

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

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of )

Federal-State Joint Board on )  
Universal Service )

CC Docket No. 96-45

To: The Commission )

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**FURTHER COMMENTS OF**  
**THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.**

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August 2, 1996

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## SUMMARY

The National Cable Television Association (“NCTA”), whose members comprise the most likely facilities-based competitors to the incumbent local exchange carriers (“LEC”), has a vital interest in the development of a nondiscriminatory and competitively neutral universal service fund (“USF”). In these Further Comments we supplement our previous submissions in this docket by responding to the questions posed by the Common Carrier Bureau on July 3, 1996. In these responses, we make the following points, among others:

While some “non-rate” factors may be considered in determining the affordability and reasonable comparability of rates, as a general matter, it is appropriate for the FCC to find that current rates for services included within the definition of universal service are affordable, given the 93% penetration rate for basic service across the country. If NCTA’s proposed list of “core” services is adopted, it is difficult to see how it would be technically infeasible for any carrier to provide the requisite services. It is not appropriate to assign 100% of loop costs to universal service, because local loops are used not only for the provision of core services but also to provide toll services and optional services such as CLASS features.

Only specifically defined services should be available at reduced rates to schools, libraries and healthcare providers, *i.e.*, those that are necessary for the provision of health care services or for educational purposes, as required by the 1996 Act. Inside wire and other internal connections should not be included in the USF because inside wire services are not telecommunications services subject to the USF and are competitive services which have been deregulated. The provision of advanced services to schools will be most effectively accomplished through regulatory policies which stimulate infrastructure investment and facilities-based competition, including appropriate incentives pursuant to Section 706 of the Act. NCTA supports the use of competitive bidding rather than the imposition of discounts in order to insure that schools, libraries and healthcare providers will receive the most economical rate for core and advanced services. However, if the Joint Board determines that discounts are appropriate, NCTA supports the use of direct billing credits to ensure that funds are used for their intended purposes

NCTA does not believe that additional discounts to schools and libraries in rural, insular and high-cost areas are necessary. Rural and insular areas are not synonymous with high cost areas. Indeed, in some instances, rural school districts may be better funded than urban districts. Thus it is not clear that rural and high cost areas require greater discounts in order to be able to purchase already discounted services. Separate funding mechanisms should be used for schools and libraries on the one hand and health care providers on the other, both for ease of administration and because the requirements for provision of service differ between schools, libraries and healthcare providers.

The existing USF mechanism cannot be retained because it does not meet the requirements of the Act to be competitively neutral, either in the method in which funding is derived or disbursed. If the existing USF is kept in place for rural areas, funding must be made available immediately to any eligible telecommunications carrier serving the geographic area in which the incumbent receives funding. The use of a proxy model would preclude the use of

book costs to determine the funding level for incumbents or new LECs. Book costs would only be useful if the proxy model showed costs higher than the book costs of the incumbent. In such an instance, the book costs could be used as a cap to limit the level of funding. The Joint Board should consider denying price cap carriers, which have the ability to retain earnings above cost, eligibility for high cost support, particularly in areas where the LEC faces little competition and where any subsidy is based on book costs. NCTA opposes the use of a bifurcated plan for rural companies. If a bifurcated approach is used, carriers should be required to transition to a proxy system over at most a three year period, and competitors should be eligible to receive the same amount and level of funding, on a per customer basis, as the incumbent carrier, both in the initial phase and during a transition period.

Competitive bidding should only be used if the subsidy will be available to multiple carriers, but should not be used to establish the initial subsidy level. Rather a proxy model should determine the initial subsidy amount, which may then be bid down. In no instance should the subsidy amount exceed that available in an area today.

The FCC should adopt a forward-looking cost proxy model that relies on non-proprietary data in order to (1) compute the economic cost of providing basic, single-line, residential local exchange service and (2) compute the level of high cost funding, if any, that is necessary in specific areas of the country. A well-designed cost proxy model will ensure that high cost funds are targeted where they are needed, and will prevent high cost funds from being used to subsidize excess network capacity that incumbent carriers will use in their pursuit of competitive ventures. In order to make informed decisions as to the various critical aspects of a model, the FCC should direct incumbent local exchange carriers to submit comprehensive and timely data on inputs to the cost proxy model.

Model proponents should be directed to submit complete supporting documentation that explains the sources of and logic for the numbers and algorithms used in any proposed cost proxy model. In its evaluation of key assumptions, such as the fill factor used in the deployment of theoretical outside plant, the FCC should limit the scope of the service being modelled to that of only the defined universal service core service, and thus should eliminate from any cost proxy model costs associated with strategic and competitive reasons.

The Benchmark Cost Model (“BCM”) overstates the universal service funding requirement because it determines need based upon an evaluation of the cost per line separately for each of the approximate 220,000 census block groups (“CBG”). Under the BCM, any CBG that is high cost automatically receives support, even if it is surrounded by low-cost exchanges which are likely served by the same ILEC. The use of CBGs is inappropriate because CBGs have nothing to do with the design of a telecommunications network and thus there is no reason to expect that networks will be designed around the properties of a CBG.

While costs can be computed at the CBG level, any determination of the need for and level of high cost support should be made at the wire center level. Alternatively the need for universal service funding can be assessed at the wire center level (by averaging the costs across all the CBGs encompassed by the given wire center) and if the average cost were less than the

price support, no universal service support would be provided. If the average cost were greater than the price support, high cost support would be granted only to the high cost CBGs within that wire center.

The original version of the Pacific Telesis Cost Proxy Model (“CPM”) relied on actual customer addresses, however these data were considered proprietary, thus limiting public review of the model. The current version of the CPM allows the use of commercially available census data which are mapped to the CPM’s grid cells. However, Pacific Telesis has yet to provide information concerning the design of the CPM, including information on how the CBG data has been mapped to grid cells. Refining the BCM to the grid level appears to be a costly and complex exercise which is not warranted, and which, in some instances, creates a misleading sense of precision.

The FCC should not adopt the CPM for use on a national basis. The CPM relies extensively on company-specific proprietary databases which reflect the characteristics of Pacific Bell’s embedded network. In order to apply the CPM to other states, one must either assume that all of the cost characteristics of Pacific Bell’s network are correct for the area under study or develop a full set of replacement costs, neither of which is a satisfactory option.

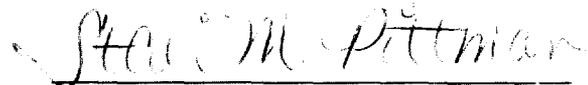
Furthermore, the CPM is not a fully self-contained model, but instead relies on numerous external data sources, calculations, and models. Also, the CPM relies on unit cost values and network parameters that must be derived from internal company databases, and, for switching costs, it relies upon Bellcore’s Switching Cost Information System, a model that Bellcore considers proprietary. Finally, the basis of the operating expenses are extensive data that are considered proprietary

In many states it has been determined that local rates cover the cost of the local loop thus calling into question the need for the CCLC and SLC. In any event, any resolution of the CCLC issue should be accomplished in a competitively-neutral manner which does not discriminate against new facilities-based entrants. A CLEC that utilizes facilities other than those of an ILEC to provide exchange access should not be required to pay any carrier common line charge or transport interconnection charge to the ILEC. To the extent an IXC obtains exchange access from such a CLEC, measured in minutes switched by the CLEC, the IXC should not be required to pay such charges to the ILEC as part of a “bulk billing” arrangement or otherwise.

The Life Line and Link Up programs should retain their separate and distinct role as a “means based” direct subsidy to low income customers. These programs should be de-coupled from the jurisdictional separations rules, thus easily transferable to new providers with a variety of technology.

**CERTIFICATE OF SERVICE**

I, Staci M. Pittman, do hereby certify that on this 2nd day of August, 1996, copies of the foregoing **“Further Comments of the National Cable Television Association, Inc.”** were delivered by first-class, postage pre-paid mail upon the following:



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GTE-California. In testimony submitted in the CPUC's universal service proceeding, GTE-California observed that:

...[t]he CPM is a heavily table-driven model. The CPM contains extensive tables of unit costs, which are developed outside the model. These unit costs are then multiplied by unit demands based on the model's grid square date. The BCM, in contrast, takes in fewer unit cost elements as inputs, and develops more information through its own simulation of the network. These CPM unit cost inputs raise a number of concerns.<sup>9</sup>

The specific concerns identified by GTE-California included the CPM's reliance on unit costs that reflect only Pacific Bell's experience, and the lack of "internal controls in the model which assure that the assumptions used in developing these different unit cost inputs are fully consistent with one another, with the size of the wire center being evaluated, or with a specific network design for that wire center."<sup>10</sup> While GTE-California proposed a separate "outboard" model to address these problems, our view is that the Commission and state regulators outside California should look to the other cost proxy models that have already been devised (namely, the BCM/BCM2 and the Hatfield Model) rather than focus on how to correct the basic structural shortcomings of the CPM.

67. Using the CPM, what costs would be calculated by Census Block Group and by wire center for serving a rural, high-cost state (e.g., Arkansas)?

Given the nature of the CPM, at this time parties other than Pacific Bell cannot respond meaningfully to this question.

68. Is the CPM a self-contained model, or does it rely on other models, and if so, to what extent?

The CPM is not a fully self-contained model, and instead relies upon numerous external data sources, calculations, and models, all of which would have to be replicated in some manner if the CPM were adopted for use in a jurisdiction outside of California. As explained in response to Question 66, the CPM relies upon unit cost values and network parameters that must be developed from internal company databases, in some cases requiring considerable analysis.<sup>11</sup> In addition, the CPM does not independently develop costs for switching investments. Instead, the CPM relies upon Bellcore's Switching Cost

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<sup>9</sup> CPUC R.95-01-020/J.95-01-021, Reply Testimony of Dennis Weller (GTE-California), April 24, 1996 at 2-3.

<sup>10</sup> Id. at 3.

<sup>11</sup> For example, INDETEC indicates that the ratios for air-to-route mileage and feeder vs. distribution length both require statistical analysis. CC Docket No. 96-98, Reply Comments of Pacific Telesis Group, May 30, 1996, Appendix C ("Declaration of Richard D. Emmerson") at 18.

Information System (SCIS),<sup>12</sup> another complex model that Bellcore considers proprietary and which has not been made generally available for public review.

A third area in which the CPM is not self-contained is the development of operating expenses. In fact, the California version of CPM does not develop Pacific Bell's operating expenses at all, but instead obtains these costs from Pacific Bell's OAND Cost Studies, which contain thousands of pages of highly disaggregated expense data and calculations, virtually all of which are considered proprietary and not publicly reviewable and which are based on outputs from Pacific Bell's internal accounting system. For other LECs, the CPM estimates operating expenses by applying ratios derived from ARMIS data to those Pacific Bell-specific expense levels. Consequently, in order to adopt the CPM outside of California, a regulator would need to accept Pacific Bell's expense calculations "on faith," or pursue development of an alternative approach to estimating operating expenses that did not rely on Pacific Bell's data.

### SLC/CCLC

69. If a portion of the CCL charge represents a subsidy to support universal service, what is the total amount of the subsidy? Please provide supporting evidence to substantiate such estimates. Supporting evidence should indicate the cost methodology used to estimate the magnitude of the subsidy (e.g., long-run incremental, short-run incremental, fully-distributed).

In many states it has been determined that local rates cover the cost of the local loop thus calling into question the need for the CCLC and SLC. In any event, any resolution of the CCLC issue should be accomplished in a competitively-neutral manner which does not discriminate against new facilities-based entrants.

70. If a portion of the CCL charge represents a contribution to the recovery of loop costs, please identify and discuss alternatives to the CCL charge for recovery of those costs from all interstate telecommunications service providers (e.g., bulk billing, flat rate/per-line charge).

Any resolution of the CCL issue should be accomplished in a competitively-neutral manner which does not discriminate against new facilities-based entrants. With these caveats, it may be rational to transition the recovery of loop costs from a per minute to a per line, bulk billed method of recovery. For ease of administration, non-facilities-based local and long distance service providers could be assessed on bulk billed basis, determined by the number of a lines they serve.

A CLEC that utilizes facilities other than those of an ILEC to provide exchange access should not be required to pay any carrier common line charge or transport interconnection charge to the ILEC. To the extent an IXC obtains exchange access from such a CLEC,

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<sup>12</sup> Id. at 17.

measured in minutes switched by the CLEC, the IXC should not be required to pay such charges to the ILEC as part of a "bulk billing" arrangement or otherwise.

### **Low-Income Consumers**

71. **Should the new universal service fund provide support for the Lifeline and Linkup programs, in order to make those subsidies technologically and competitively neutral? If so, should the amount of the lifeline subsidy still be tied, as it is now, to the amount of the subscriber line charge?**

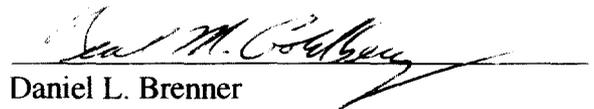
No, the Life Line and Link Up programs should retain their separate and distinct role as a "means based" direct subsidy to low income customers. The Life Line and Link Up programs stand alone as the best example of an explicit, targeted subsidy. The "direct customer credit" nature of these programs, unlike the Universal Service Fund, have avoided accusations of company manipulation and gamesmanship. The existing Life Line and Link Up programs can easily be transferred to new providers with a variety of technology. The Link Up program should be de-coupled from the jurisdictional separations rules, since not all eligible carriers will be subject to separations, but it is critical that the support mechanisms remain competitively neutral. The Lifeline subsidy should continue to be tied to the amount of the subscriber line charge as long as that charge exists on customers' bills and represents a local charge to customers for an interstate service.

**Administration of Universal Service Support**

72. Section 254(d) of the 1996 Act provides that the Commission may exempt carriers from contributing to the support of universal service if their contribution would be “de minimis.” The conference report indicates that “[t]he conferees intend that this authority would only be used in cases where the administrative cost of collecting contributions from a carrier or carriers would exceed the contribution that carrier would otherwise have to make under the formula for contributions selected by the Commission.” What levels of administrative costs should be expected per carrier under the various methods that have been proposed for funding (e.g., gross revenues, revenues net of payments to other carriers, retail revenues, etc.)?

Minimal. The type of information proposed by the various methods of funding are easily extracted from the accounting records of all providers. The Commission should simply set a level, perhaps \$1000, at which the required contribution could be considered “de minimis” and carriers would be exempted from payment.

Respectfully submitted,



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**FURTHER COMMENTS OF  
THE NATIONAL CABLE TELEVISION ASSOCIATION, INC.**

The National Cable Television Association, Inc. ("NCTA"), by its attorneys, hereby files its Further Comments in response to the Public Notice<sup>1</sup> seeking further comment on specific questions in the above-captioned proceeding.<sup>2</sup> NCTA is the principal trade association of the cable television industry in the United States and represents cable television operators serving over 80 percent of the nation's television households. NCTA has filed comments and reply comments in this proceeding which address in detail many of the issues raised in the Public Notice. In this regard, we incorporate by reference those previous pleadings and the responses in these Further Comments should be read in conjunction with our previous submissions in this docket.

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<sup>1</sup> Public Notice, "Common Carrier Bureau Seeks Further Comment on Specific Questions on Universal Service Notice of Proposed Rulemaking," DA 96-1078, released July 3, 1996.

<sup>2</sup> The responses to questions 34-48 ("Proxy Models") and 56-68 ("Benchmark Cost Model," "Cost Proxy Model Proposed by Pacific Telesis") were prepared in conjunction with NCTA's consultants at Economics and Technology, Inc. ("ETI")

## Definitions Issues

1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?

Yes. Current rates for services included within the definition of universal service are affordable given the 93% penetration rate for basic service across the country. There may be some very limited areas with particularly low penetration rates (e.g., Native American reservations) that require further examination. However, there may be factors other than price which affect those subscribership levels.

2. To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?

All of the named factors can be considered in determining the affordability and reasonable comparability of rates.

3. When making the "affordability" determination required by Section 254(j) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?

NCTA has previously stated that existing rates should be considered affordable. NCTA has also suggested the use of a national benchmark rate for determining universal service subsidies based on a proxy model. A benchmark rate would be used at the federal level to determine the federal support level (for example, if a benchmark rate of \$30 were chosen [\$30 is for illustrative purposes only - NCTA has not advocated a specific benchmark rate] then companies serving those areas in which benchmark costs are higher than \$30 would receive funding for the difference between the benchmark costs and the benchmark rate.) If a state chooses to cap rates at less than the chosen national benchmark rate then that state could create its own funding mechanism to provide for the difference between the benchmark rate and the actual rate.

4. What are the effects on competition if a carrier is denied universal service support because it is technically infeasible for that carrier to provide one or more of the core services?

If NCTA's proposed list of core services is adopted, it is difficult to see how it would be technically infeasible for any carrier to provide the requisite services. Switched local exchange service is the critical core service, which by definition must be provided by any entity purporting to be a local exchange carrier. Similarly, the ability to provide touch-tone service is built-in to every local switch available today. Access to operator services and emergency services may be provided through connection with the existing facilities of the incumbent local exchange company. If it is technically infeasible to connect to these existing facilities then the new entrant must provide such services itself as a competitive necessity. Few customers will subscribe to local exchange service if access to 911 is

unavailable. Therefore, since every local exchange carrier should be providing the core services, there should be no effect on competition if a carrier which does not provide core services is denied support.

5. A number of commenters proposed various services to be included on the list of supported services, including access to directory assistance, emergency assistance, and advanced services. Although the delivery of these services may require a local loop, do loop costs accurately represent the actual cost of providing core services? To the extent that loop costs do not fully represent the costs associated with including a service in the definition of core services, identify and quantify other costs to be considered.

While loop costs, in and of themselves, would not be the only costs incurred in providing universal service, it must also be remembered that not all of the loop costs are attributable to the provision of universal service. Local loops are used not only for the provision of core services but also to provide toll services and optional services such as CLASS features. Therefore, it would not be appropriate to assign 100% of loop costs to universal service and then add in other costs such as switching, software, and additional overheads. Rather the appropriate cost drivers are those outlined in NCTA's Attachment A to our initial comments filed in this docket.

#### **Schools, Libraries, Health Care Providers**

6. Should the services or functionalities eligible for discounts be specifically limited and identified, or should the discount apply to all available services?

Only specifically defined services should be available at a discount. The Act requires support for telecommunications services *which are necessary for the provision of health care services* to health care providers and, in the case of schools and libraries, the provision at a discount of telecommunications services *for educational purposes*. Not all available telecommunication services meet these requirements.

7. Does Section 254(h) contemplate that inside wiring or other internal connections to classrooms may be eligible for universal service support of telecommunications services provided to schools and libraries? If so, what is the estimated cost of the inside wiring and other internal connections?

No. Section 254(h) applies to telecommunications services which are defined as the offering of telecommunications (i.e., transmission) not the equipment or wiring associated with those services. Moreover, inside wire services were deregulated under Part 68 rules and the provision of inside wire services is competitive. Wireless technologies may also offer the ability to access advanced services without the necessity of installing potentially costly inside wiring.

8. To what extent should the provisions of Sections 706 and 708 be considered by the Joint Board and be relied upon to provide advanced services to schools, libraries and health care providers?

Only facilities-based competition can ultimately be relied upon to provide advanced services in a cost effective manner. However, the Commission and the Joint Board can encourage adoption of incentives, such as those provided for in Section 706 (regulatory forbearance, etc.), to stimulate infrastructure investment and facilities-based competition. They can also make recommendations to the National Education Technology Funding Corporation (recognized in Section 708) regarding how it might best fulfill its purposes.

9. How can universal service support for schools, libraries, and health care providers be structured to promote competition?

Universal service support for schools, libraries, and health care providers can best be structured to promote competition by ensuring that universal service support is available to all telecommunications carriers providing services to schools, libraries, and health care providers in a competitively neutral fashion. This includes ensuring that, even in areas where rural companies have been exempted from interconnection requirements, other telecommunications carriers are eligible to receive funding for services provided to schools, libraries, and health care providers. In addition, policies which encourage the building of facilities, such as low resale discounts and competitive bidding, should be adopted.

10. Should the resale prohibition in Section 254(h)(3) be construed to prohibit only the resale of services to the public for profit, and should it be construed so as to permit end user cost based fees for services? Would construction in this manner facilitate community networks and/or aggregation of purchasing power?

Section 254(h)(3) should be construed to prohibit any resale of services to the general public for profit. However, cost-based charges to end-users of the services provided by the educational or health institutions should be allowed.

11. If the answer to the first question in number 10 is “yes,” should the discounts be available only for the traffic or network usage attributable to the educational entities that qualify for the Section 254 discounts?

The discounts required for schools and libraries should be available only for the traffic or network usage attributable to the educational purposes that qualify for the Section 254 discounts, even if the educational entities are permitted to resell telecommunications services at “cost ”

12. Should discounts be directed to the states in the form of block grants?

No. Any required funding for discounts which may not be required if a competitive

bidding approach is adopted -- should be directed to companies, as required by the statute.

13. Should discounts for schools, libraries, and health care providers take the form of direct billing credits for telecommunications services provided to eligible institutions?

Yes. Direct billing credits will greatly enhance the ability to ensure that funds are used for their intended purposes, since the credits would only be granted when the schools, libraries and health care providers order the services to which discounts may be applied (as previously noted, only a selected list of services should be available at a discount).

14. If the discounts are disbursed as block grants to states or as direct billing credits for schools, libraries, and health care providers, what, if any, measures should be implemented to assure that the funds allocated for discounts are used for their intended purposes?

As noted in the response to Question 13, the use of direct billing credits helps ensure that funds are used only for eligible services. In addition, the school or library proposing to receive discounted services should certify in writing that the services will be used only for purposes permitted by the Act. If a requesting entity violates the terms of the certification, the service provider should be permitted to discontinue the service or discount.

15. What is the least administratively burdensome requirement that could be used to ensure that requests for supported telecommunications services are bona fide requests within the intent of section 254(h)?

As stated in our initial comments, self-certification that the requirements have been met would be the least administratively burdensome method.

16. What should be the base service prices to which discounts for schools and libraries are applied: (a) total service long-run incremental cost; (b) short-run incremental cost; (c) best commercially-available rate; (d) tariffed rate; (e) rate established through a competitively-bid contract in which schools and libraries participate; (f) lowest of some group of the above; or (g) some other benchmark? How could the best commercially-available rate be ascertained, in light of the fact that many such rates may be established pursuant to confidential contractual arrangements?

As a general matter, the rates for services for schools and libraries should be determined through a competitively-bid contract process in which the schools and libraries participate and which is accomplished in a non-discriminatory, competitively-neutral manner. In such circumstances, no "discount" off of the derived rate is necessary.

17. How should discounts be applied, if at all, for schools and libraries and rural health care providers that are currently receiving special rates?

If the discounted price results in a lower rate for an entity currently receiving a special rate, then the lower rate should apply. Conversely, if the special rate continues to be lower, the telecommunications carrier should continue to provide service at that rate.

18. What states have established discount programs for telecommunications services provided to schools, libraries, and health care providers? Describe the programs, including the measurable outcomes and the associated costs

NCTA has no information to respond to this question.

19. Should an additional discount be given to schools and libraries located in rural, insular, high-cost and economically disadvantaged areas? What percentage of telecommunications services (e.g., Internet services) used by schools and libraries in such areas are or require toll calls?

There is no necessary rationale for additional discounts to schools and libraries in rural, insular, and high-cost areas. This is because rural and insular areas are not synonymous with high cost areas. High cost areas today, and into the foreseeable future, will receive universal service funding. And, in some instances, rural school districts may be better funded than urban districts. Thus it is not clear that rural and high cost areas require greater discounts in order to be able to purchase discounted services. NCTA has no information as to what percentage of telecommunications services used by schools and libraries in such areas require toll calls.

20. Should the Commission use some existing model to determine the degree to which a school is disadvantaged (e.g., Title I or the national school lunch program)? Which one? What, if any, modifications should the Commission make to that model?

Under a competitive bidding process, the ability of a school to pay will be one of the critical factors in the bid process. Therefore it would be unnecessary to make specific determinations as to whether a school is disadvantaged.

21. Should the Commission use a sliding scale approach (i.e., along a continuum of need) or a step approach (e.g., the Lifeline assistance program or the national school lunch program) to allocate any additional consideration given to schools and libraries located in rural, insular, high-cost, and economically disadvantaged areas?

See response to question #19.

22. Should separate funding mechanisms be established for schools and libraries and for rural health care providers?

Yes. Separate funding mechanisms should be used, both for ease of administration and because the requirements for provision of service differ between schools and libraries and health care providers. The Act requires that services provided to health care providers be treated as part of a carrier's universal service obligation, while discounts for schools and libraries are to be either treated as an offset or reimbursed directly.

23. Are the cost estimates contained in the McKinsey Report and NII KickStart Initiative an accurate funding estimate for the discount provisions for schools and libraries, assuming that tariffed rates are used as the base prices?

NCTA has no information to respond to this question.

24. Are there other cost estimates available that can serve as the basis for establishing a funding estimate for the discount provisions applicable to schools and libraries and to rural health care providers?

NCTA has no information to respond to this question.

25. Are there any specific cost estimates that address the discount funding estimates for eligible private schools?

NCTA has no information to respond to this question.

### **High Cost Fund**

#### **General Questions**

26. If the existing high-cost support mechanism remains in place (on either a permanent or temporary basis), what modifications, if any, are required to comply with the Telecommunications Act of 1996?

NCTA does not believe the existing mechanism can be retained because it does not meet the requirements of the Act to be competitively neutral, either in the method in which funding is derived or disbursed. At best, a phase-out of the existing program over a three year period may be used to ameliorate the impact of a switch to a proxy methodology on certain companies. Even during the phase-out, however, funds must be made available to any eligible carrier serving a particular high cost area.

27. If the high-cost support system is kept in place for rural areas, how should it be modified to target the fund better and consistently with the Telecommunications Act of 1996?

As noted above, if the high cost fund is kept in place for rural areas, funding must immediately be made available to any eligible telecommunications carrier serving the geographic area in which an incumbent receives funding.

28. What are the potential advantages and disadvantages of basing the payments to competitive carriers on the book costs of the incumbent local exchange carrier operating in the same service area?

The book costs of the incumbent are unrelated in any way to the cost of providing service by a new entrant. Use of a proxy model as recommended by NCTA would preclude the use of book costs to determine the funding level for incumbent or new LECs. The only

circumstance in which the use of book costs may be worthwhile would be in the unlikely instance in which the proxy model showed costs higher than the book costs of the incumbent. In such an instance, the book costs could be used as a cap to limit the level of funding.

29. Should price cap companies be eligible for high-cost support, and if not, how would the exclusion of price cap carriers be consistent with the provisions of Section 214(e) of the Communications Act? In the alternative, should high-cost support be structured differently for price cap carriers than for other carriers?

The Joint Board should consider denying price cap carriers, which have the ability to retain earnings above cost, eligibility for high cost support, particularly in areas where the LEC faces little competition and where any subsidy is based on book costs.

30. If price cap companies are not eligible for support or receive high-cost support on a different basis than other carriers, what should be the definition of a “price cap” company? Would companies participating in a state, but not a federal, price cap plan be deemed price cap companies? Should there be a distinction between carriers operating under price caps and carriers that have agreed, for a specified period of time, to limit increases in some or all rates as part of a “social contract” regulatory approach?

Any company which has been granted the ability to earn profits substantially above what would be permitted under cost of service regulation, at either the state or federal level, should be considered a “price-cap” company for the purposes of universal service funding.

31. If a bifurcated plan that would allow the use of book costs (instead of proxy costs) were used for rural companies, how should rural companies be defined?

NCTA would oppose the use of such a bifurcated plan. Nevertheless, if one were adopted, rural companies should be defined as they are in the 1996 Act.

32. If such a bifurcated approach is used, should those carriers initially allowed to use book costs eventually transition to a proxy system or a system of competitive bidding? If these companies are transitioned from book costs, how long should the transition be? What would be the basis for high-cost assistance to competitors under a bifurcated approach, both initially and during a transition period?

If a bifurcated approach is used, carriers initially using book costs should transition to a proxy system over a period no longer than three years. Competitors should be eligible to receive the same amount and level of funding, on a per customer basis, as the incumbent carrier, both in the initial phase and during the transition period.

33. If a proxy model is used, should carriers serving areas with subscription below a certain level continue to receive assistance at levels currently produced under the HCF and DEM weighting subsidies?

No. This question incorrectly assumes that the level of subscribership is necessarily related to the required level of High Cost Funding and DEM funding. While other factors such as the availability of toll limiting service, general income levels, etc., are relevant to subscribership levels, HCF and DEM levels are not. Therefore, a proxy model should be used to determine the funding level in all areas of the country regardless of particular subscribership levels.

### **Proxy Models**

34. What, if any, programs (in addition to those aimed at high-cost areas) are needed to ensure that insular areas have affordable telecommunications service?

The present “Lifeline” and “Link Up” programs in concert with a properly targeted “High Cost Assistance” program are adequate to meet the universal service requirements of the 1996 Act. (See also the response below to question 59 regarding the possible need to enhance the BCM so that it accurately reflects the cost of serving areas that may have unique natural resource characteristics, such as islands, that present atypical network requirements). However, before the FCC can make a determination as to the particular universal service funding needs for any such areas, it is critical that complete information be submitted to the FCC as to the particular extenuating circumstances of such locations that could possibly justify a departure from the results of the “standard” cost proxy model that the FCC adopts. The burden is appropriately placed on the incumbent LECs (who are the likely beneficiaries of any high-cost support in such areas) to demonstrate that the cost proxy model fails to accurately reflect any unique costs of serving a particular insular area.

35. US West has stated that an industry task force “could develop a final model process utilizing consensus model assumptions and input data.” US West comments at 10. Comment on US West’s statement, discussing potential legal issues and practical considerations in light of the requirement under the 1996 Act that the Commission take final action in this proceeding within six months of the Joint’s Board’s recommended decision.

In light of the limited time frame within which the Commission must take final action in this proceeding in order to comply with the 1996 Act, it is critical for the FCC to identify the major sources of differences among the various models being proposed and to require local exchange carriers to submit the information and data that are critical to enable the FCC to resolve remaining areas of controversy. Controversy has arisen (and is not likely to be resolved within the industry) as to two general categories of attributes of cost proxy models: (1) the algorithms and logic of the model (e.g., the way in which a cost proxy model should decide when to “deploy” fiber rather than copper in the feeder plant; the objective fill factors that should be used in the theoretical outside plant; whether the model

should reflect the cost of providing single-line residential service, etc.) and (2) the assumptions about the input values (the carrying cost factor that should be used, the cost of switches, etc.)

Because there is unlikely to be consensus on all of these areas, the FCC should require that incumbent LECs immediately provide all data necessary to develop accurate cost input data for such important network elements as host and remote digital switches and digital loop carrier equipment. The prices paid for these and other network components are among the most fundamental inputs to an effective cost proxy model and should therefore be based upon the most up-to-date, accurate information available. Also, the key components of the cost factor (which is used to translate investment cost into monthly costs) should be investigated by the FCC, and the FCC should require complete and comprehensive back-up and supporting documentation by all model proponents regarding the development of the cost factors being proposed for use in a cost proxy model. As the FCC makes decisions regarding the various individual aspects of a cost proxy model, it should be guided by the overarching goal to model the cost of providing basic local exchange service. For example, the depreciation rates that the FCC uses in its computation of a reasonable cost factor should reflect the expected lives of technology necessary for *basic* local exchange service, and not the expected lives of technology that is associated with incumbent LECs' strategic business plans.

Ultimately, the FCC (and at the state level, PUCs) will need to decide the economic, relevant components of the cost factor (e.g., the appropriate depreciation rates to assume for the various components of the theoretical network, the appropriate forward-looking expense factors, etc.). It is essential that the FCC seek and obtain the necessary information to make the many individual decisions involved in designing and implementing an accurate, competitively neutral cost proxy model.

Because of the improbability of consensus on some of these more controversial aspects of a cost proxy model, this approach of gathering relevant critical data is likely to be a more fruitful avenue than US West's proposed industry task force to eliminate any uncertainties involving the inputs to a workable and publicly open cost proxy model. NCTA certainly supports efforts within the industry to harmonize differences and to attempt to develop areas of consensus (and indeed has attempted to contribute to such efforts), but believes nonetheless that, ultimately, some significant areas of difference will remain that the FCC will need to be prepared to referee.

36. What proposals, if any, have been considered by interested parties to harmonize the differences among the various proxy cost proposals? What results have been achieved?

As discussed in greater detail in response to question 58, NCTA has recommended that the need for high-cost support should be determined at the *wire center* as opposed to the Census Block Group ("CBG") level. The wire center, rather than the CBG, reflects the current architecture of the public switched network and is therefore the appropriate geographic level at which to consider the scale and scope economies arising from the provision of local exchange service. The Joint Sponsors of the BCM did not incorporate

this recommendation into the revised “BCM2.” However, they did acknowledge in an ex parte filing that “an interested user of the BCM could perform an aggregation of all CBGs in a wire center to obtain an approximation of cost at the wire center level.”<sup>3</sup>

As an alternate approach, and in an effort to harmonize differences of opinion on this issue, ETI has recommended that a “combined CBG/wire center” method be used to assess the need for and to quantify the level of high-cost support. Under this approach, proxy costs would be averaged for each wire center and compared to the adopted threshold for high cost support. If the average proxy cost for the wire center does not exceed the adopted support threshold level, the entire wire center is excluded from receiving high cost support. Alternatively, for those wire centers whose average cost is above the support threshold, high cost support would be determined at the CBG level and distributed only to those CBGs in the wire center which have average costs above the prescribed benchmark for support.

37. How does a proxy model determine costs for providing only the defined universal service core services?

In their July 3 release of the BCM2, the remaining Joint Sponsors, US West and Sprint, indicated that they “made every attempt in developing [the] model to accurately reflect the current cost of building a telephone network capable of providing service of the high quality demanded by [their] customers and [their] regulators.” In doing so, however, the Joint Sponsors repeated the same fundamental error of the BCM1, namely the failure to estimate the cost of providing only the defined universal service core services. To be useful as a policymaking tool, a cost proxy model must calculate the forward-looking cost of providing basic, single line, residential local exchange service. In addition, the model must quantify the economies of scale and scope that arise from the actual, full service business and residential telecommunications network and then properly attribute a portion of those economies to the stand-alone cost of providing services under the scope of universal service. In its analysis of the BCM1 on behalf of NCTA, ETI attempted to adjust user specified inputs so as to estimate the cost of providing single line residential local exchange service. Among the cost drivers examined by ETI were the selection of copper vs. fiber outside plant and the use of high cable and switch fill factors to properly reflect the provision of *single line* residential service. These analyses conducted on behalf of NCTA have been intended to contribute to the question of how best to model the provision of only the defined universal service core services. More importantly, the developers of cost proxy models must recognize this goal as the proper function of a cost proxy models and develop their models accordingly

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<sup>3</sup> Ex Parte Filing of the Joint Sponsors, February 21, 1996.