UNITED STATES DEPARTMENT OF COMMERCE
National Telecommunications and Information Administration
Washington, D.C. 20230

ERRATUM

June 14, 1996

RECEIVED

JUN 14 1996

Federal Communications Commission
Office of Secretary

Mr. William F. Caton
Office of the Secretary
Federal Communications Commission
1919 M Street
Room 222
Washington, D.C. 20554

Re: Docket No. 96-45
Federal-State Joint Board on Universal Service

DOCKET FILE COPY ORIGINAL

Secretary Caton:

Please find attached a corrected version of the National Telecommunications and Information Administration's Reply Comments correcting data on page 12 of the Exhibit. In the first complete paragraph on page 12 of the Exhibit the first number in each of the ranges "12-13 billion" and "1.4-1.5 billion" have been corrected. The ranges now read "6-13 billion" and ".8-1.5 billion," respectively. If there are any questions, please call me on 482-1816.

Sincerely,

Cheryl A. Kinsey

Cheryl A. Kinsey

cc: Parties of record
(corrected page only)

0+5

RECEIVED

JUN 14 1996

Federal Communications Commission
Office of Secretary

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

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

REPLY COMMENTS OF THE NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION

Larry Irving
Assistant Secretary for
Communications & Information

Shirl Kinney
Deputy Assistant Secretary

Barbara S. Wellbery
Chief Counsel

Phyllis E. Hartsock
Deputy Chief Counsel

Timothy R. Robinson
Attorney

Kathryn C. Brown
Associate Administrator
Jim McConnaughey
Tim Sloan
Office of Policy Analysis
and Development

National Telecommunications
and Information Administration

U.S. Department of Commerce
Room 4713
14th Street and Constitution Ave., N.W.
Washington, D.C. 20230
(202) 482-1816

June 12, 1996

TABLE OF CONTENTS

Section		Page
Summary		i
I.	INTRODUCTION	1
II.	THE PACKAGE OF SUPPORTED SERVICES SHOULD BE "BASIC," YET DYNAMIC	6
III.	ENSURING JUST, REASONABLE, AND AFFORDABLE RATES FOR ALL RESIDENTIAL SUBSCRIBERS	10
	A. Cost Support for Low Income Consumers	12
	B. Cost Support for Consumers in High Cost Areas	15
	C. Temporary Support Mechanisms May Be Needed To Prevent "Rate Shock" in Some Areas	19
IV.	COLLECTION, DISTRIBUTION, AND ADMINISTRATION OF UNIVERSAL SERVICE SUPPORT FUNDS	21
	A. All Providers of Interstate Telecommunications Services Should Contribute to the Funding of Universal Service	22
	B. Subsidies Should Be Distributed in a Way That Promotes Competition Among Telecommunications Service Providers	25
	C. Administration of the Universal Service Fund	28
V.	CONNECTING SCHOOLS, LIBRARIES, AND HEALTH CARE PROVIDERS	29
	A. Special Services for Schools, Libraries, and Hospitals	29
	B. The Pricing of "Special Services"	30
VI.	CONCLUSION	34
EXHIBIT		
	Estimated Cost Profiles for Connecting Schools and Libraries to Advanced Networks	

SUMMARY

In fashioning new universal service policies, the Commission and the States must ensure that those policies are consistent with the Act's mandate to foster meaningful competition in every segment of the telecommunications marketplace in all U.S. jurisdictions. Competition clearly furthers universal service goals, because it tends over time to reduce prices, spur innovation, and expand the range of available services. This is true, however, only if the nation's universal service policies permit the competitive process to operate effectively.

In NTIA's view, these policies require, at a minimum, that the rates for the Federally defined universal service package should reflect the economically relevant costs of providing it. All subsidies needed to preserve the affordability of service to all Americans should be explicit and narrowly targeted to avoid sending the market "false" signals that may deter efficient entry in some areas and attract inefficient entry in others. Moreover, such subsidies must be collected and, as importantly, disbursed in a competitively neutral manner.

NTIA recommends that the Commission and the Joint Board define a dynamic universal service package for residential subscribers that for now is predicated, as suggested in the Notice, on voice grade access to the public switched telephone network. The Commission should continue its Lifeline program as the Federal mechanism for providing support to low-income

families, with the following modification: households satisfying a State-defined means test should be eligible for Federal support (up to the full amount of the Federal subscriber line charge), provided that the State reduces intrastate service charges in an amount equal to or greater than 25 percent of the Federal support.

The Commission and the Joint Board should also provide for Federal support to areas where the cost of providing the universal service package, objectively quantified, exceeds 130 percent of the national average. Eligible companies serving those areas would be entitled to receive, for each customer served, an amount from the Federal universal service fund equal to the difference between their costs of service (objectively determined) and 130 percent of the national average. The Commission and the Joint Board could phase-in this modified high cost support program over several years. State commissions should be encouraged to adopt independent support mechanisms to furnish additional support to low-income households and high costs areas, as well as to mitigate any potential rate shocks, although we no not anticipate widespread rate shock.

The Commission and the Joint Board should require all providers of interstate telecommunications services to contribute to the Federally established universal service fund. That contribution should take the form of a percentage surcharge on

their interstate retail revenues, minus any payments for telecommunications services received from other companies who also pay monies into the Federal fund. Further, the Commission and the States should construe the Act to maximize the number of firms that can be designated as ETCs, thereby promoting greater competition. In addition, ETCs should receive universal service support based on the number of subscribers served. The Federal fund should be administered by an independent entity selected by competitive bidding.

Finally, with respect to schools and libraries, the Snowe-Rockefeller amendment to the Act presents a timely opportunity to ensure that the nation's schools and libraries can participate fully in the burgeoning Information Age. A review of some available cost studies conducted by NTIA suggests that the costs of connecting those institutions represents a relatively low percentage of the total expenditures needed to give schools and libraries full use of the Information Highway and all the information resources available through it. Thus, contrary to some fears, the universal service funding required to support the discounted portion of those connection costs would not be excessive.

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

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

REPLY COMMENTS OF THE
NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION

The National Telecommunications and Information Administration (NTIA), an Executive Branch agency within the Department of Commerce, is the President's principal advisor on domestic and international telecommunications and information policy. NTIA respectfully submits these Reply Comments to the comments submitted in response to the Commission's Notice of Proposed Rulemaking and Order Establishing Joint Board (Notice) in the above-captioned proceeding.[1]

I. INTRODUCTION

The Telecommunications Act of 1996 requires the Commission, based on recommendations from a Federal-State Joint Board (Joint Board), to issue an Order within fifteen months making fundamental changes in the nation's current policies for

---

1/ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 96-93 (released Mar. 8, 1996) [hereinafter Notice] Unless otherwise indicated, all subsequent citations to "Comments" shall refer to pleadings filed on April 12, 1996 in CC Docket No. 96-45.

preserving and advancing universal telephone service.[2] The Commission must for the first time define a national universal service package to be made available and affordable to all Americans.[3] The Commission must also create mechanisms to: (1) collect universal service support funds from providers of interstate telecommunications services,[4] (2) disburse those funds to eligible telecommunications carriers (ETCs),[5] and (3) by so doing, ensure the affordability of the Federally defined universal service package to low-income consumers and consumers in rural, insular, and high cost areas.[6] Finally, through the efforts of Senators Snowe, Rockefeller, and others, the Act requires the Commission to adopt policies to give schools, libraries, and rural health care providers access to telecommunications and information services at preferential rates.[7]

2/ Telecommunications Act of 1996, Pub. L. No. 104-104, § 254(a)(2), 110 Stat. 56 (Act) (to be codified at 47 U.S.C. §§ 151 et seq.) [hereinafter Act]. For convenience, all references to the Act in this pleading will cite to the section numbers that will apply after the Act's provisions have been codified in the United States Code.

3/ Id. § 254(a)(2), (c).

4/ Id. § 254(d).

5/ Id. §§ 254(e), 214(e).

6/ Id. § 254(b)(3).

7/ Id. § 254(h)(1), (2).

States and State regulatory commissions will also play a major role in this process. Through their participation on the Joint Board, States will exert considerable influence over the Federal universal service policies that the Commission ultimately prescribes. As importantly, the Act specifically authorizes States to adopt universal service definitions and standards over and above the Federal minimums, so long as the State initiatives are not inconsistent with the national requirements and the States create "additional specific, predictable and sufficient mechanisms [based on intrastate revenues] to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms."[8] Thus, in the area of universal service, as in other parts of the Act, Federal/State collaboration is essential if we are to realize the full benefits of the Act's design.[9]

In fashioning new universal service policies, the Commission and the States must ensure that those policies are consistent with the Act's mandate to foster meaningful competition in every segment of the telecommunications marketplace in all U.S.

8/ Id. § 254(f). Because of the considerable revenues associated with intrastate services, the potential support funds established by State commissions will most likely, in total, surpass the Federal universal service fund by a substantial margin.

9/ Cf. Reply Comments of NTIA in CC Docket No. 96-98, at 2-5 (filed May 30, 1996) (noting the importance of a joint Federal/State effort with respect to interconnection and unbundling).

jurisdictions. Competition clearly furthers universal service goals, because it tends over time to reduce prices, spur innovation, and expand the range of available services. The converse will be true, however, only if the nation's universal service policies permit the competitive process to operate effectively.

In NTIA's view, this requires, at a minimum, that rates for the Federally defined universal service package should reflect the economically relevant costs of providing it. All subsidies needed to preserve the affordability of service to all Americans should be explicit and narrowly targeted to avoid sending the market "false" signals that may deter efficient entry in some areas and attract inefficient entry in others. Moreover, such subsidies must be collected and, as importantly, disbursed in a competitively neutral manner.

NTIA recommends that the Commission and the Joint Board define a dynamic universal service package for residential subscribers that for now is predicated, as suggested in the Notice, on voice grade access to the public switched telephone network. The Commission should continue its Lifeline program as the Federal mechanism for providing support to low-income families, with the following modification: households satisfying a State-defined means test should be eligible for Federal support (up to the full amount of the Federal subscriber line charge),

provided that the State reduces intrastate service charges in an amount equal to or greater than 25 percent of the Federal support.

The Commission and the Joint Board should also provide for Federal support to areas where the cost of providing the universal service package, objectively quantified, exceeds 130 percent of the national average. Eligible companies serving those areas would be entitled to receive, for each customer served, an amount from the Federal universal service fund equal to the difference between their costs of service (objectively determined) and 130 percent of the national average. The Commission and the Joint Board could phase-in this modified high cost support program over several years. State commissions should be encouraged to adopt independent support mechanisms to furnish additional support to low-income households and high costs areas, as well as to mitigate any potential rate shock, although we do not anticipate widespread rate shock.

The Commission and the Joint Board should require all providers of interstate telecommunications services to contribute to the Federally established universal service fund. That contribution should take the form of a percentage surcharge on their interstate retail revenues, minus any payments for telecommunications services received from other companies who also pay monies into the Federal fund. Further, the Commission

and the States should construe the Act to maximize the number of firms that can be designated as ETCs, thereby promoting greater competition. In addition, ETCs should receive universal service support based on the number of subscribers served. The Federal fund should be administered by an independent entity selected by competitive bidding.

Finally, with respect to schools and libraries, the Snowe-Rockefeller amendment to the Act presents a timely opportunity to ensure that the nation's schools and libraries can participate fully in the burgeoning Information Age.[10] An analysis conducted by NTIA suggests that the costs of connecting those institutions represents a relatively low percentage of the total expenditures needed to give schools and libraries full use of the Information Highway and all the information resources available through it. Thus, contrary to some fears, the universal service funding required to support the discounted portion of those connection costs would not be excessive.

II. THE PACKAGE OF SUPPORTED SERVICES SHOULD BE "BASIC," YET DYNAMIC

The Act requires the Commission to define a universal service package that will be "supported by Federal universal service support mechanisms."[11] In NTIA's view, the Joint Board

---

10/ See Act § 254(h).

11/ Id. § 254(a)(1),(2).

should recommend that the Commission adopt a basic core of telecommunications services founded on voice grade access to the public switched telephone network.[12] Initially, the Federally established universal service package should include the following:[13]

- Access to voice-grade service with touch tone dialing and some level of local usage;[14]
- Access to toll services;
- Access to emergency services;
- Access to directory assistance, operator assistance, and repair service;
- Access to statewide relay services;
- "White pages" directory listings; and
- Privacy protections, including caller ID with blocking options.[15]

Each of the foregoing elements satisfies the four criteria identified in the Act for determining whether a service or feature should be included in the Federal universal service

---

12/ Many commenters concur with this position. See, e.g., Comments of the United States Telephone Ass'n at 12-14 (USTA); Comments of US West at 5-6; Comments of AT&T Corp. at 11-14 (AT&T).

13/ The Joint Board should also recommend that the Commission adopt minimum service quality standards for the services and capabilities included within the universal service package. See Comments of the United States Telephone Ass'n at 2-4 (USTA); Comments of MCI Telecommunications Corp. at 21-22 (MCI).

14/ Subscribers to the basic universal service package must receive more than the opportunity to make calls. Defining the package as a measured service offering might be workable if the package includes a reasonable amount of free usage.

15/ See Comments of the New York State Consumer Protection Board at 2, 7-8 (such services offer important protections to subscribers yet "are not expensive to provide and their inclusion would not place undue pressure on telecommunications prices").

package.[16] Together, these elements will provide the basic, reliable functionality necessary for households to place and receive the full range of voice telephone calls. For households with computers and modems, moreover, the basic package can furnish an effective and versatile pathway to the Information Age, including the Internet and other information networks.[17] As consumer demand grows for future telecommunications and information services, the Commission should reevaluate the universal service package.[18] This will ensure that all Americans have full and fair access to advanced services.

NTIA believes that the Federally defined universal service package would be best targeted to single-line service for

---

16/ See Act § 254(c)(1). See also Comments of the National Cable Television Ass'n, Inc. at 4-5 (NCTA).

17/ Furthermore, NTIA's proposed definition of the universal service package will promote competition by enabling more new entrants to qualify as ETCs, thereby becoming eligible to receive necessary support in order to compete better against incumbent ETCs. See Section IV.B, infra.

18/ Act § 254(c)(1)(B). The Act provides that the Joint Board "may, from time to time, recommend to the Commission modifications" in the Federally defined universal service package. Id. § 254(c)(2). The Clinton Administration remains committed to a vision of a National Information Infrastructure (NII) that provides to all Americans connections to advanced information networks and resources. To ensure regular review of the Federal universal service definition, NTIA suggests that the Commission convene a Joint Board for that purpose every three years. To minimize the risk that triennial reviews of the universal service definition do not keep pace with the rapidly changing telecommunication landscape, the Commission could consider instituting more frequent reviews in response to petitions from interested parties.

residential customers,[19] with any universal support for business customers to be provided by the States.[20] Because the costs of telephone service are likely to be a small fraction of total operating costs for most businesses, affordability of service should generally not be a problem for business users.[21] In addition, guaranteeing the availability and affordability of the universal service package for business customers would greatly expand the amount of support required. That would, in turn, heighten the risk of unintended and potentially adverse effects,[22] increase the burden on the carriers who must generate support funds (and their customers),[23] and enlarge the social welfare losses that any subsidy mechanism -- however well-crafted -- causes.[24]

19/ See, e.g., Comments of AT&T at 11-14; Comments of Bell Atlantic at 6-8.

20/ We think that universal service support for business customers should be left to the States not only because they are more familiar with the needs of the companies within their jurisdictions, but also because those needs probably vary from State to State. Of course, States are completely free under the Act to provide subsidized service to businesses or any other group of customers if they develop "specific, predictable, and sufficient mechanisms" to provide the necessary funding that neither rely on nor burden Federal mechanisms. Act § 254(f).

21/ Comments of MCI at 9; Comments of Florida Public Service Comm'n at 6 (Florida).

22/ Comments of MCI at 9.

23/ Comments of Citizens for a Sound Economy at 6.

24/ See Comments of AirTouch Communications, Inc. at 6-7.

III. ENSURING JUST, REASONABLE, AND AFFORDABLE RATES FOR ALL RESIDENTIAL SUBSCRIBERS

As noted above, competition and universal service are compatible, not conflicting.[25] In order to promote a competitive market, however, prices must be aligned with cost. Because cost-based prices both facilitate efficient competitive entry and lead to increased consumer welfare over the long term, the Joint Board and the Commission should conclude that such prices are just and reasonable under the Act.[26]

They also should not be overly concerned that movement toward cost-based pricing may cause short-term increases in basic telephone rates. The notion that basic rates are currently priced below costs appears to be based largely on company-reported, historical costs. Equating prices with historical costs, however, is not only inconsistent with economic efficiency,[27] it is also largely irrelevant in an increasingly

---

25/ See, e.g., Comments of MFS Communications Co. at 2-5 (MFS); Comments of the California Department of Consumer Affairs at 6-7.

26/ See Act § 254(b)(1) (requiring that rates must be "just, reasonable, and affordable"). For a brief discussion of why cost-based rates promote both competition and social welfare, see Reply Comments of NTIA in CC Docket No. 96-98, at 16-17 (filed May 30, 1996); National Telecommunications and Information Admin., U.S. Dep't of Commerce, The NTIA Infrastructure Report: Telecommunications in the Age of Information, NTIA Special Pub. No. 91-26, at 280-281 (Oct. 1991).

27/ See Alfred Kahn and William Shew, Current Issues in Telecommunications Regulation: Pricing, 4 Yale J. on Reg. 191, 224 (1987) ("Economically efficient pricing looks not to the past -- not to how we got where we are -- but to the future; efficiency requires that prices tell customers what incremental resources society will use if they take more of the good or

competitive market. In NTIA's view, an appropriate forward-looking assessment of costs should result in rates for basic residential service that generally are not below costs.[28]

The Joint Board and the Commission could reasonably conclude that cost-based rates for the Federally defined universal service package will also be "affordable" for the vast majority of American households. As of 1994, the average American household devoted some 2 percent of its annual expenditures to telephone service, a figure that has remained steady for more than a decade.[29] That percentage represents dollars spent on a wide range of services beyond local service, including long distance calling, directory assistance calls, connection charges, touch-tone, "vertical services" (such as call waiting and call forwarding), inside wiring maintenance, and even 900 services.[30] At this expenditure level, average telephone

---

service in question, what resources society will save if they consume less of it.") (emphasis in original).

28/ See, e.g., Comments of AT&T at 1-3; Comments of MFS at 5-7 (decrying the "myth" of subsidized local telephone service). In cases where aligning prices with relevant costs could foreseeably threaten universal service goals, the Act authorizes the Commission and the States to fashion support mechanisms to minimize harm to subscribers. NTIA discusses three such mechanisms in Sections III. A-C, infra.

29/ Industry Analysis Division, Federal Communications Comm'n., Trends in Telephone Service Table 9 (May 1996).

30/ See id. Charges for local telephone service (which average about $19 per month nationwide) comprise less than one-third of the typical household's total telephone expenditures. Id. Tables 6, 9.

penetration for households in all income categories above $20,000 is at or above the national average telephone penetration of 93.9 percent.[31] These numbers suggest that affordability of basic telephone service is not a problem for most U.S. households.

A. Cost Support for Low Income Consumers

The same cannot be said for low-income households, however. As compared with the national penetration average,[32] subscribership among central city households earning $10,000 or less per year is only 79.8 percent.[33] Rural households earning equivalent amounts did not fare much better at 81.6 percent.[34] Furthermore, the poorest American households (those in the lowest income quintile) currently devote 3.2 percent of their annual expenditures to telephone service, 50 percent more than the

---

31/ Alexander Belinfante, Industry Analysis Division, Federal Communications Comm'n, Telephone Subscribership in the United States at 5, Table 1 and 23, Table 4 (Feb. 1996) (using data through November 1995).

32/ Id. at 5, Table 1.

33/ Jim McConnaughey and Cynthia Nila, NTIA, Falling Through the Net: A Survey of "Have Nots" in Rural and Urban America Table 1 (July 1995).

34/ Id. NTIA's reply comments in the Commission's subscribership proceeding provide more detailed documentation of the extent to which poor families lack basic telephone service. Reply Comments of NTIA in CC Docket No. 95-115, at 5-7 and App. B (filed Mar. 29, 1996). We recommended there, and we reiterate here, that the Commission should adopt a National Subscribership Goal to ensure that, by the end of the year 2000, telephone penetration among low-income and other presently underserved households would be greater than or equal to the current national average. Id. at 7-8.

average household (2.1 percent) and twice as much as households in the highest income quintile (1.6 percent).[35]

These statistics demonstrate the difficulties that low-income households have in affording basic telephone service. It is no surprise, then, that Congress specifically listed such households among the groups that warrant assistance to ensure their access to affordable telephone service.[36] Congress also identified the Commission's Lifeline program as a workable mechanism for distributing universal service assistance to low-income families.[37] Under the most commonly used Lifeline program, residential subscribers that satisfy a State-determined means test become eligible for a waiver of the entire Federal subscriber line charge (SLC), provided that a State makes matching reductions in the households' intrastate charges. Thus, if the State's contribution fully matches the Federal waiver, qualified households can receive rate reductions equalling twice the SLC.[38] Local exchange carriers receive universal service

---

35/ These figures are derived from the Bureau of Labor Statistics' annual Consumer Expenditures Survey.

36/ Act § 254(b)(3). See also H.R. Conf. Rep. No. 104-458, 104th Cong., 2nd Sess., reprinted in 1996 U.S.C.C.A.N. 124, 131 [hereinafter Joint Explanatory Statement].

37/ Act § 254(j).

38/ Thirty-eight states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands currently participate in this program. Only California presently participates in the Commission's other Lifeline program, which gives qualified households up to a 50 percent reduction in the SLC if a state provides matching reductions.

support funds equal to the amount of the SLC waived for each customer served.

NTIA believes that Federal universal service support should continue to be directed to low-income households via the Lifeline program.[39/] Because the Act appears to contemplate Federal support for such households whether or not State commissions offer similar assistance,[40/] there is a question whether the current program should be modified to eliminate its matching requirement. On the one hand, removal of that requirement would mean SLC relief for all poor families regardless of whether their State participates in the Lifeline program. On the other hand, the absence of a matching component could reduce some States' incentives to continue providing additional support to low-income households. On balance, NTIA favors a modified approach under which all households that meet a State-determined means test would receive support from the new Federal universal service fund (up to the full amount of the SLC), if the State provides

---

39/ The Commission also has its Link-Up America program, which helps defray telephone installation charges for low-income families. That program currently dispenses about $20 million in assistance annually to households in every State, except California and Delaware as well as the District of Columbia and certain territories. See National Exchange Carrier Ass'n, 1995 Filing Update with the FCC (Nov. 20, 1995). The Link-Up program should also continue to be supported from the new Federal universal service fund.

40/ See Act § 254(a)(1), (2).

reductions in intrastate service charges that equal or exceed 25 percent of the Federal support.[41]

B. Cost Support for Consumers in High Cost Areas

The Act also indicates that Federal universal service support should be made available to high cost areas.[42] Due to small and scattered populations, rugged terrain and other factors, the costs of serving some areas (especially rural areas) may be several times greater than the costs of provisioning more densely populated communities. In those circumstances, cost-based rates could impose considerable hardship on many of the households within those areas.

Although the Commission should continue to provide universal service support to high cost areas, it should substantially revise the mechanisms through which it currently distributes such

---

41/ Under this plan, a low-income household would be relieved of the entire SLC if the relevant State provides intrastate low-income support at least equalling one-quarter of the SLC. Needless to say, States could choose to provide even more support to low-income households.

Furthermore, States or their agents should undertake educational activities to promote awareness of such support for eligible households. Studies have shown that those without telephones often lack knowledge of the availability of low cost service options. See, e.g., Lyndon B. Johnson School of Public Affairs, The University of Texas, Policy Research Project Report No. 116, The Evolution of Universal Service in Texas 17 (1995).

42/ Act § 254(b)(3).

assistance.[43] Most importantly, the identification of an area as "high cost" should not be based on the costs reported by the firms serving or seeking to serve that area. As the Commission well knows, linking high cost funding with company-reported costs tends to weaken a serving firm's incentives to minimize capital and operating costs.[44]

In the Notice, the Commission requests comments on a number of different "proxy" models that may provide an objective, independent basis for identifying particular areas as high cost.[45] NTIA strongly encourages the Joint Board to consider each of the alternatives discussed in the comments and recommend to the Commission an approach that can be used in lieu of

---

43/ NTIA concurs with those parties who recommend that the Commission expeditiously phase-out Digital Equipment Minutes (DEM) weighting which, for LECs with fewer than 50,000 access lines, shifts a disproportionate share of their local switching costs to the interstate jurisdiction to be recovered through long distance rates. See Comments of Ameritech at 11-12; Comments of NCTA at 7; Comments of MCI at 5-6; Comments of LDDS WorldCom at 11-12. DEM weighting is not only a policy without a technical justification. See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 10 FCC Rcd 12309, 12313-14 (1995) (Amendment of Part 36). It is also the sort of implicit subsidy that is proscribed by the Act. See, e.g., Joint Explanatory Statement, supra note 36, at 131. Its elimination would likely be followed by a reduction in interstate long distance rates, which would benefit subscribers of LECs that currently receive DEM support. If the phase-out of DEM weighting were to cause sharp increases in local rates, the Commission and State commissions could mitigate the impact through the transitional support program discussed in Section III.C, infra.

44/ Amendment of Part 36, supra note 43, at 12324.

45/ Notice ¶¶ 31-35.

continued reliance on company-reported costs.[46] By encouraging firms to operate more efficiently, an objective benchmark for identifying high cost areas should help reduce both rates to consumers and the amount of high cost subsidies needed.[47]

Determining the level of Federal universal service support directed towards high cost areas involves a balancing of several factors. One is the Act's requirement that rates in high cost areas be "reasonably comparable" to prices in urban areas.[48]

46/ In NTIA's Reply Comments in the Commission's interconnection proceeding, we supported using forward-looking total service long run incremental cost (TSLRIC) as a starting point for setting reasonable prices for interconnection and unbundled network elements. Comments of NTIA in CC Docket No. 96-98, at 18-29 (filed May 30, 1996). A number of commenters have recommended that the Commission and the Joint Board define high cost areas using the so-called Benchmark Cost Model (BCM), which is purportedly based on TSLRIC and which was developed jointly by several local and long distance companies. See Comments of Sprint Corp. at 11-16; Comments of NYNEX at 10-13; Comments of US West at 8-9; Comments of MCI at 10-12; Comments of Association for Local Telecommunications Services at 12 (ALTS); Comments of LDDS Worldcom at 12; Comments of Florida at 9-11. But see Comments of Southwestern Bell Telephone Co. at 14-16; Comments of NCTA at 7-8; Comments of State of Maine Public Utilities Comm'n, et al. at 5-8 (expressing concerns about adoption of BCM, unmodified). Other parties have suggested alternative approaches. E.g., Comments of Pacific Telesis at 16-19; Comments of New York Department of Public Service at 5-7 (New York). NTIA believes that the Commission and the Joint Board should have considerable flexibility in choosing a proxy model for determining high cost areas, so long as that model is based primarily on forward-looking, as opposed to historical, costs.

47/ Although the Commission should specify the costing methodology to be employed, State commissions would be responsible for applying that approach to determine which areas are "high cost." NTIA believes that State commissions will have sufficient flexibility under this approach to prevent undue harm to any company or its customers.

48/ Act § 254(b)(3).

In NTIA's view, this suggests that the respective rates ought to reflect to some extent differences in the costs of providing service in those areas.[49] Among other things, that approach would be consistent with the Act's overarching goal of encouraging competition in all telecommunications service markets, which is another fundamental consideration. If rates in high cost areas are significantly below relevant costs, for example, it could deter entry by more efficient suppliers. In such cases, households in those areas would be denied the many benefits that competition can produce.[50]

Furthermore, Federal high cost support should be carefully targeted to minimize the amount of subsidies needed, because their collection will reduce the economic welfare of carriers and users alike. This is a particular concern here, since high cost support is conferred on all households within a given area, without regard to need or ability to pay.[51]

49/ See, e.g., Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, 96 FCC 2d 781, 795 (1984).

50/ This problem could be avoided if prospective entrants were eligible to receive the same high cost support as the incumbent LEC. We note, however, that the Act permits a State to designate a single ETC in rural areas. Act § 214(e)(2). The Act also authorizes States to exempt rural telephone companies from the Act's interconnection and unbundling requirements, which could make it much more difficult for a new entrant to offer the range of services or the geographic coverage needed to qualify as an ETC. Id. §251(f).

51/ In this regard, support for low-income households is obviously a more refined mechanism for advancing universal service goals. And, of course, low-income households in high cost areas would be eligible to receive additional Federal

NTIA recommends, on balance, that the Commission and the Joint Board provide high cost support to companies whose costs, as determined by some objective formula, exceed 130 percent of the national average.[52] Eligible companies serving those areas would be entitled to receive, for each customer served, an amount from the Federal universal service fund equal to the difference between their actual costs of service (objectively determined) and 130 percent of the national average. Once again, States could create a separate intrastate high cost fund to provide additional support to high cost areas, or to mitigate local dislocations caused by changes in Federal high cost support.

C. Temporary Support Mechanisms May Be Needed To Prevent "Rate Shock" in Some Areas

As noted above, NTIA believes that the movement towards cost-based prices should generally not necessitate increases in basic telephone rates. We recognize, however, that the nation is in the midst of a transition between universal service polices

---

support through the modified Lifeline program.

52/ See Comments of MFS at 18. High cost support is currently provided to LECs whose costs are 115 percent above the national average. Notice ¶ 40. To avoid any potential dislocations, the Commission and the Joint Board could consider phasing this change over in over several years.

MFS also recommends that support should be denied to otherwise high cost areas in which the average household income is greater than 130 percent of the national average. Comments of MFS at 18. NTIA believes that this proposal is worthy of study to meet the Act's mandate for narrowly targeted support. This may be a way to avoid subsidizing subscribers in high income rural areas.