

may be provided over the telecommunications services (transmission services) which are obtained pursuant to Section 254(h). Indeed, nothing in Section 254 prevents the resale of non-telecommunications services that are accessed by means of those telecommunications services which are eligible for universal service support. For instance, if a school or library obtained telecommunications services from a telecommunications provider and used them to gain access to non-telecommunications services such as the Internet or other enhanced service offerings, then the public institutional telecommunications user would be free to charge the public a fee for utilization of the Internet or other enhanced services (although not for the telecommunications service itself).

There would be significant problems associated with any plan to permit eligible entities to share, sell or transfer the telecommunications services obtained to non-eligible entities. For one, non-eligible entities should not be permitted to obtain the benefit of the universal service discount at which a school or library is able to obtain a telecommunications service, either directly or indirectly. Secondly, it would appear to be an insurmountable task to distinguish between eligible and non-eligible uses of the same telecommunications service by multiple entities.<sup>15</sup> Congress cannot have intended that the universal service provisions of the Act should be used to create a national subsidy which promotes bypass of telecommunications carriers' telecommunications services. If a school does desire to resell the telecommunications services themselves, it should be required to do so as a reseller without the benefit of any universal service discounts.

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<sup>15</sup> For instance, a school may have been able to obtain better rates through use of the universal service funding mechanisms and a competitive bidding process than it would otherwise have been able to obtain and should not be able to over-order capacity with the intent of reselling the excess. Otherwise, such entities could themselves become telecommunications service providers for their local communities, and distinguishing school and library-related "educational use" from other uses such as general business use within the community (especially where accomplished over residence lines) would appear to be virtually impossible.

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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?

As explained in the previous answer, no such sale, resale, or transfer for money or other thing of value is permitted. Of course, if the Commission determines otherwise, then, at a minimum, the discount made available to the public institutional educational user should not be permitted to inure to the benefit of the non-eligible entity which is the purchaser or transferee. To do otherwise would far exceed any reasonable interpretation of Congress' intentions in limiting the Section 254 discounts to a narrow category of entities.

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

Under BellSouth's FTS proposal, the nationwide size of the fund would be determined using the Partial Classroom Model. Then each school would be provided its allotted amount based upon criteria established by the Commission and possibly varying to account for social policy. For instance, each school could be provided with the same base amount plus some variable amount based upon factors such as the number of students. Each school would receive its allotted amount either directly or through an appropriate entity such as its school district or state, depending upon state or local law requirements.

The term "block grants" is inappropriate because it connotes competition between the recipients of the funds for those funds. On the contrary, under BellSouth's proposal each school would be allotted its amount based upon nationwide criteria.

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

It is unclear what the Commission means by "direct billing credits." If this means the FTS approach, then the answer is in the affirmative. Under FTS each school would have a dollar amount of support allotted to it and would be permitted to utilize such amount among one or more telecommunications carriers and one or more services. The school could be provided with vouchers or an electronic funds account to be used for payment to the telecommunications carrier or carriers providing the service or services for which the school desires to utilize all or a portion of its allotted funds. The telecommunications carrier(s) would then submit the necessary documentation to the administrator of the universal service fund for receipt, in turn, of reimbursement (or credit against its obligation to contribute to the universal service fund) in the amount shown.

For health care, a credit or voucher system would not be required. Rather, the bill to the rural health care provider would simply display the urban rate as the charge being assessed. It would then be incumbent upon the telecommunications carrier providing the service to report to the administrator of the universal service fund the rate assessed, the rate for the comparable service in rural areas, and the difference between the two in order to obtain a credit toward its obligation to participate in universal service mechanisms. Of course, some auditing mechanisms would appear to be needed to assure straightforward compliance with such a reporting mechanism.

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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.

Whatever mechanism is chosen to assure that universal service funds are used for their intended purpose should be one which does not impose unnecessary or burdensome administrative processes or duplicate educational administrative channels at the front end. BellSouth urges that a means be found to assure that the school recipient of the funds has a plan to utilize such funds consistent with some legitimate educational technology plan, whether at the state, school district, or school level. Some states or school districts already have such plans and a means for overseeing an individual school's own plans.

The Commission should encourage states and/or school districts which do not have such plans to formulate them in order to afford individual schools with the guidance which may be needed once funds become available. Individual telecommunications service providers should not be the entity responsible for enforcing a school's use of universal service funds for educational purposes. There may be a role for each school district or state, or even the universal service fund administrator or the Commission, in obtaining reports from schools on the use of funds and/or auditing such use, as may be deemed necessary from time to time, in order to monitor the use of the universal service funding and its impact on the advancement of educational technology in schools. Schools and school districts already have budgeting and reporting processes that universal service matters could be incorporated into. For private schools, libraries and rural health care providers, similar monitoring, reporting and auditing could be performed for the universal service support which they receive.

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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)?

It is recognized that a process which is burdensome or complicated would not be desirable. On the other hand, there is a need for coordinated and compatible educational technology plans. One means for determining bona fide requests could be for each school district to publish a list of those schools which it certifies are in compliance with the district's education technology plans, are prepared to implement telecommunications services for educational purposes, and are therefore eligible to make bona fide requests for services under the Commission's universal service program. There may also be a role for the state to determine which are eligible institutions for universal service under the Act. Similar mechanisms would need to be found for private schools, libraries and health care providers. It is unlikely that such processes would be abused, but the Commission should address what remedies would be appropriate in such an event.

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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 costs; (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?

Rates established through a competitive bidding processes should provide the base service prices for schools and libraries to which the FTS amount allotted to the school or library could be applied. This would allow the competitive marketplace to determine the most efficient prices prior to the school/library's purchase of the service using its flexible discount funds. Such an

approach would be consistent with the fundamental goal of the Telecommunications Act of 1996 to increase competition and decrease regulation. Indeed, such an approach would be more realistic than discounts off of “tariffed” rates given that, as competition increases, fewer and fewer carriers will be filing tariff rates for their services, and negotiated prices will become more prevalent. Moreover, such an approach avoids the complexity and lag time of other suggested approaches such as trying to determine the lowest price at which the same or comparable service arrangement has been offered to other customers,<sup>16</sup> or the total service-long run incremental cost of the service arrangements.<sup>17</sup> Such an approach would avoid the need for collecting and monitoring data for the broad and increasingly expanding range of services which are provided by so many different service providers to so many different customers.

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

Under the FTS approach a school or library could obtain the service at the existing “special rate,” and apply its allotted amount to that “special rate,” or it could request competitive bids for a new competitively bid rate and could apply its allotted amount to that competitive bid.

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<sup>16</sup> Any attempt to tie the base service price to the best commercially-available rate could lead to an endless downward spiral. Some LECs today in some states already have the obligation to provide service to the state at the lowest price at which service is offered to any other entity. If such a LEC today were required to provide service to public institutional telecommunications users at a discount off of such rates, then it would, in turn, have to adjust downward the rate at which such service is provided to the state government, which would, in turn, require a downward adjustment at which the service is provided to the public institutional telecommunications user, and on and on.

<sup>17</sup> As BellSouth indicated in its response to Question # 9 note 13, the TSLRIC also has the disadvantage of potentially disincanting carriers from actively seeking out the business schools and libraries and from actively attempting to identify innovative solutions to their service needs.

rate. A rural health care provider could choose not to continue to take service under the existing "special rate," if it already has a better rate than the urban rate, or it could submit a request for service under Section 254(h)(1)(A) to obtain the benefit of the urban rate.

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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.

In response to education's need to offer students the advantages of information technology, BellSouth already has arranged special pricing for educational institutions. Many of these offerings are in the form of discounted exchange line rates and distance learning networks. From 1991 through 1995, the value to education of these BellSouth offerings was approximately \$57 million per year. For example, in Alabama, Georgia, Louisiana, Mississippi, Tennessee and South Carolina a potential savings to schools of \$47 million per year is offered in the form of discounted exchange lines into the classroom. Additionally, in Louisiana, Mississippi and Tennessee, BellSouth offers ISDN, SynchroNet or Megalink services at special rates to support interactive video, Internet access, and other information services, with a potential savings to schools of almost \$10 million annually.

In Florida, a 1996 Education Facilities Infrastructure Improvement Act established a procedure that allows providers to bid on telecommunications services to eligible entities, including schools and libraries. Winning bidders agree to deploy the infrastructure to provide connections to the eligible facility at no cost, not to exceed \$20,000 per eligible facility. In Georgia, Kentucky and North Carolina, BellSouth is a vendor or primary contractor for a state-wide network that provides eligible entities, including schools and libraries and health care providers, with special rates for their telecommunications services. These state networks include

the North Carolina Information Highway, the Georgia Statewide Academic and Medical (GSAMS) network, and the Kentucky Information Highway.

BellSouth has also collaborated with education and government leaders to test the use and value of the BellSouth network for distance learning, with a company investment of over \$16,500,000 during the 1990's for infrastructure, technical services and support of distance learning trials. Interactive networks connected various entities in a variety of combinations to learn about both the technical and educational requirements for effective learning over the network. The company's physical investment was augmented by support for education research, teacher training, community affairs and foundation organizations. The trials were instrumental in identifying the potential for the more comprehensive concept of an information highway and for advances in educational understanding of the teaching and learning process.

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19(a). Should an additional discount be given to schools and libraries located in rural, insular, high-cost and economically disadvantaged areas?

This is a social issue which should be decided by the Commission. The FTS approach could easily allow for such considerations, as the amount allotted to schools and libraries located in such areas could be increased above the usual amount.

19(b). What percentage of telecommunications services (e.g., Internet services) used by schools and libraries in such areas are or require toll calls?

BellSouth does not have the data which would be required to answer this question.

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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?

This is a question which would appear to be appropriately addressed by the educational community and social policy makers

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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?

This question appears to be most appropriately addressed to the education community and social policy makers. BellSouth suggests, however, that unduly complex rules not be established. It would appear that the more complicated the approach is, the more burdensome the process becomes. If the Commission does determine to use a graduated approach, then the FTS approach suggested by BellSouth would be easier to administer as the funds to each individual school would be determined at the outset when each school is assigned its allotted universal service fund amount.

By comparison, if the universal service program were administered by means of set discounts for eligible services, with discounts varying school-by-school based upon the extent to which each given school is determined to be disadvantaged, administration of those multi-level discounts could become unduly burdensome and confusing to both schools and telecommunications carriers alike.

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

As BellSouth described above in its response to Question #6 the mechanisms for providing universal service support to rural health care providers and to schools and libraries are different. Under Section 254(h)(1)(A), "reasonably comparable" rates to urban rates apply, and the support is measured by the difference in the rates for rural health care providers and rates for similar service provided to other customers in comparable rural areas. Under Section 254(h)(1)(B), the Commission and states set the amount of the discount to be supported by universal service support. For an FTS mechanism under Section 254(h)(1)(B) for schools and libraries, the total amount of the Section 254(h)(1)(B) portion of the fund would be determined, as well as each school or library's allocable share of the total. These amounts could be drawn upon by a telecommunications carrier when it submits to the fund administrator its documentation, received from the school or library customer, either as reimbursement or as an offset to its universal service obligation.

Separate funds would be appropriate given these diverse mechanisms. If only one fund is established, then separate accounting practices would need to be established and strictly maintained.

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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 Report and NII KickStart Initiative certainly represent a concentrated effort to determine an accurate funding estimate to connect schools and libraries. Although private schools were not included, it would appear that analogous funding estimates for private

schools could be extrapolated and the total funding estimate increased accordingly. Above all, it is important that the size of the fund for schools and libraries be established so that contributors will know the amount of the contribution required. If the initial fund size is later determined to be inappropriate based upon experience gained over time, modifications could be made for subsequent years.

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

The McKinsey Report lists three other studies which estimate “the national costs of connecting all public schools to the NII.”<sup>18</sup> BellSouth is not aware of any similar study for rural health care providers.

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

BellSouth is not aware of any. However, it would appear that the per school funding amounts estimated by the McKinsey Report could provide useful data for extrapolating the costs for private schools.

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<sup>18</sup> McKinsey Report, Appendix B

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**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 existing high cost support fund (the existing Universal Service Fund which is administered by NECA) is not sufficient to handle the funding of universal service in a competitive environment. It would require such substantial modification to comply with the Telecommunications Act that it makes more sense to simply start over and design a new fund which accomplishes the goals of the Telecommunications Act. The current USF provides minimal levels of explicit support to large companies since it generally only deals with about 10% of the costs that are in excess of 115% of the nationwide average cost. Other than costs assigned to the interstate jurisdiction by the jurisdictional separations gross allocator, the remaining loop costs over 115% (but less than 150%) are the responsibility of the states, and, as such, they are mostly recovered via implicit support. Another problem is that the current support is calculated at the statewide level rather than for smaller areas within the state and therefore is not targeted to the truly high cost areas.

Furthermore, the existing high cost support mechanism can only work where there is a single provider of local exchange service. Once competition is authorized, companies should transition to the new mechanism, or else the existing high cost mechanism will need to be modified to allow multiple eligible carriers in a given area.

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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?

BellSouth makes no specific recommendations at this time

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28. What are the specific 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?

BellSouth assumes this question is addressing the new federal support mechanism envisioned by the Telecommunications Act of 1996, not the existing high cost mechanism

As BellSouth noted in its comments, there are considerable advantages to calculating support for all eligible carriers based on the incumbent LEC's book costs. Those book costs provide a reliable estimate of the cost of providing service in that area. They are not theoretical in nature, but instead are grounded on the actual cost involved in building and operating a network throughout the given area

As pointed out in Gordon and Taylor [pp. 9-14], basing payments *initially* on the incumbent's book costs encourages competitors with incremental costs lower than the incumbent's incremental costs to *eventually* win over the opportunity to provide service (i.e., to win over the incumbent's customers). This is because the support that is initially set equal to the difference between the universal service rate and the incumbent's per-line book cost may prove to be greater than that needed by a competitor with a lower *incremental* cost to match the price at which the incumbent provides service. In fact, by receiving the full amount of the support received by the incumbent, the more efficient competitor could offer the same service at a price *below* that set by policy. This could encourage customers to shift to the more efficient

competitor. This process has several advantages. First, the portable support payment ensures that the most efficient competitor eventually serves the customer.<sup>19</sup> Second, it provides a strong incentive to the incumbent to become more efficient. Third, it offers the incumbent the opportunity to recover its past and present, prudently-incurred, *actual* costs. Fourth, the support payment can be determined easily by reference to the incumbent's well-publicized book cost, without requiring contentious and protracted proceedings for establishing the incremental costs of all competing providers. Finally, it avoids the need for unproven mechanisms like cost proxy models or competitive bidding processes to determine the initial level of support; the market mechanism ensures that support goes to the most efficient provider.

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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?

Within any given area, high-cost support should be provided on a consistent basis to any eligible carrier serving the area. With regard to the new universal service fund that is envisioned by the Telecommunications Act, it would be contrary to the Act to deny support to an "eligible" carrier because of the way it is regulated. Indeed, the fact that the act calls for support to be provided to multiple "eligible carriers" in any area served by a non-rural company clearly shows that companies other than rate-of-return companies should be eligible for support.

The Joint Board and the Commission could, if it wished, initially leave the existing high cost support mechanisms in place for those areas served by "rural" companies and in which

<sup>19</sup> As was noted in BellSouth's original comments, if a component of universal service support is established to deal with the reserve deficiency, then this component of support should only be available to the carrier that incurred the reserve deficiency (i.e., it should not be portable).

competition has not been authorized as well as establish a comprehensive universal service mechanism. Such a bifurcated approach should eventually transition to a single nationwide approach to funding universal service.

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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?

With regard to the new comprehensive universal service fund that the Act requires that the Commission establish, Section 214(e) does not permit eligibility to be differentiated by class of carrier. Once a carrier is designated as an eligible carrier, such carrier “shall be eligible to receive universal service support.” (Section 214(e)). The Act establishes the criteria to become designated as an eligible carrier. The criteria are based on providing universal service to an area and advertising to the public.

With regard to the existing high cost support mechanisms, there may be an occasional instance under a bifurcated approach where a “rural” company serving an area in which competition has not been authorized is operating under price cap regulation. In this case, the price cap carrier already has a huge incentive to operate as efficiently as possible and keep operating costs at an efficient level. In this case, there is no need to deviate from the same standard of actual costs that is used for rate of return companies.

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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?

“Rural” companies are defined in the Telecommunications Act. BellSouth recommends that the Act’s definition be used. To the extent a bifurcated approach is adopted, it should only be an interim approach; long-term, all areas and companies should transition to the new, comprehensive universal service support mechanism mandated by the Act.

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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?

Eventually, those companies operating under the “old” system should transition to the new federal universal service fund so long as new entrants are treated the same as incumbent LECs; this transition can be done on a gradual basis.

The difficulty with any transition will be to ensure that it is done in a manner that is initially revenue neutral. As was noted in response to question 3, proxy costs should never be mistaken for actual operating costs. Companies need to continue to have the opportunity to recover their actual costs. Thus, if universal service support is ratcheted down during some transition from book costs to proxy costs, then the affected companies would need to be provided the opportunity to raise other rates to capture the shortfall. It is imperative that all companies at least have the opportunity to recover their book costs.

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33. If a proxy cost 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 level of subscription should have nothing to do with the proper specifications of the proxy model or the existing high cost fund and DEM weighting mechanism. As all carriers transition to the new universal service funding mechanism there will no longer be a need for separate loop cost and switching cost support mechanisms. The proxy model, if done properly, should account for the cost of switching and loop in a combined manner. Of course, implementation requires revenue neutrality. If the existing level of high cost support and DEM weighting support exceeds the amount that a given company would receive from the new universal service fund, then that company would need the ability to adjust the prices of its services to make up the reduction in support.

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**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?

If the proxy model is sufficiently detailed, then it should capture all of the variables that could cause costs to be high in insular areas. This question points out the importance of ensuring that the proxy model is properly specified in order to produce a reasonable result; i.e., - it should produce costs that will ensure that the universal service support is sufficient to attract telecommunications services providers. It is interesting to note that book costs cannot be used in areas that are currently unserved, since book costs do not exist.

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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 Board’s recommended decision

If an industry task force is used, it must operate under a strict timetable in order to ensure it completes its work in time to be used by May 1997. The industry task force must not be used as an excuse to indefinitely postpone the implementation of a new universal service fund. It is also doubtful that any industry task force that includes certain carriers such as AT&T and MCI would accomplish anything. In general, these carriers benefit from the status quo and have little incentive to build a consensus to resolve the complicated cost issues.

If the industry task force is limited to working on a proxy cost model that is to be presented to the Joint Board and the Commission for their consideration solely for the purpose of converting implicit support to explicit support in a revenue neutral manner, then there should not be any legal obstacles to the task force. A task force created for other purposes certainly could present competitive problems and give rise to legal issues that would have to be resolved. It is impossible and inappropriate to speculate what the precise issues might be without a specific proposal.

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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?

The Benchmark Costing Model has been substantially revised to respond to criticisms from numerous parties (including BellSouth). BellSouth is in the process of reviewing the

Benchmark Cost Model 2 which was filed with the Commission by Sprint and US West. It is our understanding that the Hatfield Model has not been made generally available for review. In addition, any claims that the Hatfield Model incorporates key elements of the Benchmark Cost Model are specious. Based on what is available, it appears that the Hatfield model only selects from other models where such selection results in lower cost numbers. The purpose of a proxy cost model should be to produce the best estimate of the economic cost of providing the service. It should not be rigged so as to simply produce the lowest possible result.

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

A properly specified proxy model will estimate the forward looking cost of providing only the defined universal service core services, though it should include a reasonable share of joint and common costs. It is BellSouth's understanding that both the Benchmark Cost Model and the Cost Proxy Model produce results for basic local exchange service (which is the proposed definition for universal service).

Of course, it is important that economic engineering designs and other key inputs be properly specified. The challenge of designing a suitable model is to specify the appropriate inputs.

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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?

If the definition of the core services included within universal service change significantly (for example, to include ISDN and/or broadband services to every home), then the proxy cost

model would need to be totally revamped. The engineering designs underlying the model would change as would other key inputs. All of the relationships between various inputs would need to be reviewed.

With regard to changes in the model to account for changes in technical capabilities, BellSouth believes the model should not be constantly revised. Instead, the model should be used only to calculate initial levels of support. Subsequently, support could be decreased over time to represent improvements in productivity through use of an inflation based productivity factor.

If universal service support were constantly recalculated to reflect changes in technical capabilities, then the result would be unpredictable changes in the level of universal service support. Such an approach would violate the principle of the Telecommunications Act that federal universal service support be specific and predictable.

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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?

The proxy model should be limited to estimating the cost of the core services. Of course, the core services proposed in this NPRM, when combined with a computer and a modem, provide access to the Internet and other information services.

With regard to other more advanced services, Section 706 of the Act calls for a proceeding to address advanced telecommunications services.

One last point relates to calculating support for advanced services to schools and libraries. If the schools and library fund is set-up as proposed by BellSouth, then there is no need to calculate proxy costs for individual advanced services. Schools and libraries would get the best

possible prices they can in the competitive marketplace and they could then use their fund dollars towards those competitively negotiated rates.

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40 If a proxy cost 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?

Use of an affordability benchmark rate will ensure that service is priced at reasonably comparable rates in all urban and rural areas. The affordability benchmark rate will effectively set a ceiling rate for each state. So long as service is priced below the ceiling, the service should be considered affordable and price should be viewed as “reasonably comparable.”

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

A properly structured proxy cost model can calculate proxy costs for all areas, including insular areas and Alaska. Indeed, the Benchmark Cost Model 2 does include results for Alaska.

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

Encouraging infrastructure development and service quality improvements requires that service providers be assured the opportunity to recover the costs they incur in the process. Innovation and infrastructure development often involves undertaking investments that are risky, made even more so by the presence of vigorous market competition. If service providers cannot recover the embedded costs of those investments, they will likely forego any effort to innovate and improve.

So long as any new universal service fund is implemented in a revenue neutral manner (see response to question #3), incumbent LECs will continue to have an incentive to invest in their infrastructure. As long as the support is set at a sufficient level (i.e., not based on an unrealistically low proxy cost), then multiple companies will have incentive to provide service in any given area. In such a situation, competition will ensure that service quality remains high. Of course, in the meantime, there will still be regulatory oversight of items such as service quality

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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?

A proxy model produce *hypothetical* costs that are not specific to, or even necessarily representative of, a service provider's *actual* book costs. Therefore, the possibility certainly exists for book costs to exceed substantially the costs produced by a proxy model. Since service providers have to recover their actual -- not hypothetical -- costs to stay viable, it is critical that alternative recourse be available to those providers for whom support payments are insufficient to recover their actual costs. Thus, the best approach for costing out a universal service fund is to base it on actual embedded costs. If, however, a proxy model costing approach is adopted, it is absolutely imperative that the new universal service fund be implemented in a revenue neutral manner. If a company is forced to reduce rates by more than it receives out of the universal service fund, then that would abrogate the federal price regulation plan that is in place, and it could well result in confiscation.

Another possible problem could occur for a small company that is currently receiving more support from the existing high cost fund and the DEM weighting mechanism than it will

receive from the proxy cost model universal service approach. If such an outcome occurs, then this company would need the opportunity to adjust its prices to maintain revenue neutrality.

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

As pointed out by Gordon and Taylor (p. 15), technological neutrality is best ensured by setting the initial level of support with reference to the incumbent provider's book cost. Under that approach, if alternative technologies prove to be more efficient than that of the incumbent, entry by new firms adopting those technologies would occur. For example, new entrants may find wireless technology a superior and more economical alternative to the incumbent's wireline-based mode of service provision in rural or sparsely-populated areas. In any event, the technology choice of more efficient entrants will not be affected by the incumbent's technology.

The outcome of the cost proxy model by definition should be technologically neutral. Any carrier that is an "eligible carrier" would be able to collect universal service support regardless of the technology it uses to provide service. For example, even if the proxy cost model assumes copper cable as the most efficient technology to serve a given customer, an eligible carrier could use any technology (fiber optic, coaxial cable, wireless technology, etc.) available to it and still receive the same level of universal service support.

No modifications need to be made to the model to ensure technological neutrality, provided that reasonable specifications are set at the beginning. The model will, then, reflect the most theoretically efficient technology for providing the core services on a universal service basis. Also, as noted in response to question #38, if the cost proxy model is constantly updated to

reflect more efficient technologies, then the model would result in unpredictable levels of support, contrary to the principles of the Telecommunications Act.

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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?

While the proxy model does not necessarily need to be made public, all of the algorithms and inputs need to be made available for detailed inspection by any party willing to execute a confidentiality agreement. Thus, a cost model such as the Hatfield Model, which is built on hidden algorithms and which is not available for inspection, is not suitable for use in calculating universal service support.

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

See the response to question 45.

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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.

Publicly available data should be available. List prices for cable and equipment should be obtainable from a wide variety of vendors. Installation and contractor prices should also be obtainable. The Benchmark Cost Model is based on publicly available data, and its inputs could be used as a starting point. AFMIS data, which is filed annually with the FCC, could be used to calculate overhead cost estimates.

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

As long as the model specifications and the inputs necessary to meet those specifications are publicly available, then it should not matter if the actual data is proprietary.

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**Competitive Bidding**

49-55 How would high-cost payments be determined under a system of competitive bidding in areas with no competition? 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? What, if any, safeguards should be adopted to ensure that large companies do not bid excessively low to drive out competition? What safeguards should be adopted to ensure adequate quality of service under a system of competitive bidding? How is collusion avoided when using a competitive bid? Should the structure of the auction differ if there are few bidders? If so, how? 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?

Any bidding process will be subject to considerable gaming. A simple example illustrates the potential for gaming. According to the Telecommunications Act, a carrier can be "eligible" for universal service support if it provides universal service through a combination of its own facilities and resale. Thus, a company need only provide one loop over its own facilities to be considered "eligible" for universal service support. This company, if allowed into the bidding process, might bid zero simply to put a financial squeeze on the underlying facilities based carrier. The winning bidder, which is primarily a reseller, does not need any support (except for its one loop). However, the low-ball bid effectively ends support for the underlying facilities based carrier. This carrier needs support but it is unable to obtain it because of the zero bid by the reseller. If the reseller were a major interexchange carrier, it would have both the incentive and