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October 8, 1996

EX PARTE OR LATE FILED

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EX PARTE

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

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OCT - 8 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: *In the Matter of Federal-State Joint Board on Universal Service,
CC Docket No. 96-45*

Dear Mr. Caton:

In accordance with the Commission's rules governing ex parte presentations, Southwestern Bell Telephone Company (SWBT) hereby submits a detailed analysis of universal service support that uses actual book costs. SWBT's analysis is provided on hard copy and CD-ROM. SWBT requests that this analysis be included in the official Commission record in this docket.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, 47 C.F.R. Sec. 1.1206(a)(1), two copies of this letter, the analysis, and the supporting materials are provided for your use.

Should you have any questions concerning the foregoing, do not hesitate to contact me.

Sincerely,

Attachments

- cc: The Honorable Reed E. Hundt
- The Honorable Susan Ness
- The Honorable Rachelle B. Chong
- Ms. Kathleen B. Levitz
- Mr. John Stroman Morabito

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"The One to Call On"

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Paul L. Cooper
Division Manager
Separations and Settlements

Commissioner Julia Johnson:
Commissioner Kenneth McClure:
Commissioner Sharon L. Nelson:
Commissioner Laska Schoenfelder:
Ms. Martha Hogerty:

My letter to you on October 7, 1996 transmitted a binder containing Southwestern Bell's analysis of Universal Service support based on actual book costs and revenues for all States and for each LEC in those States. As promised in that letter, enclosed is the CD referenced in Attachment 4 which contains detail by wire center along with all calculations used in the analyses. The attached revised Attachment 4 contains descriptions of the data and spreadsheets on that CD.

We will be glad to discuss the information with you at your convenience.

Thank you,

Paul L. Cooper

Enclosures

CC: Commissioner David Rolka
Mr. Charles Bolle
Ms. Deonne Bruning
Ms. Lorraine Kenyon
Ms. Debra Kriete
Mr. Mark Long
Mr. Sam Loudenslager
Mr. Phillip McClelland
Ms. Sandra Makeeff
Mr. Terry Monroe
Ms. Lee Palagyi
Mr. Paul Pederson
Mr. James Bradford Ramsay
Mr. Brian Roberts
Ms. Debbie Waldbaum

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St. Louis, MO 63101-3099

Phone 314 235-8111

LIST OF INFORMATION PROVIDED ON COMPACT DISK (CD)

This attachment lists files provided on CD. These files contain data and spreadsheets used to estimate actual revenues and costs and to calculate support amounts. The files provided are listed and described below.

- 1) NW93COST.WK4 - Contains a Lotus Spreadsheet Model and Data used to estimate actual costs and revenues by study area.
- 2) WC-COST1.WK4 thru WC-COST6.WK4 - Contains wire center level data including BCM2 costs, BCM2 lines, and factors used to estimate actual wire center lines, costs and revenues. This file also contains calculation of the Universal Service support amounts for three different analyses:
 - i) Support based on actual costs and actual revenues.
 - ii) Support based on actual costs and one percent of state median income.
 - iii) Support based on BCM2 costs by wire center and actual revenues.
- 3) ACT-FCT.WK4 - Shows calculation of study area factors utilized to develop actual costs and lines by wire center. These factors were applied to BCM2 wire center costs and lines to estimate actual wire center costs and lines.
- 4) State Detail Files - Lotus spreadsheets which summarize the wire center analyses to a state level of detail. The spreadsheets contain data for all states for Attachments 2, 3 and 5. The files are:
 - i) ATT2ST.WK4
 - ii) ATT3ST.WK4
 - iii) ATT5ST.WK4
- 5) Company Detail Files - Lotus spreadsheets which summarize the wire center analyses to a company or a study area level of detail. The spreadsheets contain data for all companies for Attachments 2, 3 and 5. The files are:
 - i) ATT2CO.WK4
 - ii) ATT3CO.WK4
 - iii) ATT5CO.WK4

 **Southwestern Bell Telephone**

Let's Get to Call On!

October 7, 1996

Paul L. Cooper
Division Manager
Separations and Settlements

Commissioner Julia Johnson:
Commissioner Kenneth McClure:
Commissioner Sharon L. Nelson:
Commissioner Laska Schoenfelder:
Ms. Martha Hogarty:

In our recent discussions with you, we emphasized the importance of using actual incumbent LEC local exchange book costs as the starting point in the development of a Universal Service Fund. These actual costs are the real costs that have made universally available network access for local and toll services a reality in each of your states. Basing a fund on actual costs (rather than costs developed by a hypothetical proxy) will ensure that sufficient support revenues are available to continue the provision of a universally available network, irrespective of whether the facilities for that network are provided by incumbents or new entrants. We also emphasized that the fund should be divided between the federal and state jurisdictions based on current jurisdictional boundaries. This will (1) allow the state jurisdictions to account for differing levels of intrastate support for local exchange costs due to differing local, intraLATA toll and access rate designs; (2) minimize support flows between states and; (3) allow the states to reduce their state fund if they choose through rate restructuring. To provide insight regarding Universal Service support, SWBT is providing herein an analysis of Universal Service support based on actual book costs and revenues by wire center.

As a result of the recent FCC Interconnection Order, the current supports for Universal Service, both interstate and intrastate, are at significant risk. These supports, which allow the LECs to maintain a universally available local exchange network with reasonable local exchange rates, include interstate and intrastate carrier common line (CCL) and intrastate, intraLATA toll revenues and vertical service revenue to provide for local exchange network cost recovery.

The FCC's Interconnection Order has defined a methodology for network element rates which will artificially jump start competition, particularly for the high-volume, profitable customers. However, the Order and the pricing methodology it establishes:

- a) Does not generate sufficient revenue to provide for recovery of the actual cost of facilities used to provide Universal Service particularly in rural, low-volume areas;

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- b) Eliminates the recovery of legitimate interstate loop (CCL) costs which support universally available local access at reasonable rates; and
- c) Effectively limits the state's ability to recover legitimate intrastate loop costs in intrastate CCL and intraLATA toll rates, which also support universally available local access at reasonable rates.

Moreover, the FCC placed the burden of maintaining the Universal Service support that it eliminated in that Order, on the CC Docket 96-45 Joint Board. This support can be maintained by the Joint Board if the actual costs necessary to serve customers in all areas of a state (urban, suburban, and rural) are utilized in the Universal Service support calculation. The current universally available local exchange network should not be placed at risk by resorting to theoretical and hypothetical proxy calculations of local exchange network costs to develop Universal Service support requirements. The reality of maintaining Universal Service necessitates that actual costs which have stood the test of time and appropriately measure the cost of Universal Service (i.e., the actual book costs) be utilized by the Joint Board.

The analyses attached to this letter (Attachments 1 to 7) are provided for the Joint Board's consideration of the following:

- a) A method to utilize actual book costs to develop Universal Service support.
- b) Universal Service support calculations using estimated actual local exchange book costs for all States and LECs in those States. SWBT will provide a CD containing this information by the middle of next week.
- c) Information regarding the Benchmark Cost Model 2 (BCM2) proxy model and improvements that can be made in that model so that it can be used in conjunction with actual costs to develop Universal Service support.
- d) Other information requested by the Joint Board Staff.
- e) An analysis of the interstate Residual Interconnection Charge (RIC) filed by SWBT in CC Docket 91-213, which shows that the RIC represents legitimate transport costs for non-urban, low-volume areas and tandem switching costs (Attachment 7). This information is provided because the FCC, in its Interconnection Order indicted that this support will also be eliminated and dealt with by the Joint Board. In Docket 91-213, the FCC again made decisions that were aimed at promoting competition by instituting non-compensatory high volume rates for transport services, and by excluding costs from the common transport rates. These legitimate costs were included in the RIC in order to ensure that small lower volume IXCs

were able to have rates comparable to larger higher volume IXCs. To imply now that the RIC or TIC, as the FCC refers to it, does not contain legitimate costs is clearly wrong. The costs in the RIC are (1) the 80% of tandem costs that were arbitrarily excluded from transport rates by the FCC and; (2) lower volume, higher cost transport rates to largely rural areas and to non-urban independent telephone companies whose costs were not recovered by the arbitrary high volume transport rates established by the FCC. As SWBT demonstrated in its CC Docket 91-213 filing, the RIC supports allowed maintenance of reasonably priced access to toll in these lower volume, largely non-urban areas. Consequently, in order to preserve reasonably priced largely non-urban access to toll, and as a result of the FCC Interconnection Order, if the RIC is not recovered in access reform then SWBT recommends that 100% of the RIC (interstate and intrastate) be assigned to the respective federal and state Universal Service funds.

Finally, although SWBT believes that new eligible carriers should justify with their costs, their own level of USF support, these new entrants should receive no more support per loop in a Universal Service area than does the incumbent. In order to qualify for the support, to ensure equity in funding and to avoid gaming the USF, eligible carriers:

- a) Must meet State Commission (or if there are none, Joint Board recommended) quality of service requirements. This will ensure that a quality network and service is maintained as required by the Federal Act.
- b) Receive support only for the facilities they own and construct to a customer. No eligible carrier should receive support for service provided to a customer through resale or use of unbundled facilities. It is the underlying facilities which ensure the provision of Universal Service directly to customers, through resale or through use of unbundled facilities, and the carrier which provides those facilities should receive the support, particularly in view of the fact that both resale and TELRIC unbundled rates are not compensatory.
- c) No eligible carrier should recover Universal Service support in an area if the incumbent does not receive support.

SWBT believes that the fund should be paid for based on a surcharge on interstate retail revenues for a federal fund and individual state intrastate retail revenues for intrastate funds.

We appreciate the consideration given by the Joint Board and its Staff to this information, and hope that it proves useful in developing appropriate Universal Service funds in the interstate and intrastate jurisdictions.

Page Four
October 7, 1996

We will be glad to discuss the attached information with you at any time, and to provide any further analysis you request.

Thank you,

A handwritten signature in cursive script that reads "Paul L. Cooper".

Paul L. Cooper

Attachments

**CC: Commissioner David Rolka
Mr. Charles Bolle
Ms. Deonne Bruning
Ms. Lorraine Kenyon
Ms. Debra Kriete
Mr. Mark Long
Mr. Sam Loudenslager
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ACTUAL COST

UNIVERSAL SERVICE SUPPORT FUND ANALYSIS

A. UNIVERSAL SERVICE FUND SUPPORT BASED ON ACTUAL LOCAL EXCHANGE NETWORK COSTS

Attached to this letter are two Universal Service Support analyses based on actual LEC local exchange costs. Each of the Universal Service Support analyses is calculated using actual local exchange study area costs by LEC, by state.¹ The actual local exchange study area costs are distributed to Universal Service areas (wire centers) based on either an actual cost analysis by wire center or, if that analysis is not available, by using BCM2 costs to distribute the LECs actual study area local exchange costs to the LEC's wire centers. Shown below are the Universal Service support amounts from the analyses. Also shown are the approximate interstate and intrastate portions of this support.

<u>Analysis</u>	<u>Total Fund</u>	<u>Interstate Portion</u>	<u>Intrastate Portion</u>
1. Actual costs by wire center above the average local exchange revenues (residence, business, vertical service ²) are assigned to the fund.	\$19.8B	\$5.0B	\$14.8B
2. Actual costs by wire center above 1% of the state median household income are assigned to the fund ³ .	\$21.8B	\$5.0B	\$16.8B

The differences in the size of the Universal Service support calculated in these two analyses results from different thresholds or benchmarks to which the actual local exchange costs by wire centers are compared.

The support calculated in the first analysis reflects the total level of actual local exchange costs that have been recovered in rates for other services (interstate CCL, intrastate CCL,

¹ SWBT calculated an estimate of the actual local exchange study area costs for each LEC based on publicly available data.

² Vertical service revenues provide significant support to maintain reasonable residential local rates. These revenues are also at risk of being lost due to the FCC's Interconnection Order.

³ This analysis is similar to that used by USTA to arrive at the support fund amounts submitted to the Joint Board in its letter dated October 3, 1996.

intrastate intraLATA toll and other services) in order to provide a universally available local exchange network with local exchange rates at their current levels. In addition, there may also be local exchange revenue support (above the local exchange costs) that flows primarily from lower cost urban wire centers to support rural, high-cost wire centers.

SWBT believes that Universal Service support should be jurisdictionalized based on the current interstate and intrastate recovery of local exchange support. Consequently, the interstate portion of the Universal Service support is the current interstate CCL (plus LTS) recovery and DEM weighing support and the current Universal Service fund recovery by LEC. The remaining portion of the Universal Service support is assigned to the intrastate jurisdiction. The initial LEC support funding amount in each jurisdiction would be used to eliminate, on a revenue neutral basis, recovery of local exchange network costs from, interstate and intrastate CCL (plus LTS), intrastate intraLATA toll and vertical service rates. The current Universal Service fund will be included in the new interstate fund, thus the existing fund would be eliminated. The reduction in access rates should be flowed through on a dollar for dollar basis to reductions in interLATA toll rates.

The support calculated in the second analysis is different than the first because the threshold for determining support funding (1% of median household income by state) is different (higher or lower) by LEC than the average local exchange revenues. The fund in the second analysis should be jurisdictionalized in the same manner as occurred in the first analysis and the jurisdictional fund revenues by LEC should be used to reduce interstate and intrastate CCL (plus LTS), intrastate intraLATA toll rates and vertical service on a revenue neutral basis. Again, the existing USF could be replaced and the reduction in access rates should be flowed through on a dollar for dollar basis to reductions in interLATA toll rates. Where 1% of the median household income is above the actual local exchange revenues received in an area, additional intrastate support must be addressed. State Commissions should be responsible for either restructuring rates or augmenting the State fund to deal with the remaining intrastate CCL and intraLATA toll support. In those cases where 1% of median household income is below the average local exchange revenues as it is in the aggregate results of the analyses shown previously (\$21.8B less \$19.8B equals \$2B), the additional support produced by the fund could be used to reduce, on a revenue neutral basis, vertical service rates. The vertical service revenues which support reasonably priced residential rates are also put at substantial risk by the FCC's Interconnection Order.

SWBT had contemplated making a third analysis in order to evaluate the level of funding by LEC, by wire center, that would be available if the current small LEC Universal Service Fund (USF) high-cost thresholds (percentages) were applied to all LECs, by wire center. The USF formula would have had to be adjusted to apply it to total exchange network costs in each wire center, not just loop costs (all loop costs, not just the reduced loop costs used in the current USF formula⁴, plus the local portion of the end office switch plus local

⁴ The current USF loop formula excludes customer service, marketing, support (land, building, vehicles, etc.), and exclude all but the benefit portion of network operations and corporate expenses in order to maintain a small manageable fund and to maintain approximately the same fund size in 1988 when the Uniform System of Accounts was revised.

exchange transport trunking). SWBT did not make this analysis because simple application of the current USF thresholds is not appropriate since the current threshold formula assumes that:

- a) 25% of all loop costs are recovered via interstate CCL and EUCL charges. The interstate CCL revenue is loop cost recovery which supports local exchange network costs at the current local rates. This loop recovery in the CCL has essentially been eliminated as a result of the FCC's recent Interconnection Order and consequently, these costs should be reflected in a support fund.
- b) In the 0-115% band, not only is interstate CCL loop recovery or support ignored but the portion of the loop cost in this band recovered or supported by intrastate CCL and intrastate intraLATA toll is ignored. It would be difficult to develop a standard formula that could identify these supports because they are dependent on differing rate designs for local, intraLATA toll and access in each state. However, these local exchanges supports have also been put at risk by the FCC's Interconnection Order and these supports should also be assigned to a support fund.

In effect the simple application of the current small company USF formula, (applied to all local exchange costs by wire center) assumes that on a nationwide average basis, local exchange rates would be at approximately \$45 per loop per month in order to recover all costs in the first band (0-115%) where no support is provided. Clearly it is unlikely that local rates will be raised on an average basis to \$45 and it is doubtful if the small company formula or for that matter the current USF larger company formula could be modified to properly (by state by LEC) identify CCL and intraLATA toll supports.

Consequently, SWBT recommends that the Joint Board seriously consider developing a fund as shown in Analysis 1 which uses current local exchange revenues by wire center as the thresholds for determining the level of support by wire center. This fund properly identifies existing support and captures state variations. The Joint Board could also develop, if it chose, a fund as described in Analysis 2.

The results of SWBT's actual cost analysis is included in the following attachments:

- Attachment 1 - Discussion of the development of support amounts by wire center, and the source of actual local exchange network costs, by account and separations category.
- Attachment 2 - Analysis 1 -Summary of actual local exchange costs, less local exchange revenues and resulting support by State and LEC.
- Attachment 3 - Analysis 2 -Summary of actual local exchange cost, less 1% of the state median income and resulting support by State and LEC.
- Attachment 4 - Detail by State, by LEC, by wire center for Analysis 1 and 2 (Paper copy not included. Filed on CD along with all calculations).

B. COMPARISON OF BCM2 SUPPORT WITH ACTUAL COST SUPPORT

For comparative purposes to the actual cost support analysis, SWBT has run and attached the BCM2 support results by state, by LEC and by wire center:

Attachment 5 - Compares BCM2⁵ and the first Analysis 1 actual cost support by State and by LEC.

SWBT does not believe that any proxy, including BCM2, should be used to determine the total LEC study area local exchange network costs. In fact, it is clear that if the BCM2 results were used to identify total local exchange network cost (See Attachment 5) and a large national fund was developed, not only will most regions of the country not have sufficient support but these regions will flow more support than is necessary to other regions of the country. Instead, actual local exchange network costs (developed from the LECs books and records) are available on a study area basis and should be used as the starting point for developing Universal Service support. SWBT is aware, however, that many LECs have not undertaken the work necessary (or may not have the records) to assign the study area local exchange costs to wire centers. SWBT believes that LECs should have the option to (a) perform a basic study to distribute actual study area local exchange network costs to wire centers or (b) use BCM2 (or other improved proxy method) to distribute actual study area local exchange network costs to wire centers. This process will eliminate any distortions (variations from actual cost - See Attachment 5, Column G) which would result from using BCM2 to define total LEC local exchange network costs. Use of BCM2 (or an improved proxy) as an option to distribute actual costs to wire centers will minimize both the burden of developing actual costs by wire center for certain LECs and minimize distortions resulting from using a BCM2 proxy by limiting the distortions to their individual wire centers.

Finally, with regard to the BCM2 model, SWBT believes that its results could be improved (for the limited use discussed above) if:

- 1) Census block group (CBG) area household counts and any other related data calculations should be subdivided to reflect wire center LEC ownership boundaries.
- 2) Model estimates of line counts should be adjusted to reflect actual line counts by company, and if possible, line counts by wire center.
- 3) Investment related annual cost factors should be revised to reflect forward looking economic depreciation expenses and reserves. These factors should also be revised to reflect land, building, vehicle, furniture, computer and other work/office support equipment necessary to support the directly identified investment (these could be company specific based on ARMIS type information).
- 4) The switching costs should be broken into smaller increments. The first two of remote and switch less than 10,000 lines seems to be extremely large and may not accurately reflect the costs associated with small switches.

⁵ Attachment 4 - Provides the BCM2 results by State, by LEC, by wire center. (Filed on CD along with all calculations.)

C. OTHER INFORMATION REQUESTED BY THE JOINT BOARD STAFF

Attachment 6 contains a comparison by state by LEC (where available) on an average study area basis of:

- Actual Local Exchange Network Costs
- BCM2 Local Exchange Network Cost
- TELRIC Local Exchange Network Costs
- Hatfield Local Exchange Network Costs

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