitel*") as defined under the '96 Act that undertakes obligations established by a state agency, within Federal guidelines, as a condition for receipt of Federal universal service support.

⁴ This rules out the false solutions -- presented by such parties as AARP at i-ii -- that essentially call for continuation of the current system. The statute dictates a new system meeting new criteria.

(the "Cal-DCA") suggests (at 8) three principles should guide the Joint Board/FCC and other regulatory bodies in moving toward a competitive telecommunications market: (1) the spirit of all regulatory efforts should be pro-competitive; (2) where regulation is needed, the scope of the activity subject to regulation should be as narrow as possible; (3) support should be limited to those necessary to enable users to purchase essential services that are beyond their economic means.

Speaking from the perspective of state regulation, comments filed by the People of the State of California and the Public Utilities Commission of the State of California (the "CPUC") -- taking into account facts presented in extensive proceedings in California -- join U S WEST, GTE and Cal-DCA in calling for fundamental reform. As do many other parties,⁵ the CPUC (at 3) urges the Joint Board/FCC to stress the principle of competitive neutrality as a guide to development of the universal service plan. Accordingly, the CPUC (at 8-9) rejects the existing mechanisms for calculating and distributing assistance for high-cost areas -- the USF and Dial Equipment Minute ("DEM") programs -- because they are not competitively neutral and are not the sort of explicit mechanisms contemplated in §254(e).

New entrants stress reliance on competition. "[R]obust competition is the best way to promote the widespread availability of services, affordable prices, service quality and innovative new services."⁶ Consumers of telecommunication services also urge the Joint Board/FCC to "rely to the maximum extent possible on free competition and private sector initiative to achieve the statute's objectives." CompuServe (at 4-5).

Accordingly: The Joint Board should base its recommendations to the FCC on the broadly accepted principles that: (i) heavy reliance must be placed on the force of competition; (ii) the scope of regulation should be as narrow as possible; and (iii) competitive neutrality should be a capstone of governmental policy.

⁵ See Ameritech at 5; AT&T at ii, 21; ALTS at i; GTE at 16-18; CompTel at ii.

⁶ Florida Cable Telecommunication Association at 8. See also, e.g., MFS at 4; LDDS WorldCom at 2-3; CompTel at 9; Time Warner at 5; AirTouch at 5.

III. TO HAVE ANY HOPE OF SUCCESS, THE PLAN ADOPTED BY THE JOINT BOARD/FCC MUST BE GROUNDED IN SYMMETRICAL TREATMENT OF ALL LECs.

Under the '96 Act, the Joint Board/FCC plan must be competitively neutral in all respects. Thus, as a crucial element of the criteria under which *Elteks* receive Federal universal service support, the same obligations must apply to all providers that seek funding, whether incumbent LEC or not.⁷ This would include any rate ceilings found necessary, requirements to serve all of a specific geographic area, and the various aspects of service quality. Any such requirements may be established by state regulatory agencies, as part of their ongoing regulatory authority, subject to the condition for Federal funding that they be applied equally.

The consistent application of a rate ceiling is necessary to ensure that rates are affordable, and that universal service policy is competitively neutral. This is not to suggest that a binding rate ceiling is necessary in every market. No COLR obligation at all is necessary in areas where the market outcome will lead to ubiquitous supply at an affordable rate. Nor is it necessary that the rate ceiling be the same everywhere.⁸

With regard to service quality, the CPUC (at 3) recognizes the importance of treating symmetrically ILECs and new LECs. Thus, a key part of fundamental reform for the CPUC is (*id.*) the requirement that new LECs must meet the same quality of service standards that are imposed on ILECs, including such

⁷ Congress mandated that the Joint Board/FCC fashion a program that is "specific, predictable and sufficient ... to preserve and advance universal service." §254(b)(5). New programs must connect the payment of universal service support to actions and offerings of local service providers that will promote universal service.

⁸ As the CPUC notes at 8, it may be reasonable to expect rural, high cost customers to pay more than urban customers, within some reasonable limits. However, where a binding rate constraint is necessary, it should be applied symmetrically to all carriers that receive funding. The CPUC at 3 stresses the importance of this neutrality, and says at 8 that it plans to base support on the difference between the cost of providing service and "the rate that local exchange carriers will be authorized to charge."

things as dialtone speed, operator answering time, and repair service answering time.⁹ There must be some assurance that the public's investment in universal service programs are effective. And absent symmetrical treatment of all COLRs, there cannot be competitive neutrality.

All COLR obligations should be made "bilateral" in this sense; that is, the COLR should be compensated as in the case of any other vendor the government hires to perform a desired function.¹⁰ This is necessary to ensure competitive neutrality, not only among COLRs, but also between COLRs as a group and non-COLR carriers. This is particularly important because, at the start of this process, the COLR responsibility itself has been assigned asymmetrically -- it lies entirely with the ILECs. If COLRs are not adequately compensated, this will remain the case, since other providers would have no incentive to become COLRs.

In light of the foregoing, and because competition will bring increased service quality, the CPUC (at 3) suggests it will not be necessary for the Joint Board/FCC to impose further service quality requirements. GTE wholeheartedly supports the CPUC on this point. The state commission is in the best position to follow quality of service.¹¹ GTE is not suggesting that there should be an aggregate increase in service quality regulation. In GTE's view, regulation of ILECs' service quality should diminish as the very

⁹ *See also*: "The OPUC has determined that service providers must meet minimum service quality standards in order to qualify for universal service support funds.... The service quality standards set by the OPUC are not a requirement for market entry; they are a requirement for obtaining universal service support." *Emphasis added.* Oregon Public Utility Commission ("OPUC") at 2-3. "The VSCC required new entrants to comply with the service quality criteria that have been applied to incumbent LECs for many years.... We urge the FCC to base its quality measurements on existing standards in the states." Virginia State Corporation Commission Staff ("VSCC") at 1. The VSCC adds at 6: "We have long held in Virginia that poor service at any price is no bargain. Affordable rates must always be based on good service." The Public Utility Commission of Texas at 2-5 expresses special concern with maintaining levels of quality.

¹⁰ *See* Ameritech's discussion of unilateral requirements as opposed to bilateral requirements. Ameritech at 5 and n.6 and n.7.

¹¹ The Communications Workers of America at 7-9 discussed the quality of service provided by GTE. Their concerns were apparently shaped by the data available in the Commission's ARMIS 43-05 reports. GTE had already notified the Commission that it had discovered an error in the automated system that generates data for the ARMIS reports. This error caused an overstatement of repair measurements during the reporting period (4Q1994 through 3Q1995). *See* letter of Edwin J. Shimizu, Director-Regulatory Matters, to Mr. William F. Caton, Acting Secretary, dated April 12, 1986.

same regulation is applied to new LECs. It would be irresponsible for governmental agencies to funnel great amounts of money to carriers of all kinds without solid and supportable grounds to believe that the public -- the ultimate source of the funds -- will get its money's worth. And to create an environment in which an ILEC and a new LEC receive the same amount of support per customer when the new LEC is subject to no performance regulation, while the ILEC -- which is heavily regulated in all aspects of its business -- must serve the customer at the highest level, would be anything but competitively neutral.

In discussing the application of rate and quality requirements, the comments of the state agencies mentioned *supra* recognize that states have the ability to establish conditions for *Entels* beyond those set forth in the '96 Act. These requirements would, as OPUC says, not be conditions for entry, but conditions for obtaining universal service support. NYNEX (at 11) agrees that "an eligible carrier should be required to provide these core services with a level of quality that is at least comparable to the quality provided by the incumbent LEC, and at rates that are no higher than are charged by the incumbent LEC for that service."

Accordingly: To achieve the object of competitive neutrality the Federal plan should require, as a condition of Federal funding, that any COLR requirements state regulatory agencies may establish should apply symmetrically to all COLRs in the same area.

IV. GTE's PLAN OFFERS A SOUND BASIS FOR CARRYING OUT THE STATUTORY MANDATE AND ADDRESSING CONSTRUCTIVELY AND REALISTICALLY THE ESSENTIAL UNDERLYING ISSUES

Within the framework decreed by Congress, the Joint Board is empowered to recommend and the FCC to adopt a plan that accomplishes and balances several interrelated objectives: (i) assuring universal service at an affordable price; (ii) promoting competition; and (iii) promoting deregulation. GTE offers its integrated plan designed to permit the Commission, on Joint Board recommendation, to carry out the fundamental reform mandated by the '96 Act. This plan would permit the Joint Board/FCC to avoid the endless complexity of the current system, which would drive the Harvard faculty to distraction. By comparison GTE's plan is straightforward.

Under this plan, the Joint Board/FCC would set out the guidelines under which an *Eitel* (designated under §214(e)) that preserves and advances universal service will receive an appropriate level of support. This support would be available on the same basis to any carrier that agrees to become a COLR, and meets any requirements established by the state agency within Federal guidelines as a condition for the receipt of funds. The Federal support mechanism, together with those adopted by the states, will replace the current system of implicit support for universal service contained within ILEC rates for access, toll, local business services, and vertical services -- a mechanism inconsistent with the requirement of §254(e) that support for universal service be explicit.¹² The key elements of the GTE plan are the following.

- 1 GTE's plan defines "core" service in accordance with Section 254(c) and the broad consensus of parties filing comments.

As to the Joint Board/FCC task under §254(c) of identifying core service to be supported by the Federal fund, the WUTC (at 9) issues a very sensible warning against "focus[ing] inappropriately on the 'laundry list' approach."¹³ It adds

The guiding principle should be that the market rather than regulatory mandates should determine the definition of universal service. A fundamental difficulty with selecting services for inclusion as 'basic' or 'core' is that regulators run great risk of choosing technological winners and losers. The more prescriptive the approach, the greater the risk to competitive and technological neutrality. In addition, to the extent that more new services are added to the definition, the costs and burdens of universal service become proportionately greater.¹⁴

¹² GTE recognizes that a reasonable transitional period may be necessary to implement this program. See USTA at 18, NARUC at 11, OPUC at 6, Florida Public Service Commission at 12, WUTC at 11-12, NECA at 14, and the Missouri Public Service Commission at 8.

¹³ See also Sprint at 8: "It is critical that only services that a majority of consumers have subscribed to be funded because ultimately it is the consumer that funds the subsidy."

¹⁴ *Emphasis added.* While WUTC warns against regulatory action picking technological winners and losers, MCI at 16 would plunge regulation into precisely that morass, since MCI would have technology specified as part of the plan: "[T]he LECs should be required to use all digital switches and provide SS7 signaling throughout their network." As correctly stressed by the wireless carriers, the definition of core service should not be linked to any particular technology. See Western Wireless at 7-9, AirTouch at 10, and PCA at 14-16

In fact, the extent of agreement on what should be defined as core services is striking. While terminology employed by the commenting parties varies, few parties argue for defining the core service pursuant to §254(c)(1) beyond that proposed by GTE, namely: (1) residence voice grade access to the network with the ability to place and receive calls, including long distance calls; (2) touch-tone; (3) single party service; (4) access to emergency services, such as 911 and (5) access to operator services.¹⁵ There is no warrant in the record of this proceeding for including in core service anything that falls outside the bounds of the guidelines set out in §§254(c)(1)(A)-(D). GTE suggests that the foregoing list includes those services that would properly come within the intent of Congress.

A few commenters have suggested that a distinction should be made, for support purposes, between "first" and "second" residence lines.¹⁶ GTE opposes any attempt to restrict support to primary residence lines only. Even if such a distinction were desirable -- a proposition not supported by the record -- it would not be practical to implement.¹⁷

In many states there is no tariff distinction between first and subsequent residence lines. If only one line per household is to be supported, the COLR must have a definition of a "household" that can be

¹⁵ These features are used by a "substantial majority" of residential customers, but not all features are ubiquitously available today. A transition plan will be needed to meet these standards nationwide. For example, locations where the transition to single party service has not yet been completed should continue to receive support for party line service.

¹⁶ See, for example, NCTA at 6 and Attachment A at vi. Illinois Commerce Commission ("Illinois CC") at 5; Ad Hoc at 12. NCTA's Attachment A at 101-106 develops an elaborate argument that ascribes virtually all of the costs of any spare capacity in the network to second lines. In fact, any network is engineered to provide a combination of services. Spare capacity simply represents the engineer's trade offs between the frequency and magnitude of network additions, given that it is usually very costly to add actual distribution plant. Factors that affect the achieved level of utilization in a network include growth in demand, indivisibilities of basic network resources (such as minimum cable sizes), uncertainty concerning demand (based perhaps on competition for basic service), and the need to provide additional lines. The engineer cannot distinguish between two lines provided to a single family dwelling, and two lines provided to a dwelling that is shared by two households.

reasonably applied. Certainly there can be more than one "household" at a single address, or in a single building. Examples could include a person renting a room in a house; or unrelated persons sharing a house or apartment. When a customer calls and requests service, the COLR should not be put in the position of having to determine whether the customer is a separate "household" or not.¹⁸ Further, once customers discover the basis for the support decision, it is reasonable to expect that orders will be placed in such a way as to meet the prescribed criteria. And if such a distinction could be enforced, it would run the risk of denying affordable service to genuine "households."¹⁹

2. The proposed affordability threshold of GTE's plan would bring the Federal universal service fund into play when costs cause prices for core service to exceed a certain threshold.

GTE (at 7-8) suggests that the Federal plan should include two threshold rate levels that trigger the availability of funding for the core service. Both threshold levels should incorporate automatic inflation adjustments, both to prevent the effect of support from being diluted over time, as happened with the frozen EUCL, and to avoid future concerns regarding growth in fund size.

¹⁷ A broadly expressed concern is to avoid "haves" and "have-nots" with respect to information services and access to the Internet. Access to most such services is possible today, using "core" service and a computer equipped with a modem. However, any prolonged access to such services using a single line would preclude the use of the line for other purposes -- such as receiving calls in emergency situations. Parties proposing that the definition should be limited to a single line simply assume -- without any supporting argument, or evidence of Congressional intent -- that the national policy objectives will be fully satisfied by the provision of only a single line per unit.

¹⁸ In recent testimony before the CPUC, Dr. Nina Cornell, appearing for AT&T and MCI, suggested that one line be provided to each "household." When asked how a household should be defined, she suggested such criteria as whether a person commonly took meals with other household members. Dr. Lee Selwyn, also appearing for AT&T and MCI, proposed a different criterion, in which one line would be provided to a "dwelling." He suggested that a COLR, in responding to a customer request for service, should consult municipal zoning records to determine if the customer occupied a separate "dwelling." In cases where a room or other portion of a structure were rented, he suggested that the COLR should inspect the rental agreement. Any of these suggestions would be not only burdensome but unworkable for the serving COLR.

¹⁹ Indeed, households with modest incomes, or who have recently moved to a new area, are probably the most likely to be living in some shared arrangement that would make it difficult to distinguish one household from another. These are also the households for whom concerns over the need for affordable service are the greatest.

The first threshold should be the desired maximum rate level.²⁰ Costs that would lead to prices exceeding this threshold should trigger a combination of state and Federal funding to maintain the affordable level.²¹ However, if costs cause prices to exceed a second threshold at a higher level, the Federal plan alone would provide funding. This second threshold is necessary to avoid undue burdens on contributors in states with higher costs and limited funding sources. Each guideline could be established as a percentage of median family income or expenditure. This two-threshold approach allows the Federal plan and any state plans to operate in a complementary way while avoiding conflict or redundancy.

Parties proposing an affordability threshold generally agree with GTE that this should be applied to the service as a whole, not to some arbitrary interstate portion. The division of responsibility for funding, between state plans and the Federal plan, would then be determined by setting of the threshold levels. This would be a policy decision by the Joint Board/FCC, and would not be driven by the current separations process. AT&T proposes a very similar mechanism (at 15, with illustrations in Appendix B), in which the amount by which the cost estimate exceeds the nationwide affordable rate would be provided by the Federal fund, and the amount by which the state-established rate fell below the threshold would be supported explicitly by the state.²²

²⁰ The *NPRM* seeks comment at ¶24 as to whether the Federal plan should be designed to achieve an objective rate. A wide range of parties joined GTE in proposing that the Federal plan should establish rate thresholds based on policy determinations as to what rate level is affordable. *See* Michigan Department of Commerce at 2; Illinois CC at 7; MFS at 18; General Communication at 9; Time Warner at 7; US WEST at 8. Ad Hoc at 17-18, MCI at 4, Sprint at 4, 9, AT&T at 14 and Appendix B.

²¹ States that restrict the rate the COLR may charge to a level less than the affordable level should fund the entire difference between the permitted rate and the cost, not just the difference between the threshold and the cost. The Federal plan could include a guideline which requires the state plan to be "sufficient" in this sense, as a condition for the provision of Federal funding toward offsetting reductions in state rates. *See also* AT&T at 15.

²² The separations treatment of the support can then be adjusted to match the policy judgment made by the FCC in setting the thresholds. Such an adjustment for LECs would be similar to the way USF works today. However, separations should accommodate the FCC's policy, not drive it. *See, for example*, US WEST at 13.

3. The GTE plan funds universal service in a competitively neutral manner through an explicit surcharge applicable to all interstate and intrastate end user retail revenues.

Section 254(d) requires providers of interstate telecommunications to contribute to the funding of Federal universal service mechanisms. The statute does not restrict the basis for determining these contributions to interstate demand units or revenue alone. If, as GTE proposes, the Federal plan is based on the entire core service on a non-jurisdictional basis, and is used to fund offsetting reductions in both state and interstate rates, then the basis for funding should be all end-user retail revenue, both state and interstate.²³ This approach is competitively neutral, will provide the largest possible funding base, the lowest possible "rate" for the surcharge, and hence the least distortion in customer behavior. As new firms enter the market, and as the rates of the ILECs are less closely regulated, it will become increasingly difficult to identify interstate revenue separately.²⁴ An interstate-only surcharge may also create incentives for gaming and arbitrage. The use of total retail revenue, both state and interstate, will be simpler and more efficient.

Moreover, a surcharge on retail revenue will meet the requirements of the '96 Act more effectively than the other funding approaches discussed in the *NPRM* (at ¶¶122-124) or proposed by parties. In order to be competitively neutral, and structurally neutral, a funding mechanism should avoid double-counting wholesale transactions.²⁵ Double counting of wholesale transactions would unfairly burden providers of wholesale services, and would create an uneconomic incentive for the retail provider to eliminate the

²³ It will be essential that the Joint Board/FCC plan approach with great skepticism any claim to be entitled to receive support and/or be eligible for reciprocal compensation under §251 combined with a denial of obligation to pay the appropriate contribution to the universal service fund. See Telecommunications Resellers Association at 6 and 9.

²⁴ See AT&T at 9: The use of surcharge on both interstate and intrastate retail services "obviates altogether the potentially difficult problems associated with having to make jurisdictional determinations."

²⁵ AT&T at 8 says: "A surcharge on all retail telecommunications services, both interstate and intrastate, creates a fair, simple and efficient recovery mechanism." *Footnote omitted*. CompTel at 15 recognizes that "a tax assessed on end user retail revenues" would be the "most equitable way to collect universal service funds."

wholesale transaction by self-supplying the input.²⁶ A retail surcharge provides a simple and easily administered way to avoid such double-counting. The practicality of a retail surcharge has been amply proven by experience in the state.²⁷

The surcharge proposed by GTE is also clear and explicit. Retail customers would actually see, in a line item on their bills, how much they are contributing to universal service; while a "net revenue" approach would not make the contribution explicit, but would continue to bury it in the rates customers pay for service. Further, this retail surcharge would ensure that the contribution is uniform across providers, and across services. The retail customer could not affect this contribution by changing suppliers, or by changing the mix of services purchased. Because of this, the retail surcharge approach would maximize neutrality by minimizing the effect of the contribution on the customer's purchase decision.

A net revenue method, under which the carriers would recover their contributions through their service rates, would not have this same neutrality, because such recovery is unlikely to be uniform across all service rates. This will influence customers to choose different services, in different amounts. Further, a system in which carriers must adjust their rates to recover their contributions to universal service is inherently not competitively neutral, because some carriers (ILECs) are not free to adjust their rates in the same way as their competitors.

In contrast, the surcharge would create an automatic mechanism that would generate each carrier's remittance to the fund, without the need for any adjustments to prices themselves to recover the necessary contributions. This means that customers' service choices will be unaffected. It also means that carrier's choices to offer new services, or enter new areas, will be similarly unaffected by the

²⁶ The current TRS method does not satisfy this requirement because ILEC access revenues are counted twice: once as ILEC access revenues, and a second time through the price for interexchange service that must be set to recover those input costs. While the resulting distortion may be tolerable in a relatively small fund, such as TRS, it would certainly present a major problem in a mechanism large enough to support the requirements of the '96 Act. *NPRM* at ¶122.

²⁷ The CPUC already employs what it calls an "All End User Surcharge" to fund its state lifeline program, which requires more than \$300 million per year. Vermont has also implemented a retail surcharge to fund its universal service program.

surcharge, since each dollar of retail sales will automatically generate the necessary amount to be remitted to the fund.²⁸

There is also a fundamental difference between a retail surcharge and a net revenue approach in terms of the opportunity it affords to correct current implicit support flows. A net revenue approach serves chiefly to raise the cost level of the contributors. It therefore tends to ratify, rather than correct, rate levels for services like access and toll, which are contributing to support today. On the other hand, a retail surcharge will immediately put in place a new source for the necessary funding which is completely separate from carriers' rates. For the ILECs, this means that the full amount of the fund would be available to make offsetting reductions in rates that are too high today, allowing those rates to be brought closer to their efficient market levels.

Finally, as the *NPRM* (at ¶124) itself recognizes, it would be impossible to establish a contribution method based on demand units, such as minutes or lines, that would be competitively and technologically neutral. Since carriers would provide service in different units, equivalency formulas would have to be applied; these would inevitably favor some carriers over another. The retail surcharge approach assures, as a demand-based system cannot, that every time a customer spends a dollar on telecommunications, a given percentage of that dollar will go to support universal service. This will be true regardless of who the retail customer is, what services are purchased, or what carrier supplied them.

4. The GTE plan provides explicit, necessary and appropriate support to telecommunications carriers that are found to be *Eltels* and that preserve and advance the universal service principle of the '96 Act

Support for *Eltels* should be based on the market intervention imposed on the *Eltels* that serve as COLRs. This would be measured by the difference between any ceiling imposed to allow rates to remain "affordable" and the rate the COLR would otherwise set in a competitive market. Where the rate ceiling is

²⁸ Using a retail surcharge, the carriers are simply the "tax collectors" for the fund. Issues raised by some parties as to which carrier should "contribute" more or less are thus moot. The retail surcharge approach recognizes that all revenues come ultimately from customers.

less (*i.e.*, where the regulatory constraint is binding), the support should fund the difference.²⁹ A proxy cost measure should therefore serve as the means for estimating what the market price for the "core" service would be in a competitive market. It should include those costs a firm in a competitive market would be able to recover through its price. Once other carriers enter a given market, and are willing to become COLRs subject to an identical set of requirements, then a competitive bidding process should replace this cost-based comparison to determine the support amount.³⁰

A number of parties recommend that the Joint Board/FCC require that the price for the core service be set equal to the Total Service Long Run Incremental Cost ("TSLRIC").³¹ This proposal must be rejected. Claims that TSLRIC represents the price that an efficient firm would choose in a competitive market grossly exaggerate the role of TSLRIC in setting prices.

TSLRIC studies are useful in identifying the price floor that a firm would choose so that revenues from a service support the direct costs of providing that service.³² Thus, TSLRIC is just one of several inputs to a pricing process. A regulated multi-product firm has several different types of costs -- including incremental costs, joint or common costs, overhead costs -- that must be considered when setting a price.³³

The TSLRIC of a service equals the difference in the firm's total costs with and without the provision of that service. This means that all incremental costs of a service are avoidable by ceasing the

²⁹ Proposals that ILECs meeting the criteria of the Joint Board/FCC plan but falling within certain arbitrary regulatory classifications be ineligible for universal service support are clearly in conflict with the '96 Act. *See, e.g.*, Time Warner at 11-12 (only rate-of-return ILECs should be eligible for support) and NCTA at 13 ("must seriously consider whether support is required for price cap LECs").

³⁰ Under the bidding approach, the sum of the required COLR rate and the support determined through the auction process will be an estimate of the market rate.

³¹ *See, e.g.*, AT&T at 6-7; MCI at 4; TCG at 7.

³² TSLRIC studies also may be useful to regulators in determining if cross-subsidies exist. TSLRIC is not useful in establishing a cost floor for individual rates. Instead, it establishes a floor for the revenue that all rates for the service must generate. This will be equivalent to a price floor only in the special case where there is a single uniform rate for all units sold.

provision of that service. The firm's joint or common costs are those costs incurred in the provision of two or more services (but not the collection of all the firm's services) that are not incremental to any individual service. The firm's overhead costs are those costs incurred in the provision of all the firm's services that are neither incremental to any individual service nor joint or shared to any group of services.

Any multi-product firm that would set all prices for all services equal to TSLRIC would not remain in business for very long, for TSLRIC does not include three of the four possible types of costs that must be recovered. Simply put, prices set equal to TSLRIC do not allow the firm to recover common and overhead costs. Therefore, the process of setting a price for the "core" universal service must entail not only consideration of the TSLRIC costs but also the other legitimate costs of the firm.

In a competitive market, each firm would set its prices using "Ramsey" pricing principles. The firm would establish a markup over the direct cost of each service based on the elasticity of demand for that service. In order to survive for an length of time, the firm must be able to set these markups to cover its total cost. Two important points may be drawn from this.

First, it is not reasonable to suppose that the market outcome for a service, representing the firms' largest single output, would be priced at equilibrium to generate no contribution over direct costs. On the contrary, since local service is generally less elastic than other telecommunications services, it is reasonable to expect that the competitive process would result in a higher level of contribution from the "core" service than the average markup for all services. Therefore, if the proxy cost measure is developed using an average loading for shared and common costs, this approach would yield a conservative estimate of the true market price.

Second, the embedded cost of the firms in the market is relevant in the setting of the market price. While no competitive firm is guaranteed recovery of its embedded cost, the level at which the firm can set

³³ There is a fourth possible cost -- a "residual" cost. A regulated multi-product firm may have residual costs caused by assets that remain on its books through the actions of regulatory requirements even though they have no current economic value. These assets remain as a cost even though they cannot produce any positive cash flow.

its prices is determined by the average cost level in the industry at any given time. Today, that average cost level is the cost of the ILECs. This average level of cost -- and price -- does not change simply because a new technology is discussed in the trade press, or because someone runs a forward-looking cost model. It changes over time as firms actually supply service at a lower cost level. If a firm introduces a cost-reducing innovation into the industry, initially the firm will earn rents, since the average cost level in the industry will still be dominated by the older technology. These transitory rents are the return to innovation. As more firms -- both entrants and incumbents -- adopt the new technology, seeking to share in these rents, they will bid them away. Over time, as more capacity to supply at the new cost level enters the market, the average cost in the industry is driven down. At the end of this process, the average cost is set at the new level, the market price reflects this, and all of the benefits of the new technology have been passed to consumers.

Therefore, when setting the correct markups for their services at any given time, firms will choose markups that reflect their actual levels. For these reasons, the price measure the Joint Board/FCC must use in determining the amount of universal service support is the price that would be found in a competitive market. TSLRIC is not that price. A price that allows a firm to recover all direct costs plus a reasonable amount of all other costs is an appropriate price.³⁴ Better yet, the price set through an open competitive bidding process will be a market price.

5. GTE's plan initially establishes the core service cost based upon estimates derived from a cost model.

The *NPRM* (at ¶¶31-33) seeks comment on proxy cost models that would be available for use in developing a cost measure. As noted *supra*, the objective of universal service policy should be to compensate the COLR to the extent of the market intervention applied to its local service rate. The purpose of the cost measure, therefore, is to serve as a basis for estimating prior to actual entry by a new competitor what the local service rate would be in a competitive market. The difference (if any) between

this market rate and the required rate is what should be funded. This means that the cost measure should represent the average level of compensation the ILEC would expect in a competitive market, including a market-determined level of contribution toward shared and common costs.

The cost measure should be estimated, and support calculated, for small units of geography. GTE suggests that a unit smaller than a wire center is necessary, since the evidence from existing models indicates an order-of-magnitude variation in cost within many wire centers.³⁵ GTE supports the use of Census Block Groups ("CBGs") as a reasonable geographic unit for purposes of identifying a support need.³⁶ The use of small geographical units will best allow the Federal plan to target support to areas with high cost, and will send more accurate price signals to potential new entrants.³⁷

Some parties, however, propose that CBG-level results should be aggregated to a "zone" level before the level of support is calculated.³⁸ GTE emphatically opposes this suggestion. It will simply lead to the averaging of results within each zone -- which is just the kind of inaccuracy the use of small areas like CBGs is intended to avoid.³⁹ Further, aggregating will not lead to any meaningful advantages in the administration of the fund. The existing proxy models produce results by CBG today, the calculation of

³⁴ This approach is also consistent with the FCC's current rules for the pricing of new access services, which is based on direct cost plus a uniform overhead loading.

³⁵ NCTA suggests at 10 that the use of CBGs will somehow "fail to recognize the economies of scale of serving several CBGs from a single wire center...." NCTA therefore proposes that costs be estimated at the wire center level. NCTA fails to understand the design of existing proxy models. Both the Benchmark Cost Model ("BCM") and the Pacific Bell model ("CPM") engineer plant at the wire center level for all of the CBGs assigned to the wire center. They therefore capture the economies NCTA is concerned about.

³⁶ *NPRM* at ¶34. Many parties agree on the use of small units such as CBGs. *See, for example*, CPUC at 9, NYNEX at 10, US WEST at 8, Sprint at 15-16, MCI at 10-11.

³⁷ Use of a small geographic area makes academic consideration of changes in the definition of study area. *NPRM* at ¶45.

³⁸ *See, for example*, AT&T at Appendix B; NCTA, Attachment A at Appendix 8B.

³⁹ Within a limited number of zones, the actual density of each CBG could vary widely. Further, every existing proxy model considers explanatory variables other than density. Variations in cost attributable to these factors will not be captured when CBGs are grouped according to density. Within each zone, CBGs with lower costs and/or higher revenues will offset CBGs with higher costs and/or lower revenue. The effect of CBG aggregation would be to underestimate the true funding requirement, and to target support inaccurately.

support for each CBG is relatively simple, and computers are good at repetitive tasks. Why introduce the likelihood of error into the support calculation when there is nothing to be gained by doing so?

The *NPRM* (at ¶32) seeks comment on whether a proxy cost model can be made technology-neutral. GTE's submissions in CC Docket 80-286 ("D.80-286") have previously discussed why it is not reasonable to expect a proxy cost model to represent all possible technologies or network arrangements. None of the proxy cost models now available is in any sense an optimizing model. Each simply represents the best practice used by ILECs in placing equipment today. They do not, nor should they, attempt to select cost-minimizing solutions outside the range of this "best practice;" neither do they consider technology not used today.⁴⁰ The bidding process proposed by GTE obviates these concerns, since it would automatically incorporate bidders' own estimates of their costs, and avoid the need for regulatory agency review of cost estimates.

6. GTE's plan replaces the estimates derived from the cost model with a bidding mechanism that would allow the market to determine the level of universal service support.

GTE urges the Joint Board/FCC to make provision for a competitive bidding process in its Federal plan, since bidding would provide a far better, and market-based, approach for determining the amount of support. This would make the outcome hinge on economic reality as actually estimated by the parties involved in the bidding process. It would also be more consistent with the overall intent of the '96 Act to maximize reliance on market forces and to minimize regulation. Further, bidding furnishes a sound approach to reducing the amount of support over time; as the *NPRM* (at ¶35) recognizes, it would "harness competitive forces to minimize the level of high-cost assistance."

⁴⁰ The Illinois CC at 6 explains that any attempt to make a model technology-neutral would cause it to lose its ability to estimate meaningful costs. The CPUC at 12 also recommends starting with "a wireline model" because this approach would "encourage the carrier with the least-cost technology to offer service, without prejudging which technology should be used."

An auction proposal -- a concept that received qualified support from CPUC,⁴¹ the Florida Public Service Commission (at 11), NCTA (at 11-12), LDDS WorldCom at (12-13), PCIA (at 15), and Time Warner⁴² -- and specifically GTE's plan would eliminate the need to modify a cost model over time in order to reflect changes in technology, or to accommodate changes in the definition of core service, or to apply ILEC technology to other carriers. It would also capture any non-price considerations that would affect a carrier's decision to serve as a COLR -- something a cost model cannot do. These considerations might include the burden on the carrier of any requirements the state may impose, as well as the benefits of any complementarity of demand or cost with other services the carrier may provide.

As the *NPRM* (at n.84) recognizes, bidding cannot take place until competitors enter the market and are willing to become COLRs in a given area. GTE has proposed a flexible approach that would set the initial level of support based on cost. Bidding would be introduced in each area as competitors enter at their own initiative and nominate areas for bidding. The plan allows this flexibility, and permits the use of a great number of small geographic areas, yet will be reasonable to administer because it would group the bidding for all areas nominated in a given year within pre-announced bidding cycles.⁴³

GTE proposes that the Federal plan provide for state administration of the auction process, within Federal guidelines, in order to ensure that each COLR selected will be able to receive universal service support under both Federal and state regimes. Responsibility for funding the support determined by the

⁴¹ While the CPUC at 12 says that market conditions may not warrant the introduction at present of a competitive bidding process to determine high-cost support amounts, it does not foreclose possible support for a bidding procedure in the future. Indeed, it says (*id.*) it is "considering using competitive bidding to determine subsidy amounts once they come up for review" because of "the level of difficulty experienced in getting parties to agree on a proxy cost model."

⁴² Time Warner at 10 rejects a bidding procedure that would award the lowest bidder exclusive high cost support for a particular area, but this does not describe GTE's plan. It adds at 11: "Absent such an alternative [a non-preclusive bidding procedure like GTE's proposal where bidders are provided "with the greatest incentive to bid efficiently, ensuring that support would be provided at the least cost"], it is imperative that the Commission implement a bidding mechanism that will provide a similar incentive."

auction could then be divided between the state and Federal mechanisms in the same proportion as the cost-based support had previously been divided.

The result is a plan that is competitively neutral. Indeed, any carrier seeking to receive support payments would be able to pursue this goal through the bidding process. This means, instead of hiring squadrons of lawyers and accountants to submerge the state and Federal decision-makers in quasi-data, the entrant into the competition to be an ILEC would have to make commitments of real economic consequence. By the same token the ILEC and the state agency and the FCC and all the other parties to the bidding transaction would be obliged -- simply because of what is at stake -- to make decisions of real economic consequence. GTE's plan replaces empty rhetoric with economic decisions.

7 The GTE plan rebalances ILEC prices on a revenue neutral basis.

To ensure that the new Federal plan is revenue neutral, and that it does not provide a windfall to LECs, new explicit funding must be applied toward reductions in rates for services that provide implicit support today.⁴⁴ This process of price rebalancing must occur simultaneously with implementation of an explicit universal service support program. Thus, there is a pressing need for the Joint Board/FCC and state regulatory agencies to link decisions in the instant docket to a process of reform of interstate access charge rules and revisions to intra-state pricing structures. This matter should be addressed in this proceeding.

The *NPRM* (at ¶¶112-114) seeks comment on proposals to reduce or eliminate the current interstate Carrier Common Line ("CCL") charge, and to fund these reductions through increases in the cap on the interstate End User Common Line Charge ("EUCL") charge. GTE joins the CPUC and many other

⁴³ See (i) Appendix C to GTE's comments for a description of GTE's proposed bidding process submitted in *D.80-286* and (ii) GTE's comments at 10-12. The *NPRM* at ¶36 proposes that a winner's preference, or "incentive bonus," could be provided to the lowest bidder in an auction as an incentive to bid aggressively. GTE has proposed a process wherein the size of this incentive bonus is itself determined through the bidding process.

⁴⁴ For LECs that receive USF today, the offsetting rate reductions should be based on the net change in support caused by the new plan. For non-LEC *Elte/s*, no offsetting reductions will be required, since these carriers do not provide implicit support through their rates today.