services. Clearly such an approach does nothing, and, in fact will probably damage the goal to promote competition in the education market.

Likewise, using the lowest commercially-available rate is also problematic. It may be difficult to even identify what the lowest commercially-available rate is. Many times the "best" rate will be provided to large volume customers in a packaged offering. This best price may be proprietary or may not even be identifiable because of the packaging of service offerings. Tariff rates can also be problematic as a basis for a price discount plan. In many cases, services offered to schools and libraries are not described in tariffs. This is particularly true for new entrants that are not required to file detailed tariffs. This will become even more prevalent as competition unfolds, service packaging expands, and LECs are relieved of detailed tariff filing requirements. Basing the solution on today's regulatory model of tariff pricing constructs may prove short-sighted.

The "funds to schools and libraries" approach solves this problem and lets the competitive marketplace establish pricing levels for schools and libraries. It also provides States with the flexibility to keep existing plans and to create new ones which meet their specific needs.

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

This question illustrates another serious problem with implementing a federal pricing discount scheme. Many schools and libraries already receive discounts on services, and attempting to overlay a national pricing discount plan is simply not feasible especially since some of these discount plans have resulted from regulatory agreements reached in States. The "funds

to schools and libraries" approach would avoid this problem. Where schools and libraries already have a discount pricing option, they simply purchase the service at that discounted price using the credits provided by the universal service fund. The "funds to schools and libraries" approach would naturally integrate with the many discount plans already in existence.

As previously stated by SWBT, rural health care providers should be offered services at statewide-averaged prices, ensuring reasonable comparability of prices.

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.

SWBT provided a summary of current State plans within its region as Attachment 3 to its initial Comments in this proceeding. For ease of reference, a copy of that Attachment is attached and incorporated by this reference as Attachment 2.

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?

While SWBT has explained that a discount plan is not the best approach at the federal level, SWBT agrees with the principle of providing additional assistance to schools and libraries that are economically disadvantaged or that experience higher telecommunications costs because of the need for long distance services or exceptionally long dedicated transport connections. Additional funding should be allocated to schools and libraries through the "funds to schools and libraries" approach as a means to accommodate these special needs. However, the Joint Board and the Commission should not adopt a presumption of the need for additional assistance simply

because a school or library resides in a rural or insular area. Rural or insular areas may have local Internet service providers, and the schools and libraries in that area may not otherwise face high telecommunications costs.

Finally, a point of clarification may be needed. In and of itself, Internet service is not a "telecommunications service." See 47 U.S.C. 153(46). The Common Carrier Bureau agreed that Internet service is an enhanced service in approving a Comparably Efficient Interconnection (CEI) plan[2] and, under the Act, Internet service is properly categorized as an "information service." See 47 U.S.C. 153(20). Although the telecommunications service to provide a connection to an Internet service provider may be appropriately included within the definition of universal service for schools and libraries, the separate charges for the Internet service itself fall outside the scope of Section 254.

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?

It seems reasonable to use an existing mechanism for identifying economically disadvantaged schools rather than creating a new approach. However, SWBT is open to alternative approaches which accurately identify these schools.

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

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[2] See *Bell Atlantic Telephone Companies Offer of Comparably Efficient Interconnection to Providers of Internet Service*, Order, CCBPol 96-09, DA 96-891, at para. 1 (released June 6, 1996) ("Prior to offering the enhanced service, the carrier must obtain Commission approval of the CEI plan. . . . we approve Bell Atlantic's CEI plan.").

allocate any additional consideration given to schools and libraries located in rural, insular, high-cost, and economically disadvantaged areas?

Under the "funds to schools and libraries" approach, several factors could be taken into account for determining the distribution of funds. For example, the number of school buildings, the number of students, and the number of economically disadvantaged students could be factored in to create a support plan that would provide sliding scale benefits.

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

Yes, separate federal funds should be established for each of the universal service targets (e.g., low-income customers, high-cost areas, schools and libraries, rural health care providers). This will ensure proper accountability and a targeted focus. SWBT recommends that, for the funding of each of these accounts, that they be combined to calculate a single surcharge level so that the customer sees one surcharge for the recovery of the total universal service funding.

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?

The McKinsey study appears to be the most extensive study on the subject and seems to be a reasonable basis from which to estimate the funding level for a "funds to schools and libraries" approach. Independent of this basis for estimating the funding level is the need to create a specific, fixed annual fund amount. Telecommunications carriers and educators need to know how much money is at issue for accurate forecasting.

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?

NTIA's Reply Comments in this proceeding provide additional information as well as Appendix B in the McKinsey Report.

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

SWBT does not know of any specific cost estimates for private schools. One approach would be to extrapolate estimates from the McKinsey Report.

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?

The current high-cost fund, which does not include those costs recovered through implicit support flows, meets the principles embodied in Section 254(b). In response to the Commission's Notice of Proposed Rulemaking concerning the existing federal Universal Service Fund (USF), SWBT evaluated several proposed changes to the USF to help align it with the competitive marketplace.[3] SWBT's position regarding the USF continues to be that changes are not necessary except as specifically identified below. Except for the possible elimination of some funding to Tier 1 LECs,[4] SWBT believes the USF is properly targeted and sized. The USF does help ensure

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[3] See SWBT's Comments filed on October 10, 1995 (SWBT NPRM/NOI Comments), in response to the Notice of Proposed Rulemaking and Notice of Inquiry in *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, 10 FCC Rcd 12309 (1995).

[4] Assuming USF is kept in place, SWBT believes that for larger LECs, support should be maintained through rate restructuring. The most sustainable restructuring would be to phase-in

access in "rural, insular, and high cost areas" to telecommunications services at "just, reasonable, and affordable rates." Sections 254(b)(3), (b)(1). SWBT's analysis demonstrated that without the current USF, basic local rates for numerous rural LECs would likely need to increase substantially. The USF is thus a "specific, and predictable" mechanism that is necessary to "preserve and advance universal service." See Section 254(b)(5), SWBT NPRM/NOI Comments, Attachment 1.

A change is necessary, however, to comply with the Act related to funding of the USF. Currently the USF is supported through assessments to IXCs based on their respective shares of pre-subscribed lines. Section 254 requires that "all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." Use of pre-subscribed lines does not meet that requirement in that it only recovers support from toll providers who have customers subscribed to the wireline network. Under this system, numerous carriers are not required to pay support. For example, providers of toll through prepaid calling cards or on a "dial around basis" (10XXX) are exempt from funding. Funding of the USF should be modified so it is consistent with the nondiscriminatory provisions of the Act. Assessment of the federal USF based on interstate retail revenue would be the most appropriate method.

Another topic that needs to be addressed is the "study area" question versus the need to

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increases to the interstate EUCL in areas where interstate common line costs are not recovered by the current EUCL. If there is a transition period, the CCL and, if necessary, the USF, would be bulk billed.

create "universal service areas" as set forth in Section 254. The current "study area" rules limit a "study area" to those established as of November 15, 1984, or those for which a waiver has been approved. While the currently approved waivers have been granted to accommodate purchase/sale of exchanges, there would presumably be no impediments for incumbent LECs, as new entrants requesting a waiver, to establish a new study area that may overlap an existing incumbent's "study area," to perform the cost calculations required by the current rules and to be eligible for support from the existing high-cost fund. Until such time as universal service areas are defined to be smaller than the existing study area, entry by an existing LEC into another LEC's "study area" should not result in USF funding for costs incurred to enter areas served by other LECs.

If, as defined by the Act, a rural incumbent were to expand its study areas into the area of another rural incumbent, reassessing USF support may be appropriate because both LECs are on equal footing with regard to qualifications for USF (presumably both are rural and high-cost and in both cases the study area and the universal service area established under the Act are synonymous). However, it is inappropriate for a rural or non-rural incumbent LEC to enter the territory of a non-rural LEC and to receive support from the USF for the new area. SWBT believes an inappropriate disparity would be created in these potential situations, due to the fact that such non-rural LEC's costs are the average of low- and high-cost areas, whereas the costs of a rural LEC are relatively high as a result of the rural nature of its study area. In sum, the rural LECs should not be allowed to enter portions of a non-rural LEC's service area and continue

receiving support while the non-rural LEC cannot.

The new entrant should cost justify their support and recover support only for facilities it owns that are used to provide universal service. New entrants should not receive support for services provided via resale.

Although other modifications would not be necessary to the current high-cost rules, there is a sincere need to address other high-cost funding mechanisms such as Long Term Support (LTS), which is currently funded implicitly through an addition to specific LECs not in the National Exchange Carrier Association (NECA) Common Line Pool. LTS and CCL, both currently forms of implicit support, should be recovered explicitly.

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 stated previously, SWBT believes the fund is properly targeted with the exception of Tier 1 LECs.[5] Largely, the small LEC fund recipients will not face competition in the near future and in certain cases may be exempt from Section 252 interconnection requirements. These carriers are likely to be the only "eligible telecommunications carrier" for their service areas. Consequently, making the USF available to new LECs entering rural territories will be at most a minor requirement. Assuming new LECs enter these markets, it is not necessary to have a complex process in place to determine which LEC would receive USF support.

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

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[5] See footnote 4.

area?

SWBT believes that new entrants should only recover support in an area if the incumbent is receiving support, and then only for those costs attributable to its own facilities used to provide universal service. Support, if any, for resold services must go to the provider of the facilities underlying the services. New entrants should also have the same regulatory obligations as the incumbent LEC (e.g., quality of service, reporting).

Finally, new entrants should justify their support based on their own costs. If their claims are accurate, the costs of prospective entrants will be less than the incumbent LEC's costs, which should serve as a cap on the level of support received by any entrant. If the Joint Board determines that a new entrant does not need to cost justify its support, but instead simply receive the incumbent LEC's level of support per line, if any, the following advantages and disadvantages would be realized:

Advantages:

- Simple and easily administrable. Costs studies are not required by new entrants and all parties clearly know the level of support per customer.

- No complex proxy studies would be required. The difficulty of selecting a particular proxy would be avoided.

- Each competitor would receive exactly the same support amount per line for which it owns the underlying facility.

Disadvantages:

- Support payments to new entrants would not reflect their actual costs. Entrants could under-recover or over-recover their costs. Either outcome would be problematic under Section 254: either the support would not be "sufficient" under Section 254(e) or the

excessive funds would not be used in the manner required by that same subsection.

- May result in less efficient operation of the marketplace. If the incumbent LECs costs are higher, entrants would not have an incentive to reduce costs as much as they would otherwise, since they may be able to recover additional amounts from support payments based on ILEC's costs.

- Incumbent LECs would need additional resources (compared to its competitors) and incur associated expenses necessary to produce required cost studies. This results in a competitive disadvantage to the ILECs by requiring additional costs.

- Continued regulation and monitoring is required to review ILEC cost studies.

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?

Section 214(e) does not provide for the exclusion of any group of carriers, including price cap LECs (as currently understood under Commission Rules). Excluding any carrier based upon the method under which it is regulated would be wholly inconsistent not only Section 214(e), but the Act as well. Being categorized as a price cap LEC denotes absolutely nothing about the costs incurred by that LEC to provide service in any of its areas. For example, within the serving area of a price cap LEC, such as SWBT in Texas, there are both low-cost areas and high-cost areas which SWBT must serve because it is the carrier of last resort (COLR). This is shown by the actual embedded cost information provided by SWBT in its February 14, 1996, and February 19, 1996, ex partes. SWBT believes that all price cap LECs experience such variations in costs to serve.

Price caps are instead a form of rate regulation intended to eliminate some of the

disincentives and perverse incentives created by the historical method of rate base, rate of return regulation. Indeed, assuming for the sake of argument that price cap regulation were the answer, then the entire universal service issue could be solved by a stroke of the regulatory pen by merely adopting price cap regulation for all LECs. With Sections 254 and 214, Congress clearly rejected that notion and understood that high-cost areas do indeed exist.

Congress also did not believe that competition alone would provide universal service at affordable prices in those high-cost areas. Sections 254 and 214 were based on an understanding that there are high-cost areas that either will not be served or served at higher-than-desirable prices absent regulatory intervention. Consistent with its desire for competition in all telecommunications markets, Congress established a framework to make the regulatory intervention explicit and competitively neutral in both its funding and its distribution.

Using that framework to establish mechanisms to discriminate against price cap LECs (or Tier 1 LECs) would violate Sections 254 and 214 in both letter and spirit, would be unreasonable, arbitrary, capricious, and an abuse of discretion, and violate the substantive due process and/or equal protection rights of price cap LECs. Any distinction between the funding mechanisms used to support high-cost areas served by non-price cap LECs and those of price cap LECs would implicitly rest on the assumption that the price cap LECs could somehow "afford" funding of a lesser amount.

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?

A price cap LEC should be defined as a LEC under price cap regulation, with no sharing obligation and no price freezes on any of the regulated services, in both the federal and State jurisdiction. LECs operating under price cap regulation in only one jurisdiction would not be deemed to be a price cap LEC LECs that are operating under "social contracts" to limit or freeze some prices should be allowed greater pricing flexibility for other services or the amount of high-cost support should be adjusted to compensate for the "social contract." If a LEC is denied additional flexibility to rebalance rates, additional explicit support should be provided until the rates under the "social contract" can be adjusted.

See also response to Question No. 29.

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?

A plan should not be adopted that forces non-rural LECs to use proxies which are not reflective of the network used to provide universal service. Although the Act defines "rural" carriers, a carrier should not be excluded from the use of book costs to determine high-cost support based on that definition and distinguishing between "rural" and "non-rural" companies. Even with LECs that would be considered non-rural under the definition of rural LECs from the Act, there may exist areas served by those "non-rural" LECs that are "rural areas" with high costs. For example, SWBT serves urban, suburban, and rural areas. In Texas, 203 SWBT wire centers (approximately 500,000 lines) are in areas where the line density is less than 25 lines per

square mile; 183 wire centers (approximately 2,000,000 lines) are in areas where the density is between 25 lines and 500 lines per square mile; and 127 SWBT wire centers (approximately 4,500,000 lines) are in areas with a density greater than 500 lines per square mile.

Moreover, attempting to distinguish between "rural" and "non-rural" carriers for the purpose of determining universal service costs or support would also violate Sections 254 and 214, would be unreasonable, arbitrary, capricious, and an abuse of discretion, and violate the substantive due process and/or equal protection rights of "non-rural" LECs, for the same reason as attempting to distinguish between "price cap" LECs and other LECs. See response to Question No. 29.

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?

A proxy or competitive bidding should not be mandated, either as a final solution or in a transitional period. As will be discussed further in response to Question Nos. 35-48, proxies have not been shown to be more accurate in determining high-cost areas, and in SWBT's analysis of the BCM, have not even shown a consistent ability to determine relative costs when compared to actual costs. SWBT has serious questions regarding the practical implementation of competitive bidding and if a bidding process would properly implement the Act.

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?

The current HCF (USF) and DEM weighting should be retained for small LECs, regardless of 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?

Existing explicit federal support as well as rate restructuring to address the CCL charge will assist in assuring a universally available network is maintained in high-cost insular areas. Lifeline and Linkup programs should also be available to meet the needs of low-income subscribers in these areas.

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.

Question Nos. 35 - 48 deal with various aspects of the proxy models that have been introduced in this proceeding. The Commission has requested, and SWBT anticipates filing, further comments regarding these models on August 9, 1996. However, SWBT has consistently and clearly demonstrated in this docket and others (e.g., CC Docket Number 96-98) that the proxies proposed to date do not adequately reflect the actual costs incurred in the provision of universal service. Moreover, these models frequently misstate the level of support necessary for a particular LEC. Interestingly these models are continually being updated and modified to reflect changes in assumptions, to correct errors, and to add variables not previously considered. These continued adjustments cause the current models to be extremely suspect.

SWBT understands the desire to have a costing process that can be used for any telecommunications carrier. Additionally, SWBT understands that, especially as it relates to large LECs, it will be necessary to derive costs which are much more discrete than current study level costs. SWBT also understands the possible reluctance of regulators to rely on incumbent LEC costs.

However, none of these considerations justify the adoption of any proxy (including all of those proposed to date) which does not adequately reflect the actual costs necessary to provide universal service. Attachment 1 to these Responses displays, to the extent that such data is available to SWBT, the results derived from the various models, comparing such to actual costs.

Prior to the adoption of any proxy cost model, the Joint Board and the Commission should ask and require answers to the following questions:

1) Why have the model results changed with each new output?

2) What variables were added?

3) What new assumptions were necessary?

4) What assumptions and variables are missing?

5) Why do the models produce differing results between themselves?

6) Which set of variables and assumptions, if any, are correct?

7) Why do some models generally generate more than actual costs for small rural LECs when a number of IXCs have argued that the actual costs of these same small LECs are overstated?

8) Why are the costs generated by the models for large LECs often less than actual costs? SWBT has shown in its submissions that the difference in cost levels between

> proxies and actual costs are not, as a number of IXCs often argue, inefficient and/or poor investment decisions. These arguments are absurd, and without any factual support. Incumbent LECs, especially Tier 1 LECs, have properly and efficiently expended resources to maintain universal service and have been thoroughly scrutinized by Federal and state regulators to safeguard against the matters of which those IXCs claim.
>
> 9) Who determines when the models should be updated to reflect technology, network, and other pertinent changes? What technologies should be reflected at that time?

The questions could continue. Those posed so far remain unanswered by the proponents of the proxies. In fact, since the proxies have been introduced, as such questions have been asked and model differences uncovered, the models have been revised in an attempt to mitigate the issues. Unfortunately, the results continue to deliver inexplicably differing results. These revisions have not improved the models, but have simply yielded a much more complex model.

SWBT does not believe that the use of a proxy cost model to determine universal service support levels is in concert with the Act. Universal service is now provided via actual network facilities that have actual underlying costs. These costs have survived continued close scrutiny in the past. These costs have been appropriately placed to develop a network designed to deliver quality services to customers upon demand. Allegations of others regarding LEC actual costs which are often used to support adoption of proxy models simply have no basis in fact. Such allegations cannot be relied upon to justify the use of any proxy model which does not adequately replicate actual costs, which have not been subjected to the intense scrutiny that LEC actual costs have undergone, and which will not provide "sufficient" support for universal service.

Until the questions posed above are adequately addressed and until a proxy model is developed which can adequately replicate actual costs, the Commission should continue to rely on

actual costs. If some large LECs are unable to disaggregate their study areas, then perhaps limited use of a proxy model might be appropriate to disaggregate those actual costs, thereby minimizing the distortions created by the proxy models.

Moreover, the statement referenced by US West as referenced in the instant question was preceded by the qualifier that "If the Commission makes the threshold decision that a 'proxy modeling approach' represents the most efficient and effective way to target high-cost support in a multi-vendor marketplace." It is not likely that an industry group (which would include LECs that support proxies, LECs that do not support proxies, IXCs that want the lowest possible amount of support, potential payers that also want the smallest possible fund, and recipients that want the largest possible fund) would be able to agree on model logic, much less the inputs to such a model. Some parties would also advocate the number of variables be extensive, while others would want to have no variables in a nationwide model (one of the initial reason for proxies to be considered was the concern regarding ability to manipulate data and the need for a process independent of company-specific data). SWBT is nevertheless willing to work with an industry group to determine if a proxy model can indeed be developed that accurately reflects actual costs, and thereby would supply universal service support that would be "sufficient" under the Act.

36. <u>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?</u>

The documentation of the Benchmark Cost Model 2 (BCM2) released July 3, 1996, provides some information that would appear to be in response to questions raised by others of the original BCM released in late 1995. Apparently, as a result of revised assumptions, variables,

and other model attributes, the output of the BCM2 shows a significantly higher cost ($59.3 billion in BCM2 versus $25.4 billion in BCM1) than the original BCM. To harmonize the differences between the models, it would be necessary to also reconcile significantly different assumptions and network designs upon which the models are based. Even if such were feasible, the credibility of these models would be even more questionable.

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

The existing proxy models, which are based on numerous assumptions and hypothetical guidelines unique to each model, have provided little explanation regarding how the theoretical costs that have been calculated meet the definition of universal service that has been proposed in this proceeding. The costs calculated by a proxy model must reflect the definition of universal service. The success of such an approach is based on the ability of the model designer to accomplish that objective.

38. How should a proxy model evolve to account for changes in the definition of core services or in the technical capabilities of various types of facilities?

Any proxy model would have to be reevaluated and changed each time the definition of universal service changed, or when the technical capabilities of the facilities providing universal service changed. This would require that some administrative process be established to continually review the latest technologies for applicability to meet the subjective forward-looking criteria typically established in these types of models. This continuing reevaluation and subjective analysis of the best forward-looking technology may, in fact, result in newer technology and/or

facilities being held out as an inappropriate standard.

In contrast, the use of actual costs would reflect the implementation of new technologies and/or facilities as they are actually placed in service.

39. Should a proxy model account for the cost of access to advanced telecommunications and information services, as referenced in section 254(b) of the Act? If so, how should this occur?

No. Proxies have not been shown to reflect actual costs of providing universal service.

40. If a proxy model is used, what, if any, measures are necessary to assure that urban rates and rates in rural, insular, and high-cost areas are reasonably comparable, as required in Section 254(b)(3) of the 1996 Act.

The comparability of urban and rural rates should continue to be the responsibility of State regulatory commissions.

41. How should support be calculated for those areas (e.g., insular areas and Alaska) that are not included under the proxy model?

Actual costs should be used for all areas. A proxy model should not be adopted unless it adequately addresses the entire definition of universal service and all of those areas for which universal service is an objective.

42. Will support calculated using a proxy model provide sufficient incentive to support infrastructure development and maintain quality service?

No, a proxy model that does not reflect the actual costs of providing service provides no incentive to the further development of the infrastructure.

43. Should there be recourse for companies whose book costs are substantially above the costs projected for them under a proxy model? If so, under what conditions (for example, at what cost levels above the proxy amount) should carriers be granted a waiver allowing alternative treatment? What standards should be used when considering such requests?

All carriers should have the option to present book costs. There should be no artificial or arbitrary conditions on the ability of a carrier to seek such a waiver. The question demonstrates the problem with proxies in determining which number is correct. Attachment 2 shows a limited comparison of some of the data presented in connection with this proceeding. This Attachment addresses the question "Which Cost is Right?".

44. How can a proxy model be modified to accommodate technological neutrality?

Unless a proxy model can adequately replicate actual costs, its use is inappropriate. Absent such a demonstration, SWBT does not believe the models should simply be modified for the sake of being able to say technological neutrality was somehow taken into account.

45. Is it appropriate for a proxy model adopted by the Commission in this proceeding to be subject to proprietary restrictions, or must such a model be a public document?

All data and the proxy model must be available to the public. The data and calculations used in the USF are publicly available, and still unfounded allegations are made and concerns expressed that the process is being "manipulated." One of the alleged reasons for developing a proxy was to create a publicly available process and set of data that would not be susceptible to manipulation, and which would theoretically provide for portable support to all incumbent LECs and new entrants on the same basis. Presumably, each participant should have the right to verify that inputs and calculations pertaining to its area are correct. Proxy models must be completely public to provide a competitively neutral basis for distributing universal service funds. Even thinking that a proxy would be allowed to contain information not available to public access and review would run counter to the existing, though unfounded concerns about the use of company-

specific cost data being manipulated to gain some unspecified advantage. In fact, there should be a greater concern that the proxy models may be manipulated to achieve desired competitive results using the regulatory process.

46. Should a proxy model be adopted if it is based on proprietary data that may not be available for public review?

No. See response to Question No. 45.

47. If it is determined that proprietary data should not be employed in the proxy model, are there adequate data publicly available on current book costs to develop a proxy model? If so, identify the source(s) of such data.

Actual costs submitted by each eligible carrier should be the basis for any high-cost mechanism. Under the current USF each LEC submits data that is used to calculate a cost and determine a payment based on the relationship to a nationwide average. This same approach could be used to obtain data for a new high-cost fund.

48. Should the materiality and potential importance of proprietary information be considered in evaluating the various models?

No proxy model should be adopted unless it and the data necessary to run the model is publicly available.

Competitive Bidding

49. How would high-cost payments be determined under a system of competitive bidding in areas with no competition?

Competitive bidding for universal service support should be rejected by the Joint Board and the Commission. This proposal may seem theoretically attractive but, if adopted, would result in the following consequences:

a) Allow manipulation of the process by new entrants. New entrants could selectively construct facilities to lower cost customers in high-cost areas. The remaining customers would be served via resale of the incumbent LEC's services or use of network elements. The new entrant is uniquely and unfairly advantaged in the competitive bidding process because the new entrant (as a result of its lower facilities cost to serve a few selected customers) can underbid the incumbent LEC which must provide facilities to all of the remaining higher cost customers.[6] Competitive bidding can work only in an environment where all competitors face equivalent regulations, including a requirement to build its own facilities to serve.

b) Competitive bidding is at odds with the Act. Competitive bidding discourages competition in rural and high-cost areas because as bidding manipulation discussed above occurs, new entrants will be less likely to construct facilities to serve high-cost customers. Their own tactics will serve to diminish the economic incentives to construct those facilities. Moreover, the incumbent LEC may be required to reduce service quality, to increase rates to its remaining customers in that area, or to place its financial viability at risk. Finally, the development and delivery of new and advancing services and technologies will be disincented in light of the manipulation and economic disadvantages. Each of these consequences go against the very grain of the Act.

c) Competitive bidding would result in additional layers of administration and regulation, which is in direct conflict with the intent of the Act.

50. How should a bidding system be structured in order to provide incentives for carriers to compete to submit the low bid for universal service support?

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[6] For instance, if in a universal service area the overall support requirement was $20 per loop per month, a new entrant could selectively provide facilities to secure higher volume, lower cost customers in that portion of the area where only $5 per loop per month is required. Competitive bidding would allow the new entrant to bid that $5 per loop per month, thus causing the overall support for the universal service area to be $5 per loop per month. The result is that the incumbent LEC, which is required to provide facilities to serve all of the higher cost customers (either to provide service directly or which are used by the new entrant to provide service) no longer secures "sufficient" support to maintain universal service to those higher cost customers. Competitive bidding where the new entrant is permitted to construct facilities to serve only a few lower cost customers in an area will result in manipulation of support levels for competitive reasons, will result in insufficient support, will have a detrimental effect on universal service, and should be rejected.

See SWBT's position above.

51. What, if any, safeguards should be adopted to ensure that large companies do not bid excessively low to drive out competition?

See SWBT's position above.

52. What safeguards should be adopted to ensure adequate quality of service under a system of competitive bidding?

Competitive bidding is inherently subject to the manipulations and consequences described above; SWBT is unaware of how to ensure adequate safeguards for quality of service under a competitive bidding scenario.

53. How is collusion avoided when using a competitive bid?

See SWBT's position above.

54. Should the structure of the auction differ if there are few bidders? If so, how?

See SWBT's position above.

55. How should the Commission determine the size of the areas within which eligible carriers bid for universal service support? What is the optimal basis for determining the size of those areas, in order to avoid unfair advantage for either the incumbent local exchange carriers or competitive carriers?

See SWBT's position above.

Benchmark Cost Model (BCM)

56. How do the book costs of incumbent local exchange carriers compare with the calculated proxy costs of the Benchmark Cost Model (BCM) for the same areas?

In an ex parte dated February 22, 1996 in CC Docket No. 80-286, SWBT provided a company-by-company comparison of the loop investment per loop/household, and the loop cost

per loop/household results of the BCM and 1994 Universal Service Fund data. A copy of that ex parte is attached hereto as Attachment 3.

57. Should the BCM be modified to include non-wireline services? If wireless technology proves less costly than wireline facilities, should projected costs be capped at the level predicted for use of wireless technology?

SWBT believes that support must be based on actual costs as stated herein.

58. What are the advantages and disadvantages of using a wire center instead of a Census Block Group as the appropriate geographic area in projecting costs?

SWBT supports using either an exchange or wire center definition for universal service area.

Advantages of Using Exchanges or Wire Centers Rather Than Census Block Groups:

1) It is consistent with the existing local exchange rate definition for customers.

2) It is well defined and data is tracked on an exchange or wire center basis.

3) Using existing areas keeps the amount of additional regulatory and administrative requirements at a minimum.

4) Census Block Groups (CBG) do not conform to existing LEC service area boundaries. Consequently, if CBGs are arbitrarily assigned, costs may be misallocated to a particular LEC and would not accurately portray actual universal service support requirements. Wire centers and exchanges do not suffer from this deficiency.

5) Using existing exchanges or wire centers to determine eligibility for universal service support does not disadvantage new entrants. If they had not planned to serve an entire exchange, they can simply use resale provisions to offer service to the remaining customers in the exchange.

59. The Maine PUC and several other State commissions proposed inclusion in the BCM of the costs of connecting exchanges to the public switched network through the use of microwave, trunk, or satellite technologies. Those commenters also proposed the use an additional extra-high-cost variable for remote areas not accessible by road. What is the feasibility and the

advisability of incorporating these changes into the BCM?

The question clearly demonstrates why proxy models are inappropriate. Certainly additional variables can be added. However, the constant need to modify and alter these models should lead one to question the validity and the credibility of the model producing results that must be adjusted. If the model does not produce accurate results, the model should be thrown out, not its outputs adjusted to make them right.

60. The National Cable Television Association proposed a number of modifications to the BCM related to switching cost, fill factors, digital loop carrier subscriber equipment, penetration assumptions, deployment of fiber versus copper technology assumptions, and service area interface costs. Which, if any, of these changes would be feasible and advisable to incorporate into the BCM?

See SWBT response to Question No. 59 and SWBT's position on proxy cost models.

61. Should the support calculated using the Benchmark Cost Model also reflect subscriber income levels, as suggested by the Puerto Rico Telephone Company in its comments?

Proxy models, however inappropriate, simply attempt to identify high-cost markets and some limited proxy of costs. They do not by themselves derive support levels.

Median household income can be used as one input in determining an affordable level of household expenditures for universal service. Costs above the affordable level would be considered "high cost" and eligible for explicit support. SWBT has supported 1.0% of a State's median income as an affordable level, thereby acknowledging the economic variances between States. Other programs such as Lifeline and Linkup deal directly with the ability of low-income customers to initiate and pay for telephone service.

62. The BCM appears to compare unseparated costs, calculated using a proxy methodology, with