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

MAY - 7 1996

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

DOCKET FILE COPY ORIGINAL

REPLY COMMENTS

BELLSOUTH CORPORATION
BELLSOUTH TELECOMMUNICATIONS, INC

M. Robert Sutherland
Richard M. Sbaratta
Rebecca M. Lough

Their Attorneys

Suite 1700
1155 Peachtree Street, N.E.
Atlanta, Georgia 30309-3610
(404) 249-3386

Date: May 7, 1996

No. of Copies rec'd 0+11
List ABCDE

TABLE OF CONTENTS

Summary

The task of the Joint Board and the Commission is to sort through the positions presented, identify common ground and create an approach that satisfies the requirements of the Telecommunications Act of 1996 ("Act"). BellSouth believes that the approach presented in its comments can provide for a new approach to universal service for both the core services and support for services provided to educational institutions, libraries and health care providers

With regard to universal service support for core services, BellSouth demonstrates that the objectives of the Act can best be achieved through distinct federal and state universal service funds. While some commenters would view all universal service support to be provided from the new federal fund, BellSouth believes that an approach that recognizes the distinct jurisdictional responsibilities of the state and federal jurisdictions utilizes the particular experience and expertise of the individual commissions and avoids the pitfall of presuming a one size fits all approach can be delineated within the compressed period mandated by the Act.

The Joint Board should seize upon the consensus reflected in the comments and adopt the definition of universal service that was proposed in the Notice. Applying this definition to primary residential lines would serve as the starting point for sizing the universal service fund.

BellSouth shows that universal service support should be based on actual costs. Indeed, a fundamental flaw of a benchmark cost model approach suggested by some commenters is that it is totally unrelated to actual cost. Such models were never intended to provide the absolute cost of providing universal service but rather to provide a

benchmark of how much more or less expensive one area maybe to serve relative to another.

Equally flawed are the suggestions by some that Total Service Long-Run Incremental Cost (TSLRIC) should be used in sizing the universal service fund. These parties incorrectly contend that access prices must be reduced to TSLRIC to remove excessive universal service support. These parties overlook that it is appropriate for the price of all services to provide a contribution to the recovery of joint and common costs. TSLRIC is not a price ceiling but rather a price floor and is used as a check against cross subsidization. Further, all multiproduct firms, whether regulated or not, recover their joint and common costs by pricing services at levels that exceed incremental costs. The amount prices exceed incremental costs is determined by analyses of market conditions with particular emphasis on demand elasticities, cross-elasticities and potential substitutes. It is absurd for some commenters to suggest that only prices set at TSLRIC are competitive prices.

The cost of universal service has three components: (1) the ongoing cost--including the future cost--of providing universal service; (2) the cost of low-income assistance; and (3) the cost of unrecovered investment associated with the past provision of universal service. These costs relate to the historical circumstances under which decisions were made both by BellSouth and regulatory commissions regarding the provision of service. They are not and, in fact, cannot be captured by a current incremental cost study.

BellSouth demonstrates that embedded costs should be used to initially size the fund. Based on these costs, the federal universal service fund for the industry would be approximately $7.7 billion.

The size of the federal universal service fund could be reduced if subscriber line charges for single line business and residential lines were increased. Such increases would not adversely affect telephone subscribership. Furthermore, any increase in subscriber line charges should be followed by an immediate flow through of the corresponding access charge reduction in the form of lower toll rates. BOC entry into the interLATA market will provide a means by which to assure that toll users will continue to benefit from access charge reductions.

With regard to the Act's requirements concerning universal service support for services provided to educational institutions and libraries, BellSouth urges the Joint Board to adopt a flexible discount mechanism with a fixed fund size. As BellSouth shows, its approach addresses many of the concerns expressed in the comments. The Joint Board can then move forward to focus upon the specific means by which such an approach could be implemented. In so doing, the Joint Board will be able to recommend a "total" approach to achieving the goal of assuring that schools and libraries have access to telecommunications services needed for educational purposes.

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

BellSouth Corporation and BellSouth Telecommunications, Inc. (BellSouth) hereby submit their Reply Comments in the above referenced proceeding.

I. INTRODUCTION

The importance of this proceeding is evidenced by the number of commenting parties. The extensive range of interests presented not only show the diversity of opinion but also illustrate the complexity of the issues The task of the Joint Board and the Commission is to sort through the positions presented, identify common ground and create an approach that satisfies the requirements of the Telecommunications Act of 1996.[1] Although the volume of comments and the truncated schedule add to the difficulty of the task, BellSouth believes that the approach presented in its comments can provide the foundation for a new approach to universal service support.

Section II of this Reply addresses the core universal service issues. Matters pertaining to supporting services provided to educational institutions, libraries and health care providers are presented in Section III.

---

1 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

II. CORE UNIVERSAL SERVICE ISSUES

A. Universal Service Support For Core Services Should Recognize Distinct Federal and State Responsibility

In addressing core universal service support, the comments present an array of jurisdictional approaches. It would appear that some suggest that all universal service support come from a federal fund directed under the auspices of the Commission.[2] Others propose that a single federal fund be distributed to the states in the form of block grants to then be distributed to carriers by state commissions.[3] Many of the comments are ambiguous, with no clear indication of the jurisdictional reach of their proposals. Still there are some, such as BellSouth, that view distinct federal and state support mechanisms as the best means for achieving the Act's universal service goals.

In mandating the establishment of new universal service support mechanisms in the Act, the express intent of Congress was to replace the existing systems of implicit support with explicit and competitively neutral support mechanisms. The paramount question is how best to achieve this objective. The states and this Commission have historically followed different paths in supporting universal service. The individual state commissions and this Commission are each in the best position to evaluate the implicit support reflected in the rates and rate structures over which they have regulatory oversight. The most efficient means by which to replace the implicit support with explicit mechanisms is for each regulatory jurisdiction to be responsible for addressing its respective implicit support.

---

2 See, e.g., AT&T at 14.

3 See, e.g., MCI at 4.

This is not to suggest that the instant proceeding does not have relevance to state universal service issues. To the contrary, BellSouth believes that its approach to identifying the amount of implicit support universal service currently receives provides a ready, verifiable and practical approach to the quantification of total universal service support.[4] The approach also provides for a ready identification of jurisdictional responsibility.

Jurisdictional responsibility allows each regulatory agency to address affordability/rate rebalancing within its respective jurisdiction. It utilizes the particular experience and expertise of the individual commissions. Finally, and perhaps most importantly, it avoids the pitfall of presuming a satisfactory one size fits all approach can be delineated within the compressed period mandated by the Act.

B. Federal Universal Service Support--The Core Mechanism

There are several key, interrelated issues, addressed in the comments, whose resolution are essential to the determination of the size of the universal service fund. The threshold issue is the identification of the core services and functions that are to be included within the definition of universal service Next is the methodology for identifying the level of support for universal service. Last is the consideration of rate rebalancing. In the context of an interstate fund, rate rebalancing centers on whether subscriber line charges should be increased. Each of these issues is discussed below.

---

4 See, BellSouth Comments at 7-8.

1. The Definition Of Universal Service

The Act sets forth criteria for the Joint Board to consider in arriving at its recommendation of the services to be supported by the federal universal service fund.[5] Based on these criteria, the Notice proposes that the features of the core service to be supported by the federal universal service fund are 1) voice grade access to the public switched network; 2) touch-tone capability; 3) single party service; 4) access to emergency service (911); and 5) access to operator services. BellSouth along with a majority of commenters concurred that the five capabilities constitute the service to be supported by the interstate universal service fund In addition, there was an overwhelming consensus that universal service support should only extend to service provided to residential users.[6]

A few parties urge the Joint Board to broaden the service definition or extend universal service support beyond primary residential lines. These suggestions are not well founded. For example, some parties urge that toll limitation services be brought within the definition of universal service.[7] As used by the commenters, toll limitation services include a variety of capabilities that enable consumers to block and screen their toll usage. In suggesting that the universal service definition be expanded to include these capabilities, commenters apparently believe that such an expansion would increase telephone

---

[5] See, Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) at Title I, Subtitle A, Sec. (a), Universal Service, to be codified at 47 USC § 254(c)(1).

[6] See, BellSouth Comments at 6. NCTA at 6, LCI at 2-5, Sprint at 6-8 and AT&T at 11-14, all suggested that only primary residence lines should be supported by the federal universal service fund

[7] Florida PSC at 14-15, LDDS World Com at 7-10, ICC at 3-5, IURC at 2-4.

subscribership by reducing the number of disconnections. While BellSouth believes that these capabilities can meet specific customer needs, and accordingly, BellSouth offers such services at nominal fees, blocking and screening services do not satisfy the statutory criteria for including them within the definition of universal service. These services are not widely subscribed to by residential customers nor are they essential to education, public health or public safety.[8]

At least one party goes so far as to suggest that the universal service definition include "privacy" type features such as call blocking which would prevent a calling party's signaling information from being transmitted to the called party through services such as Caller ID. This suggestion is misplaced. The Commission already requires each local exchange carrier that uses SS7 signaling in its network to provide its customers with the capability of blocking the transmission of the calling party's name and number information (i.e., placing a privacy indicator on the information) to the called party. Accordingly, there is absolutely no reason to clutter the definition of universal service with an independently established and existing regulatory requirement.

Other parties suggest that single line business service be included within the class of service to be supported by the universal service fund.[9] This proposal likewise fails to satisfy the statutory criteria for determining the services to be supported by the federal

---

[8] On the other hand, the statute authorizes state commissions, as part of an intrastate universal service fund, to include services not included within the definition used to establish federal universal service support. See, n.5 supra, to be codified at § 254(f). To the extent, then, that local conditions warrant, state commissions would be free to support toll limitation services through the intrastate universal service fund.

[9] See, e.g., LDDS WorldCom at 7-10, LA PSC at 1-4, PUC TX at 6-7.

universal service fund. Indeed, the market-based element of these criteria is specifically based on residential customers only.[10] It would appear that the motivation for recommending that single line business service be included within the definition of universal service is to address local needs. Rather than expanding the classes of customer to which federal universal service support would be extended, such needs would be better accommodated through the state universal service funds. In authorizing states to establish intrastate funds, the Act clearly recognizes that a state may have reason to go beyond the universal service definition established for the federal fund. Extending universal service support to customers other than residential users would certainly come within the type of circumstances contemplated in the Act to be addressed by individual state funds.[11]

2. The Methodology For Determining The Size Of The Universal Service Fund

While the comments evidence a broad consensus regarding the definition of universal service and, therefore, should facilitate a Joint Board recommendation on that issue, a far more contentious issue surrounds the size of and the method for calculating the universal service fund. While the comments reveal widespread agreement that replacing implicit support with an explicit funding mechanism should result in the elimination of interstate carrier common line charges[12] and transport interconnection charges,[13] there are

---

10 See, n.5 supra, to be codified at § 254(c)(1)(B).

11 The potential for individual states having to meet special circumstances further evidences the efficacy of BellSouth's proposal that there be distinct federal and state universal service funds.

12 AT&T at 16, MCI at 15, Time Warner at 19, MFS at 22.

13 AT&T at 4, Citizens at 7-9.

fundamental disagreements regarding the level at which the initial federal fund should be established. Several commenters, such as AT&T, MCI and Ad Hoc perceive this proceeding as an opportunity to reprice and reduce interstate access charges without any recognition for the recovery of costs incurred by LECs in meeting their obligation to serve customers upon reasonable request for service. Other commenters who urge the adoption of benchmark cost models focus on reducing the size of the initial interstate fund.[14] Whatever the motivation, the recommendations of these parties would have the Commission depart from actual costs in establishing the universal service fund. As explained below, the Commission should not adopt an approach that is not based on actual costs.

The benchmark cost model ("BCM") approach endorsed by several commenters, as observed in the Notice in this proceeding, is not based on costs reported by any company or the embedded cost of any company providing service today.[15] Instead, it purports to develop a cost range of a predetermined set of telecommunications services based on efficient wireline engineering and design, using current technology.[16] These very characteristics of the BCM explain why it is not sufficient for determining the appropriate level of universal service support. The purpose of the model is to identify geographic areas which are relatively high or low cost areas to serve. It does not provide an absolute

---

14 See, e.g. AT&T.

15 Notice at ¶¶ 31-32.

16 Id.

level of cost for any area but rather provides a benchmark of how much more or less expensive one area may be to serve relative to another.[17]

In their paper, Drs. Gordon and Taylor were highly critical of the BCM for the purpose of sizing the universal service fund:[18]

> By construction, this model would not produce the forward-looking costs of any particular carrier that would likely compete in the local exchange market in a particular state. The BCM uses nationwide values for critical cost inputs such as network equipment costs and installation costs, and assumes engineering practices that cannot be attributed to a particular carrier and might not be feasible or optimal in particular circumstances. Also, since it only produces relative costs, the BCM cannot help to determine the absolute size of the proposed universal service fund. Instead, the model only indicates which service areas (census block groups or CBGs) are more costly to serve than others. (emphasis in the original)[19]

There are other problems with the BCM that call into question the relative costs that the model purports to develop. In its October 10, 1995 comments in CC Docket 80-286, BellSouth submitted a critique of the BCM and its results based on census block groups. This analysis showed that the BCM misassigns census block groups to wire centers and that the BCM bore little relationship to the cost of providing service. A copy of the analysis is provided as Attachment I to this Reply. Simply put, the BCM is not reliable.

---

17 Thus, even an area which under the BCM is low cost relative to another area does not mean that such area should not receive, for example, high cost support from the federal universal service fund

18 Kenneth Gordon and William E. Taylor, Comments on Universal Service, April 12, 1996 submitted as Attachment I to BellSouth's Comments in this proceeding. ("Gordon and Taylor")

19 Id. at 37.

The inappropriateness of the BCM is not exclusively associated with its design flaws. Equally inappropriate for the purpose of sizing the universal service fund is the use of Total Service Long-Run Incremental Cost (TSLRIC). Interexchange carriers such as AT&T and MCI attempt to size the universal service fund on the basis of TSLRIC. The gist of their argument is that access prices must be reduced to TSLRIC to remove excessive universal service support and to ensure competitive fairness in local markets.

There are several flaws in these parties' contentions. First, it is appropriate for the price of all services including access services to provide a contribution to the recovery of joint and common costs. It is not economically efficient to set service prices at the TSLRIC of the service. The relevance of TSLRIC is that it is the measure by which to make certain that a service is not being cross-subsidized, that is, the incremental revenue of a service should exceed the TSLRIC for the service. Price will frequently exceed this incremental revenue due to flat rate elements, volume dependent prices or other non-linear pricing structures. This fundamental construct is ignored by AT&T and MCI.

Another pitfall of the TSLRIC approach is that as presented, it disregards that telecommunications carriers incur considerable proportions of fixed costs that are shared among multiple services or are common among all services provided by the carrier. These costs are not part of TSLRIC for any individual service, so that the total revenue that would be received if all services were priced at TSLRIC would not recover any of these (shared and common) fixed costs.

Local exchange carriers cannot survive financially by pricing all of their services at incremental costs. All multiproduct firms, whether regulated or not, recover their joint and common costs by pricing services at levels that cover incremental costs plus a contribution to joint and common costs. The contribution levels are determined by analyses of market conditions with particular emphasis on demand elasticities, cross-elasticities, and potential substitutes. Given that unregulated, multiproduct firms set their prices in this way, it is absurd for some commenters to suggest that only prices set at TSLRIC are competitive prices.[20]

From BellSouth's perspective, universal service cost has three components: (1) the ongoing cost--including the future cost--of providing universal service; (2) the cost of low-income assistance programs; and (3) the cost of unrecovered investment associated with the past provision of universal service. These costs relate to the historical circumstances under which decisions were made both by BellSouth and regulatory commissions regarding the provision of service. They are not and, in fact, cannot be captured by a current incremental cost study.[21]

For instance, BellSouth's (as well as other incumbent LECs) reserve deficiency arose from slower-than-economic depreciation of investments committed to universal service provision in return for regulatory protection from competition. This "regulatory

---

[20] It is doubtful that either MCI or AT&T could demonstrate that all of their "competitive" services are priced at TSLRIC

[21] Indeed, even the current, ongoing cost element is not measured correctly by a forward-looking incremental cost study, because the incremental cost study would not include a reasonable share of the joint and common costs that are part of the cost of providing service. In addition, there may be unique costs arising from the obligation to serve universally that may not be captured by an incremental cost study. Lastly, there are numerous variables that impact cost, and most proxy cost models only account for a few of the variables. Use of recent accounting data would avoid this deficiency.

compact" which guaranteed recovery over time was the expedient that regulators used to hold down local exchange rates for residential customers. BellSouth and other incumbent LECs should be entitled to recover their reserve deficiencies because these amounts were not accumulated on the basis of voluntary and unfettered business decisions, but rather as part of the regulatory compact. Dr. Lewis Perl, testifying on universal service funding before the Kentucky Public Service Commission on behalf of BellSouth, stated that it would be unfair and economically damaging to require any LEC who has had carrier of last resort responsibility to write-off the reserve deficiency.[22]

The ongoing cost component of the universal service fund should be based on embedded costs. As explained in Dr. Perl's testimony:

> The incumbent LEC incurred its current embedded cost under market and institutional arrangements which were quite different from those which prevail today. The incumbent was the assumed monopoly supplier and was entitled to recover <u>all</u> of its investment in promoting and providing universal service and to earn a fair return on investments in those services. The only requirement was that the investments had to be prudent as judged and approved by regulators in place at the time they were made. While circumstances are now different and these markets are potentially competitive, the incumbent should surely be afforded the opportunity to recover its investments in universal service unless they are threatened by genuine and effective competition. Such an opportunity requires that the universal service fund initially be set to cover the level of embedded cost. Setting a lower level of support (consistent with the incumbent LEC's LRIC or TSLRIC, for example) would deny the LEC the opportunity to recover its embedded investment even if no lower cost competitors entered the market. Such regulatory treatment would be unfair and confiscatory.[23] (emphasis in the original)

---

22 Kentucky Public Service Commission, In re: An Inquiry into Local Competition, Universal Service , and the Non-Traffic Sensitive Access Rate, Administrative Case 355, Direct Testimony of Dr. Lewis Perl, February 16, 1996 at 10. A copy of Dr. Perl's testimony is provided as Attachment II.

23 <u>Id</u>. at 14. Dr. Perl also pointed out that measuring the relevant incremental cost upon which the universal service fund might be based would be all but impossible. In (Continued......)

Some commenters contend that if the universal service fund were based on embedded costs, such a fund would guarantee incumbent LECs' recovery of their costs and insulate them from competitive losses.[24] This contention is incorrect under BellSouth's proposal. Except for the reserve deficiency component of the fund, the support provided under the fund will be available to incumbent LECs or competitor LECs on a per line basis to the LEC who actually supplies the lines and provides the universal service. Thus, the incumbent LEC will lose universal service support when it loses customers to competition.[25]

Further, use of embedded costs to initially size the universal service fund would not adversely affect the development of competition. Portability of universal service support will encourage efficient competition in the local exchange market by allowing competitive providers of universal service to compete on the basis of their costs. As Gordon and Taylor demonstrate, a universal service fund based on an incumbent carrier's embedded cost would eventually result in least-cost provision of basic service.[26]

BellSouth has estimated the size of the universal service fund for the industry. For the industry, the federal universal service fund would be approximately be $7.7 billion. As discussed further below, the size of the federal universal service fund can be reduced if

---

these circumstances Dr. Perl concluded that "targeting the universal service fund to a speculative estimate of such costs would be both risky and pointless." Id. at 15.

[24] MCI at 10-12.

[25] Commenters who view embedded costs as a "keep whole" approach for incumbent LECs fail to consider the effects of portability of universal service support.

[26] Gordon and Taylor at 10-14.

the Commission would increase the single line business and residential subscriber line charge.

A final issue relating to the universal service fund is the determination of a carrier's contribution to the fund. The Act provides that carriers providing interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis to the universal service fund.[27] A challenge in this proceeding is to determine that equitable and nondiscriminatory basis for a carrier's contribution.

There is virtual agreement that a revenue basis should be used in determining a carrier's contribution to the fund. Essentially three different revenue proposals have been made. A few commenters suggest that contributions be based on gross revenues.[28] Others argue for revenues net of charges paid to other carriers (value added approach).[29] Finally, some parties, including BellSouth, urge the Joint Board to adopt a contribution methodology based on interstate retail revenues.[30]

Unquestionably the use of gross revenues would be inappropriate. It would lead to a double assessment of access revenues, once on the revenues earned by the LEC and the second time on the retail revenues earned by an interexchange carrier.

Both the value added approach and the retail revenue approach would avoid the double assessment malady from which the gross revenue approach suffers. Nevertheless, from an equitable standpoint BellSouth believes that a retail revenue approach is superior.

---

27 See, n.5 supra, to be codified at § 254(d)

28 CBT at 14-16, 360° at 9.

29 Teleport at 13, Sprint at 4, 16, NY State Consumer Board of Protection at 10.

30 See, AT&T at 7-8, BellSouth at 15, GTE at 16-18, USTA at 24.

The purpose of the Act was to eliminate from interstate access charges implicit support and to make that support explicit. Because carriers would be the contributors to the fund, the Act implicitly recognizes that these carriers would then recover their contributions from the broad body of retail services and users. If a value added approach were used, then LEC contributions would be based on its access revenues but, unlike the IXCs, there would be no broad body of interstate retail users and services from which to recover the contribution to universal service. Indeed, the largest interstate retail revenue source for LECs are end user charges--which the Commission by rule limits. Therefore, LECs would not have the same opportunity as IXCs to recover their contributions from end-users. Thus, for LECs, contributions to the interstate fund would have to be recovered through access charges, transforming a substantial portion of the explicit support mechanism back to an implicit support mechanism. BellSouth does not believe this result is desirable or intended by the Act.

The interstate retail revenue approach would minimize the amount of universal service support that would have to be, in effect, funded (implicitly) through interstate access charges. While LECs would have some responsibility to contributing to universal service support under the retail revenue approach, the amount of their contribution would be rationally related to their relative proportion of total industry retail revenues. Afforded the appropriate pricing flexibility, these properly sized contributions could likely be recovered from the LECs retail interstate services. BellSouth believes this result is both equitable and most consistent with the intent of the Act.

3. Rate Rebalancing--A Subscriber Line Increase Will Reduce The Size Of The Universal Service Fund

As noted above, the size of the universal service fund is $7.7 billion. BellSouth indicated in its comments that the Commission could take steps to reduce the size of the initial fund by increasing subscriber line charges. Indeed, several commenters suggested that subscriber line charge increases be made before the Commission establish the new universal service fund. For example, AT&T suggested that subscriber line charges should be increased to approximately $7.00 so as to eliminate the interstate carrier common line charge.[31] In its comments, USTA suggested that subscriber line charges should be permitted to increase up to a cap of the nationwide average loop cost which is approximately $6.00.[32]

Certainly, increasing subscriber line charges is a means by which to reduce the overall level of universal service support. The tension that increased subscriber line charges creates with the policies of the new Act is the extent to which such increases affect the affordability of universal service.[33] As BellSouth demonstrated in its comments,

---

31 AT&T at 16.

32 USTA at 14-16.

33 Some parties (See, e.g., Fla. P.S.C. at 21, MCI at 14) in arguing against subscriber line charge increases contend that the cost of a loop is a common cost and should be recovered through charges for all services that use the loop. These parties incorrectly characterize the loop as a common cost. In his recent article "The Economic Necessity of an Increased Subscriber Line Charge (SLC) in Telecommunications", Dr. Steven Parsons noted:

> A true common cost is a cost that must be incurred regardless of the volume of associated individual services. When considered carefully and properly, it is clear, from the width of economics literature on the subject, that loop costs are not common costs. Rather, they are directly attributable to the services that cause

(Continued......)

an increase in subscriber line charges would not adversely affect telephone subscribership.[34] BellSouth believes that an increase can be implemented gradually so as to avoid any negative effect on subscribership or the affordability of telephone service.

Furthermore, as recognized by the interexchange carriers, any increase in subscriber line charges should be followed by an immediate flow through of the access reductions in the form of lower toll rates.[35] The Commission should also bear in mind that BOC entry into the interLATA market will provide further assurance through increased competitor that all toll users will continue to benefit from access charge reductions.

Further, because the increase in subscriber line charges is coming primarily from residential users, the entire reduction in toll rates should be made to an interexchange carrier's basic toll schedule. The modest size of the real increase in subscriber line charges coupled with a targeted reduction in prices of toll services that would accompany the increase should assuage any concern that a subscriber line charge increase would be detrimental to universal service objectives. This approach would mean that the average telephone bill would not increase for residential users, even with a subscriber line charge increase.

While the affordability of telephone service would not be adversely affected by a subscriber line charge increase, the increase would carry with it the public policy benefit

---

> them (e.g., private line, special access, Centrex, and the subscriber access component of basic local exchange service). [footnote omitted]

48 Administrative Law Review 227 (Spring 1996).

[34] See BellSouth Comments at 11.

[35] AT&T at 16, n.21, and Sprint at 3.

of reducing the size of the federal universal service fund. The modest increase proposed by BellSouth would enable the Commission to right size the new federal universal service fund from its creation

III. FEDERAL UNIVERSAL SERVICE SUPPORT - SCHOOLS AND LIBRARIES

The flexible universal service support discount mechanism proposed by BellSouth in its Comments in this proceeding would achieve the legislative goals underlying Section 254(h)(B) of the Act Under a "flexible discount" plan, the FCC would determine the size of an "education universal service fund" based on a reliable estimate of the cost of connecting every school in the country to the National Information Infrastructure ("NII"). The education fund would then be divided among the states using whatever allocation methodology was deemed appropriate to meet national policy goals. An appropriate entity within each state would be responsible for allotting a specific dollar amount to each eligible school/library in the state. Each school or library, in turn, would use its allotted dollars to purchase the universal telecommunications services that meet its needs from the carrier that offers the best price and quality.

As discussed below, the flexible discount approach has many potential benefits and addresses many of the concerns raised by other commenters. BellSouth urges the Joint Board to immediately adopt a flexible discount approach with a fixed support fund size and to focus its attention during the remainder of this proceeding on crafting the implementation details of such an approach

A. A Flexible Discount Mechanism Would Address Many of the Concerns Raised by Commenters

The strengths of a flexible discount mechanism are evident when consideration is given to the manner in which such an approach could successfully address many of the concerns which have been expressed by commenters in this proceeding, as is demonstrated below:

> Concern - Schools and libraries should have a choice regarding the types of services and/or functionalities for which universal service support dollars can be utilized. A "one size fits all" approach to universal service support for schools and libraries would be inappropriate.
>
> Response - Under the flexible discount approach, each school would be free to use its allotted funds to purchase any available regulated telecommunications service determined to fall within the definition of universal services. Such a mechanism could allow a school or library to apply its allotted dollars to those services which it most needs at that point in time, akin to a cafeteria-style health plan. A school might choose to apply all of its funds to one service or it could spread its funds across multiple services. As such, the approach provides a realistic solution for unconnected and/or low budget schools and libraries which could use their allocated amount to pay the full cost of services that get them connected. These schools/libraries might remain unconnected under a flat discount mechanism. For example, a school or library might not benefit from a fixed percentage discount on a telecommunications service if its budget did not provide for the remainder of the charges. Under BellSouth's proposal, however, that school or library may be more likely to obtain such a service because it would be provided with a specific dollar amount of support which it could choose to apply to the entire price of the service.
>
> Concern - The rules and mechanisms adopted pursuant to this rulemaking proceeding should complement and enhance existing programs already in place or planned at the state or local level.
>
> Response - Through the involvement of an appropriate state/local entity in the allocation process, guidelines can be established (consistent with any adopted by the Commission) to assure such coordination with existing and future state/local programs. The appropriate state or local entity could be responsible for assisting individual schools and libraries in formulating their educational telecommunications plans and integrating them into an overall coordinated technology plan.
>
> Concern - Shared arrangements should be accommodated.

Response - Under a flexible discount approach, eligible entities could pool their individual universal service allotments to obtain a mutually beneficial joint network arrangement. For instance, funds could be used for off-premises projects that directly support and extend the educational activities of K-12 schools, such as distance learning networks. Such pooling arrangements could provide for efficient utilization of universal support dollars while not involving resale and at the same time could make a substantial contribution toward the elimination of geographic boundaries between and among schools and libraries.

Concern - The availability of universal service support should not impede the positive impact which greater competition in the telecommunications industry can have on the availability of affordable access to schools and libraries.

Response - A flexible discount approach would permit the competitive marketplace to determine the most efficient prices prior to the school/library's purchase of the service using its flexible discount funds. Thus, the marketplace would be permitted to operate freely to drive prices down, for instance, through competitive bidding arrangements. In addition, since every school/library would have funds designated specifically for telecommunications, competing service providers would have the incentive to propose attractive and innovative service proposals at efficient market prices in order to win the school/library's business.[36]

Concern - Some means should be provided for variation in fund allocation in a manner which addresses social needs such as income levels and/or population density.

Response - A flexible discount approach would permit allocations to states, school districts and individual schools and libraries to vary based upon such factors.

Concern - The approach adopted should meet the requirements of the Act for a specific, predictable and sufficient universal service support mechanism.

Response - The flexible discount approach would meet such requirements. The amount of the overall nationwide universal service support available to fund educational discounts through the flexible discount mechanism would be sized by the Commission, and the amount of each contributing carrier's amount could be calculated.

---

[36] Such an approach would be more realistic than discounts off of "tariffed" rates given that as competition increases fewer and fewer carriers will be filing tariff rates for their services and negotiated prices will become more prevalent. In addition, such an approach avoids the complexity of other suggested approaches such as trying to determine the lowest price at which the same or comparable service arrangement has been offered to other customers, or the total service-long run incremental cost of the service arrangement.

B. The Joint Board Should Move Forward To Determine The Size Of The Fund As Well As The Mechanism Under Which Amounts Are To Be Allocated

Once the Joint Board accepts the basic approach of a flexible discount mechanism with a fixed size fund, it can then move on to focus upon the specific means by which such a plan would be designed and implemented. This would include such issues as determining the actual size of the overall universal service support fund for schools and libraries and the mechanisms for allocating amounts to eligible recipients.

BellSouth recommends that the Partial Classroom model detailed in the McKinsey Report[37] be used as the basis for establishing the fixed size of the education universal service fund. This model is based upon connections with speeds of up to 1.544 Kbps (i.e., DS-1) and provides an excellent estimate of the cost of achieving the national policy goal of connecting every school to the NII.[38]

BellSouth further recommends that in the context of the universal support mechanism, only the cost of connections to the school should be included in the education fund calculation. BellSouth recognizes that connections within the school at the classroom level is an important factor in enhancing education through technology.

---

[37] McKinsey & Company, Inc., "Connecting K-12 Schools to the Information Superhighway," (report prepared for the National Information Infrastructure Advisory Council, hereinafter "McKinsey Report").

[38] Of course, under BellSouth's proposal, although the size of the fund would be determined in this manner, the flexible discount mechanism could be used by any given school or library, or groups of schools and libraries, to fund any service or services within the definition of universal service for schools and libraries, in whole or in part as permitted by the amount allocated.