

Warner, for example, asserts that carriers subject to incentive regulation, such as price caps, have flexibility and increased earnings opportunities and are expected to accept and anticipate risks from which rate-of-return regulated companies have been insulated. Time Warner argues that price cap regulated companies, having been given the opportunity for increased earnings, should not have increased earnings guaranteed through universal service support.<sup>450</sup> Teleport maintains that price cap companies should not be eligible because they have agreed that they have full responsibility for their costs. It further contends that permitting universal service subsidies would undermine the incentive of price caps. To retain competitive neutrality, Teleport proposes to exclude any carrier from receiving support in an area where the incumbent is a price cap carrier and for that reason is excluded from eligibility.<sup>451</sup>

145. Some commenters maintain that, while price cap companies should be eligible for universal service support, such companies should receive different treatment. Some commenters argue price cap companies should not receive high cost support unless they can demonstrate the need for such support on a statewide or company-wide basis.<sup>452</sup> ALTS contends that such different treatment is entirely reasonable given the flexibility that price cap regulation grants these companies and that these companies, by agreeing to price cap regulation, have signalled their ability to manage overall costs and make a reasonable firm-wide profit, even if they operate in some high cost areas.<sup>453</sup> CFA argues that companies should be eligible for support only if the price cap includes an exogenous factor that would allow rates to be adjusted up or down if the level of high cost support changes.<sup>454</sup> CFA further maintains that such an adjustment should not occur if the carrier's loss of revenue is the result of competition rather than a loss or reduction of high cost support.<sup>455</sup> MCI argues that price cap companies should not be treated differently if costs are computed using MCI's proposed methodology but that these companies should not be eligible for high cost support

---

<sup>450</sup> Time Warner comments at 11-12.

<sup>451</sup> Teleport further comments at 7-8.

<sup>452</sup> ALTS further comments at 7-9 (arguing that carriers subject to price cap regulation should not receive universal service support unless and until they can show that without an explicit subsidy the company as a whole will be unable to earn a fair return); AirTouch further comments at 21 (arguing that price cap regulated companies must be required to base claims of high costs on the same level of aggregation as the price cap ceilings, i.e., an RBOC must show high costs on average over its entire multi-state service area); SNET further comments at 6 (arguing that "[p]rice cap companies should not be eligible for high-cost support unless they meet the high-cost support test for their entire service area").

<sup>453</sup> ALTS further comments at 7-9.

<sup>454</sup> CFA further comments at 13. Maine PUC notes that many state price caps expressly provide for rate adjustments following changes in high cost assistance levels. Maine PUC further comments at 17 n.12.

<sup>455</sup> CFA further comments at 13.

that is computed based on the carrier's booked costs as this would dilute the price cap incentives to control costs.<sup>456</sup> NYNEX, while arguing that price cap companies are eligible to receive support, contends that support should be structured differently for price cap companies. It maintains that the Commission should use a cost proxy model like the Benchmark Cost Model (BCM) to identify areas served by price cap LECs that are likely to have higher-than-average costs. NYNEX argues that carriers subject to rate-of-return regulation, however, should have universal service support levels based on such company's "actual" costs determined on a study area basis.<sup>457</sup>

146. Most commenters, however, argue that price cap companies should not be excluded from receiving universal service support or treated differently from other companies receiving such support.<sup>458</sup> They argue that excluding price cap companies would be contrary to the statute and that the cost characteristics of a particular area and the obligations that the carrier has agreed to undertake, not the carrier's regulatory regime, govern the determination of eligibility.<sup>459</sup> Alliance for Public Technology asserts that price cap regulation is an important tool to promote competition and excluding price cap companies from receiving support would discourage the use of price caps.<sup>460</sup> Bell Atlantic contends that excluding price

---

<sup>456</sup> MCI further comments at 13-14. *See also* TCI further comments at 26 (arguing that price cap companies should not be eligible in areas where they face little or no competition and where the universal service subsidy is based on booked costs).

<sup>457</sup> NYNEX further comments at 20-21, 24-26.

<sup>458</sup> *See, e.g.*, AT&T further comments at 26-27; Ameritech further comments at 26-27; BellSouth further comments at 34-35; Bell Atlantic further comments at 10; Citizens Utilities further comments at 8-9; GSA further comments at 5-6; GTE further comments at 31-33; MFS further comments at 36; Maine PUC further comments at 16-18; NECA further comments at 20-21; PacTel further comments at 30; Puerto Rico Tel. Co. further comments at 9; RTC further comments at 18-19; SWBT further comments at 24-25; Sprint further comments at 8-9; USTA further comments at 21-22; U S West further comments at 15. *See also* ITC further comments at 12-13 (arguing that, while price cap companies should not be excluded, there may be a need for some special cost allocation rules or other minor changes in the way they are treated).

<sup>459</sup> *See, e.g.*, BellSouth comments at 34-35; Ameritech further comments at 26-27; Bell Atlantic further comments at 10; Citizens Utilities further comments at 8-9; GTE further comments at 32-33 (arguing that price cap companies cannot be excluded from eligibility as a matter of law); Maine PUC further comments at 16-18; PacTel further comments at 30; SWBT further comments at 24-25; Sprint further comments at 8-9; USTA further comments at 21-22.

<sup>460</sup> Alliance for Public Technology further comments at 10-12. *See also* Maine PUC further comments at 17 (excluding price cap companies would have the perverse effect of discouraging the form of regulation the 1996 Act encourages). Alliance for Public Technology also argues that the Commission should utilize the universal service proceeding to address ways to require or ensure that price cap regulation can be used to finance the deployment of advance telecommunications services. Alliance for Public Technology further comments at 11-12.

cap companies would increase the incentive of such companies to sell high cost exchanges.<sup>461</sup> Bell Atlantic also contends that it would be very difficult to define a price cap carrier.<sup>462</sup> Citizens Utilities points out that many smaller companies that serve rural, high cost areas are subject to price cap regulation and an exclusion of price cap companies would not just affect the large companies.<sup>463</sup> NYNEX contends that, since the Commission has decided in the *Local Competition Order* to remove most of the access charge revenue stream from the rates for unbundled elements, the price cap LECs will require universal service support to replace the contribution from access charge revenues that they have used to support affordable service to high cost areas.<sup>464</sup> Sprint argues that excluding price cap carriers would result in a policy that is not competitively neutral, since a non-price cap competitor could receive a subsidy in a high cost area served by the excluded price cap LEC.<sup>465</sup> Sprint also asserts that excluding price cap carriers would violate the statute's directive to make universal service funding explicit because many price cap carriers today maintain internal, implicit subsidies between low cost and high cost areas in their regions.<sup>466</sup> Washington UTC opposes any blanket exclusion of price cap companies and contends that the issue should be decided by state commissions on a case-by-case basis.<sup>467</sup>

147. Those carriers proposing to exclude or vary the treatment of carriers subject to price cap regulation suggest varying definitions of what would constitute a price cap company for these purposes. Some argue that a price cap company should be defined as a company subject to price cap regulation at the federal or state level or pursuant to a social contract.<sup>468</sup> Some commenters also maintain that the definition should include any form of regulation that is, in substance, similar to price cap regulation.<sup>469</sup> ITC contends that only carriers subject to

---

<sup>461</sup> Bell Atlantic further comments at 10.

<sup>462</sup> Bell Atlantic further comments at 10. *See also* Citizens Utilities further comments at 9.

<sup>463</sup> Citizens Utilities further comments at 8-9.

<sup>464</sup> NYNEX further comments at 24.

<sup>465</sup> Sprint further comments at 8-9.

<sup>466</sup> Sprint further comments at 8-9.

<sup>467</sup> Washington UTC further comments at 18.

<sup>468</sup> *See, e.g.*, AirTouch further comments at 22.

<sup>469</sup> ALTS further comments at 9 (companies subject to any plan that gives the carrier sufficient pricing flexibility to warrant different treatment); AirTouch further comments at 22; (any company subject to any plan in which rate-of-return review is suspended); NCTA further comments at 8 (any carrier under a form of regulation, at the federal or state level, that permits it to retain earnings substantially above what it could earn under rate-of-return regulation); Teleport further comments at 8 ("If it looks like price caps, then it should be treated like price

the Commission's price caps should be considered for these purposes.<sup>470</sup> MCI maintains that only companies under the price caps at the federal level should be included if the Commission adopts an interstate-only fund and, if the Commission adopts a unitary fund, then companies under price caps at the state or federal level would be included.<sup>471</sup> In either case, MCI would include companies under either explicit price caps or a "social contract" to limit price increases.<sup>472</sup> SWBT maintains that a price cap company should be defined, in both the federal and state jurisdictions, as one under price cap regulation with no obligation to share earnings above certain levels with its customers and no price freezes on any of the regulated services.<sup>473</sup>

148. Ensuring that universal service support is used as intended. In response to the Commission's question concerning how to ensure that carriers use universal service support for its intended purposes, several commenters suggest that carriers certify that the funds received will only be used for their intended purposes,<sup>474</sup> or that carriers must follow accounting standards or cost allocation rules required by the 1996 Act and be subject to federal or state audits to ensure that funds are used properly.<sup>475</sup> ALTS contends that the most important thing the Commission can do to ensure that funds are used as intended is to make support mechanisms explicit.<sup>476</sup> Moreover, argues ALTS, to the extent that support is set at the "appropriate level," there will be far less ability to use universal service support for inappropriate purposes.<sup>477</sup> GVNW argues that reimbursing companies on the basis of "actual cost[s]" will ensure that companies have used universal service support for the intended purpose and that it would be extremely difficult to make this determination using a proxy

---

caps."); Time Warner further comments at 36 (any incentive regulation that offers the incumbent LEC significant regulatory and pricing flexibility and the ability to increase earnings substantially).

<sup>470</sup> ITC further comments at 13-14; SNET further comments at 6 (arguing that, for a federal universal service mechanism, a price cap company should be defined as one under price cap regulation at the federal level).

<sup>471</sup> MCI further comments at 13-14.

<sup>472</sup> MCI further comments at 13-14.

<sup>473</sup> SWBT further comments at 26.

<sup>474</sup> AT&T comments at 21 n.33; Governor of Guam comments at 12.

<sup>475</sup> See Alaska Tel. reply comments at 3. See also Alaska PUC comments at 17; Pacific Telecom comments at 3 (proposing that recipients of support should demonstrate annually the source and application of the funds).

<sup>476</sup> ALTS comments at 14.

<sup>477</sup> ALTS comments at 14.

model.<sup>478</sup> NCTA suggests that using high cost credits or customer vouchers given to the service provider could minimize carrier misuse of funding.<sup>479</sup> MCI suggests that the Commission require recipients of universal service support to provide specified network features, such as use of digital switches, that will enhance the ability of carriers to provide more advanced and reliable service.<sup>480</sup> Ohio Consumers' Council argues that the states are best equipped to address whether carriers are misusing funds and no specific, national rules are necessary.<sup>481</sup>

149. Prohibiting cross-subsidization. Some commenters argue that the prohibition against cross-subsidization contained in section 254(k) can only be enforced if cost data are regularly collected and audited.<sup>482</sup> AirTouch maintains that carefully targeting support to only those groups that need it -- as opposed to subsidizing local services to everyone -- will reduce cross-subsidization.<sup>483</sup> AirTouch further contends that carriers offering non-competitive services must put in place accounting methods and other non-structural safeguards to prevent cross-subsidization.<sup>484</sup> MCI states that competition will ensure that rates are set at the carrier's cost and that the Commission must adopt regulations to ensure that result in non-competitive markets.<sup>485</sup> WinStar argues that cross-subsidization can be mitigated by ensuring that universal service support payments not be used to allow less efficient providers to match the rates charged by more efficient competitors.<sup>486</sup>

150. Ensuring only eligible carriers get support. Few commenters addressed the

---

<sup>478</sup> GVNW comments at 14-15. *See also* Montana Indep. Telecom. comments at 10-11.

<sup>479</sup> NCTA comments at 12.

<sup>480</sup> MCI comments at 16-17.

<sup>481</sup> Ohio Consumers' Council comments at 6-7.

<sup>482</sup> Michigan Consumer Federation comments at 14; Michigan Library Ass'n comments at 10. *See also* NCTA comments at 12 (arguing that stringent reporting rules or cost allocations rules are appropriate); Texas PUC comments at 10 (encouraging further study of incremental costs of telecommunications services and maintaining current monitoring programs such as ARMIS); NorTel reply comments at 6 n.11 (contending that accounting safeguards should be sufficient; separate networks or facilities for universal services are unnecessary).

<sup>483</sup> AirTouch comments at 7. *See also* PCIA comments at 14 (suggesting that narrow targeting and limiting of the size of the fund will prevent cross-subsidization).

<sup>484</sup> AirTouch further comments at 21.

<sup>485</sup> MCI comments at 17.

<sup>486</sup> WinStar comments at 3-4.

issue of how the Commission could ensure that only eligible carriers receive universal service support. ALTS argues that the Commission's concerns about ineligible carriers obtaining support are probably unfounded because only carriers found eligible by a state commission would receive support.<sup>487</sup> MCI contends that, as long as carriers must offer services throughout the service area and the area the LEC carrier must serve coincides with the area used to compute support, there should be no problem with ineligible carriers receiving support.<sup>488</sup> Ohio Consumers' Council argues that this issue should be left to the states and that the states can provide the Commission with a list of companies they find eligible to receive support.<sup>489</sup>

151. Use of a carrier's own facilities. Various commenters address the question of whether the Commission should establish standards concerning compliance with the requirement in section 214(e)(1) that eligible telecommunications carriers provide universal service using their own facilities or a combination of their facilities and resale. Several commenters contend that "facilities" should include any unbundled network elements obtained by the carrier and any network transmission capacity obtained on a leased basis.<sup>490</sup> CompTel argues that a carrier is using its own facilities when it purchases unbundled elements at cost from the incumbent and creates a local service product using them.<sup>491</sup> AT&T argues that any carrier using its own facilities, using another carrier's network elements, or using any combination of such facilities and elements should be eligible.<sup>492</sup> Sprint asserts that, while carriers may offer services in part through resold facilities, such carriers must also use some of their own facilities.<sup>493</sup> LDDS contends that a carrier should be eligible as long as at least some portion of its services is not resold service.<sup>494</sup>

152. TRA argues that carriers that offer service solely through the resale of another carrier's telecommunications services or through the use of unbundled network elements

---

<sup>487</sup> ALTS comments at 13.

<sup>488</sup> MCI comments at 18.

<sup>489</sup> Ohio Consumers' Council comments at 6.

<sup>490</sup> CompTel comments at 16; Ohio Consumers' Council reply comments at 18. *See also* LDDS comments at 6-7 (arguing that the term "facilities" should not only include facilities constructed and deployed by the carrier, but also facilities that are leased from incumbent LECs and other carriers).

<sup>491</sup> CompTel reply comments at 12-13.

<sup>492</sup> AT&T comments at 21.

<sup>493</sup> Sprint comments at 15-16.

<sup>494</sup> LDDS reply comments at 4.

should be eligible to receive universal services support.<sup>495</sup> TRA asserts that resellers should be eligible for universal service support because they have "stepped into the shoes" of the underlying carrier and, by purchasing services or elements, have guaranteed the underlying carrier a return on its investment and thus assumed some of the underlying carrier's risk. It further contends that denying resellers universal service support would provide the underlying carrier with a competitive advantage.<sup>496</sup> TRA contends that reading section 214(e) as precluding "pure" resellers would be unduly narrow, but if that reading is valid, the Commission should exercise its forbearance authority to allow universal support to such carriers.<sup>497</sup>

153. Other commenters contend that only facilities-based carriers should be eligible for support.<sup>498</sup> They argue that, if new entrants are allowed to offer universal service via resale, new entrants could disadvantage incumbents by constructing facilities only for the lowest cost customers in the area and reselling the incumbent's services to serve the high cost customers, creating a potentially confiscatory situation for incumbents.<sup>499</sup> Still others contend that, while carriers may provide services through a combination of their own facilities and resale, support for the resold services should go to the underlying carrier providing the facilities since that carrier bears the cost of building and maintaining those facilities.<sup>500</sup> USTA argues that, when eligible carriers resell the incumbent's universal service package, the incumbent should continue to receive the support, but when the eligible carrier purchases unbundled network elements "at the market price" to provide universal service, the new

---

<sup>495</sup> TRA comments at 8-10. *See also* CompTel reply comments at 12-13.

<sup>496</sup> TRA comments at 8-10. *But see* Colorado Indep. Tel. comments at 5 (maintaining that pure resellers should not be eligible because they have made no investment in the facilities supported by universal service support mechanisms).

<sup>497</sup> TRA comments at 9.

<sup>498</sup> *See, e.g.*, Alaska Tel. comments at 3; Minnesota Tel. Ass'n comments at 3; TCA comments at 5; Telec Consulting comments at 14; United Utilities comments at 1; Siskiyou reply comments at 4. *See also* Bell Atlantic comments at 10 (proposing that universal service funds should be distributed to eligible LECs that "provide local service using their own loop facilities"); RTC comments at 9 (contending that support "must only go to those carriers that actually own and maintain facilities").

<sup>499</sup> Alaska Tel. comments at 3.

<sup>500</sup> *See, e.g.*, BellSouth comments at 6 n.8; Colorado Indep. Tel. comments at 5; NECA comments at 8-9; RTC comments at 8-10; SWBT comments at 21-22; NYNEX reply comments at 2 n.6; TCA reply comments at 3 (arguing that eligible carriers should not receive support for the portion of the service provided through resale).

carrier, not the incumbent, should receive the support.<sup>501</sup> PacTel contends that, if the reseller pays the underlying carrier full deaveraged cost (including some recovery of shared and common costs) and that cost is above the benchmark, the reseller should get the subsidy; if the reseller purchases a line at rates below full deaveraged cost, the underlying facilities-based carrier should receive the subsidy.<sup>502</sup> CompTel maintains that, if the new entrant pays economic costs for the unbundled element, the underlying carrier receives full compensation, and the new entrant, as the retail provider of the services, is entitled to the universal support payment.<sup>503</sup>

154. Guidelines for advertising. Washington UTC urges the Commission to take an affirmative role and define as narrowly as possible the types and scope of advertising that should be considered as being required by section 214(e)(1).<sup>504</sup> Washington UTC contends that rate-of-return regulated carriers might seek to justify including in their rates the costs of image-enhancing advertising just because such advertising may mention universal services.<sup>505</sup> Governor of Guam recommends the development of standards that include a minimum of consumer education through advertising in local media outlets.<sup>506</sup> New Jersey Advocate argues that adequate, understandable information is essential in a competitive market and recommends that the Commission adopt or strengthen standards relating to truth-in-advertising; the presentation of clear, written terms of service and rates; and the provision of bilingual information.<sup>507</sup> Several commenters propose guidelines that require carriers to publicly post information concerning available services and rates at appropriate government agencies and libraries and that ensure that this information is accessible to persons with

---

<sup>501</sup> USTA comments at 17 n.24. *See also* TCA reply comments at 3 ("If a reseller becomes eligible for funding on a facility that they are leasing from a facilities based carrier, then the rate they pay must be fully cost-based"); TCG reply comments at 7-8 (proposing that universal service support should flow to the reseller when the reseller pays the facilities-based carrier the full cost, otherwise the underlying carrier should receive the subsidy).

<sup>502</sup> PacTel reply comments at 10. *See also* WinStar reply comments at 6 (contending that carriers that purchase unbundled elements at cost should be eligible; pure resellers should be eligible only if they purchase resold service at or above "actual cost").

<sup>503</sup> CompTel reply comments at 13.

<sup>504</sup> Washington UTC reply comments at 6.

<sup>505</sup> Washington UTC reply comments at 5-6.

<sup>506</sup> Governor of Guam comments at 12.

<sup>507</sup> New Jersey Advocate comments at 13.

disabilities or language barriers.<sup>508</sup> Florida PSC, on the other hand, suggests leaving to the states the establishment of any guidelines governing advertising.<sup>509</sup> MCI argues that no standards are necessary because competition will ensure that LECs make known the services they will offer to their potential customers.<sup>510</sup>

### 3. Discussion

155. Determination of eligible carriers. We recommend that the Commission adopt, without further elaboration, the statutory criteria contained in section 214(e)(1) as the rules for determining whether a telecommunications carrier is eligible to receive universal service support. Pursuant to these criteria, a telecommunications carrier would be eligible to receive universal service support if the carrier is a common carrier<sup>511</sup> and if, throughout the service area for which the carrier is designated by the state commission as an eligible carrier, the carrier: (1) offers all of the services that are supported by federal universal service support mechanisms under section 254(c);<sup>512</sup> (2) offers such services using its own facilities or a combination of its own facilities and resale of another carrier's services, including the services offered by another eligible telecommunications carrier; and (3) advertises the availability of and charges for such services using media of general distribution. We agree with the majority of commenters who argue that any carrier that meets these criteria is eligible to receive federal universal service support, regardless of the technology used by that carrier.<sup>513</sup> We

---

<sup>508</sup> ACE comments at 7; Catholic Conference comments at 22; Michigan Library Ass'n comments at 10-11; Benton reply comments at 16; NAD reply comments at 21-22.

<sup>509</sup> Florida PSC comments at 13-14.

<sup>510</sup> MCI comments at 18.

<sup>511</sup> The Circuit Court for the District of Columbia defines a common carrier as one that undertakes to carry for all people indifferently. *National Association of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630, 641-42 (D.C. Cir. 1976), *cert. denied*, 425 U.S. 992 (1976) (*NARUC I*); *National Association of Regulatory Utility Commissioners v. FCC*, 533 F.2d 601, 608 (D.C. Cir. 1976) (*NARUC II*). The *NARUC I* Court established a test to determine whether a carrier may be regulated as a common carrier. This test requires a determination of "whether there will be a legal compulsion . . . to serve [the public] indifferently, and, if not, . . . whether there are reasons implicit in the nature of . . . [the] operations to expect an indifferent holding out to the eligible user public." *NARUC I*, 525 F.2d at 642.

<sup>512</sup> We recommend, however, that carriers that lack the technical capability to offer toll limitation services not be required to offer such services to qualifying low-income consumers, as otherwise provided *infra* in section VIII.

<sup>513</sup> *See, e.g.*, 360 comments at 4; ALTS comments at 12-13; Colorado PUC comments at 6-7; CompTel comments at 16; LCI comments at 5; LDDS comments at 4-7; NASUCA comments at 22-23; NCTA comments at 12; PacTel comments at 13; Sprint comments at 15-16; WinStar comments at 10; MFS reply comments at 6; Ohio Consumers' Council reply comments at 17-18.

conclude that this approach best embodies the pro-competitive, de-regulatory spirit of the 1996 Act and ensures the preservation and enhancement of universal service.

156. We recommend that the Commission not impose eligibility criteria in addition to those contained in section 214(e)(1). For example, some commenters argue that the Commission should require competing telecommunications carriers to meet all the obligations imposed by the state on the incumbent LEC, such as COLR requirements or rate regulation.<sup>514</sup> The proponents of this point of view argue that such symmetrical regulation is necessary to prevent new entrants from selectively targeting only the lowest cost customers in an area, and to prevent unfair treatment of incumbent LECs.<sup>515</sup> We conclude that establishing specific federal rules or guidelines that would impose symmetrical regulatory obligations on all carriers receiving universal service support are unnecessary to protect the incumbent and would chill competitive entry into high cost areas.<sup>516</sup> The statute already conditions eligibility for support on the requirement that telecommunications carriers be common carriers and offer the defined services "throughout the service area."<sup>517</sup> The plain meaning of these two requirements is that eligible carriers must hold themselves out to provide the specified services to any customer in the service area. We find that GTE's concern that eligible carriers will fulfill this mandate in theory only and attempt to "cherry pick" customers by offering differential rates is misplaced. The 1996 Act requires carriers to advertise their rates for universal service throughout the service area. Any attempt to "cherry pick" or "cream skim" customers through differential charges would thus be readily detected.

157. We also reject arguments that a carrier must be subject to whatever exit barriers are imposed on the incumbent LEC as a condition of eligibility. The 1996 Act limits the ability of an eligible carrier to exit a market in which there is more than one eligible carrier. Section 214(e)(4) requires an eligible carrier to notify the state of that carrier's intent to relinquish its designation as an eligible carrier. Section 214(e)(4) also requires the state

---

<sup>514</sup> See, e.g., Ameritech comments at 12; BellSouth comments at 14 n.26; GTE comments at 6-7; USTA comments at 2-3; Tel. Ass'n of Michigan reply comments at 5.

<sup>515</sup> See, e.g., GTE comments at 6-7; Tel. Ass'n of Michigan reply comments at 5; GTE further comments at 47-48; Ameritech Ex Parte Materials Regarding Competitive Bidding Process, July 31, 1996 at 8-9.

<sup>516</sup> We note that, in the *Local Competition Order*, the Commission concluded that states may not unilaterally impose on non-incumbent LECs the additional obligations imposed on incumbent LECs in section 251(c). *Local Competition Order* at para. 1247-48. The Commission there ruled that it would not anticipate imposing such additional obligations on non-incumbent LECs absent a clear and convincing showing that the LEC occupies a position in the telephone exchange market comparable to the position held by an incumbent LEC, has substantially replaced an incumbent LEC, and that such treatment would serve the public interest, convenience, and necessity and the purposes of section 251. *Local Competition Order* at para. 1248.

<sup>517</sup> 47 U.S.C. § 214(e)(1).

commission, before permitting the carrier to cease providing service, to ensure that the remaining carriers can serve the relinquishing carrier's customers.<sup>518</sup> The state commission must also ensure sufficient notice to permit the purchase or construction of adequate facilities by any remaining eligible carrier.<sup>519</sup> This obligation to serve the entire service area upon the cessation of service by another carrier or carriers applies to incumbents and new entrants alike. We find that additional exit restrictions are unnecessary.

158. We recommend that the Commission reject arguments to disqualify certain classes of carriers from eligibility. Commenters suggest, for example, that only incumbents should be eligible for universal service support<sup>520</sup> or that price cap companies should be excluded from eligibility.<sup>521</sup> We believe that any such wholesale exclusion of classes of carriers from eligibility is inconsistent with the plain language of the 1996 Act. Section 214 contemplates that any telecommunications carrier that meets the eligibility criteria of section 214(e)(1) shall be eligible to receive universal service support. The statute directs a state commission "upon its own motion or upon request [to] designate a common carrier that meets the requirements of [section 214(e)(1)] as an eligible telecommunications carrier for a service area designated by the State commission."<sup>522</sup> Moreover, section 214(e)(2) provides that more than one carrier could be eligible for universal service support in an area. It requires the designation of multiple eligible carriers in areas not served by rural telephone companies as long as such carriers meet the eligibility criteria of section 214(e)(1).<sup>523</sup> Even for areas served by rural telephone companies, section 214(e)(2) gives state commissions the discretion to designate more than one common carrier as an eligible carrier, as long as such designation is found by the state commission to be in the public interest.<sup>524</sup> Moreover, we recommend against limiting eligibility for universal service support to incumbents. We conclude that restricting universal service support to incumbent local exchange carriers would not be in accord with section 214(e).

159. In addition, we recommend that companies subject to price cap regulation be

---

<sup>518</sup> 47 U.S.C. § 214(e)(4).

<sup>519</sup> 47 U.S.C. § 214(e)(4).

<sup>520</sup> *See, e.g.*, Cincinnati Bell comments at 10-11.

<sup>521</sup> *See, e.g.*, Staurulakis comments at 11-12; Time Warner comments at 11-12; NCTA further comments at 8; Teleport further comments at 7-8.

<sup>522</sup> 47 U.S.C. § 214(e)(2).

<sup>523</sup> 47 U.S.C. § 214(e)(2).

<sup>524</sup> 47 U.S.C. § 214(e)(2).

eligible to receive universal service support. No persuasive rationale has been advanced to explain why the flexibility and the opportunity for increased earnings that companies obtain when they are subject to price caps<sup>525</sup> should disqualify such companies from receiving universal service support as long as they otherwise meet the statutory criteria for eligibility. Rather, we agree with those commenters that argue that price cap regulation is an important tool to smooth the transition to competition and that its use should not foreclose price cap companies from receiving universal service support.<sup>526</sup> Having recommended against the exclusion of price cap companies, we conclude that we need not address how to define precisely which carriers are subject to price cap regulation.

160. Section 214(e)(1) requires that, in order to be eligible for universal service support, a common carrier must offer universal service throughout the state-designated service area either using its own facilities or a combination of its own facilities and the resale of another carrier's services, including those of another eligible carrier.<sup>527</sup> We find that the plain meaning of this provision is that a carrier would be eligible for universal service support if it offers all of the specified services throughout the service area using its own facilities or using its own facilities in combination with the resale of the specified services purchased from another carrier, including the incumbent LEC or any other carrier.

161. We recommend that the Commission reject the arguments of TRA and others that a carrier that offers universal service solely through reselling another carrier's universal service package should be eligible for universal support.<sup>528</sup> We find that the statute precludes such a result because it plainly states that a carrier shall be eligible for support only if the carrier offers universal service by using its own facilities and reselling another carrier's services.<sup>529</sup> Similarly, we recommend that the Commission reject arguments that only those telecommunications carriers that offer universal service wholly over their own facilities should be eligible for universal service.<sup>530</sup> The statute precludes this result because section 214 permits a carrier to offer universal service through a combination of its own facilities and

---

<sup>525</sup> See e.g., Teleport comments at 7-8; Time Warner comments at 11-12. See also ALTS further comments at 7-9 (proposing to treat price cap companies differently).

<sup>526</sup> See e.g., Alliance for Public Technology further comments at 10-12; Maine PUC further comments at 17.

<sup>527</sup> 47 U.S.C. § 214(e)(1).

<sup>528</sup> TRA comments at 8-10. See also CompTel reply comments at 12-13.

<sup>529</sup> 47 U.S.C. § 214(e)(1)(A).

<sup>530</sup> See, e.g., Alaska Tel. comments at 3; Minnesota Tel. Ass'n comments at 3; TCA comments at 5; Telec Consulting comments at 14; United Utilities comments at 1; Siskiyou reply comments at 4. See also Bell Atlantic comments at 10; RTC comments at 9.

resale and still be eligible for support.

162. We also recommend that the Commission reject TRA's request that the Commission exercise its forbearance authority to permit "pure" resellers to become eligible for universal service support.<sup>531</sup> We find that TRA's pleading does not sufficiently address the statutory criteria for forbearance. TRA's sole argument in support of forbearance is that it is necessary "to avoid discriminatory treatment that might either discourage competitive entry by resale carriers . . . or provide incumbent LECs with an unjustified competitive advantage. . . ." <sup>532</sup> Yet, in order to exercise its authority under section 160(a) to forbear from applying a provision of the Act, the Commission must determine that three criteria are met. It must determine that: (1) enforcement of the provision "is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;" (2) enforcement of such provision "is not necessary for the protection of consumers;" and (3) "forbearance from applying such provision . . . is consistent with the public interest."<sup>533</sup> TRA's pleading fails to show that these criteria are met. For example, it fails to address whether enforcement of the facilities requirement in section 214(e) is not necessary for the protection of consumers.

163. Other issues related to eligibility. The NPRM sought comment on various other issues related to eligibility. Specifically, it sought comment on whether rules should be developed to: (1) ensure that universal service support be used as intended (i.e., for the "provision, maintenance, and upgrading of facilities and services for which the support is intended");<sup>534</sup> (2) ensure that only eligible carriers receive support; and (3) set guidelines for advertising. Because relatively few commenters addressed these issues, there are few detailed proposals in the record on how to resolve them. For the first of these issues, developing rules to ensure that universal service support is used as intended, we believe that concerns about misuse of funds would largely be alleviated once competition arrives. We find that a competitive market would minimize the incentives and opportunities to misuse funds. In the absence of competition, we find that the optimal approach to minimizing misuse of funds is to

---

<sup>531</sup> TRA comments at 9 (citing 47 U.S.C. § 160). In this case, TRA asks the Commission to forbear from the requirement that, in order to be eligible for universal services support, a carrier must offer the supported services through its own facilities or its own facilities in combination with resale. TRA requests that the Commission forbear from applying this provision in order to allow pure resellers to be eligible for support.

<sup>532</sup> TRA comments at 10.

<sup>533</sup> 47 U.S.C. § 160(a). Section 160(b) provides that a Commission determination that forbearance will promote competition may be the basis for a finding that forbearance is in the public interest. 47 U.S.C. § 160(b).

<sup>534</sup> 47 U.S.C. § 254(e).

adopt a mechanism that will set universal support at levels that reflect the costs of providing universal service efficiently. Should additional measures be necessary, we recommend that the Commission, to the extent that states monitor carriers to ensure the provision of the supported services, rely on the states' monitoring.<sup>535</sup> Where necessary, for example, if the state has insufficient resources to support such monitoring programs, we recommend that the Commission conduct periodic reviews to ensure that universal service is being provided. On the question of ensuring that only eligible carriers receive support, we agree with commenters that additional rules are unnecessary because only carriers found eligible by the states will receive funding.<sup>536</sup> We recommend no additional rules at this time.

164. We recommend that the Commission not adopt, at this time, any national guidelines relating to the requirement that carriers advertise throughout the service area the availability of and rates for universal service using media of general distribution. We agree with the Florida PSC that states should, in the first instance, establish guidelines, if needed, to govern such advertising.<sup>537</sup> Pursuant to the 1996 Act, the states designate eligible carriers, and area-wide advertising is an explicit condition of eligibility. The states may be in the better position to monitor the effectiveness of advertising by carriers offering universal service. We also agree with MCI that competition will help ensure that carriers make known the services they offer.<sup>538</sup>

### C. Definition of Service Areas

#### 1. Background

165. Section 214(e)(5) defines the term "service area" as "a geographic area established by a State commission for the purpose of determining universal service obligations and support mechanisms."<sup>539</sup> For areas served by a rural telephone company,<sup>540</sup> section 214(e)(5) provides that the term "service area" means the rural telephone company's study

---

<sup>535</sup> See, e.g., Ohio Consumers' Council comments at 6-7 (arguing that states are best equipped to address whether carriers are misusing funds).

<sup>536</sup> See ALTS comments at 13; Ohio Consumers' Council comments at 6.

<sup>537</sup> Florida PSC comments at 13-14.

<sup>538</sup> MCI comments at 18.

<sup>539</sup> 47 U.S.C. § 214(e)(5).

<sup>540</sup> The term rural telephone company is defined *supra*.

area<sup>541</sup> "unless and until the Commission and the States, after taking into account the recommendations of a Federal-State Joint Board instituted under section 410(c), establish a different definition of service area for such company."

166. The Commission sought comment on issues relating to the definition of the service areas for which carriers would receive designation. The Commission asked parties to comment on the appropriate basis to define the "service area" of a rural telephone company, taking into account the possible effect on competition, and requested comment on whether the Commission should amend its rules to revise existing study area boundaries.<sup>542</sup> In the context of implementing a "pro-competitive, de-regulatory national policy framework",<sup>543</sup> the Commission asked the Joint Board to prepare recommendations regarding the appropriate "service area" boundaries of areas served by a "rural telephone company."<sup>544</sup>

## 2. Comments

167. Service areas for rural telephone companies. Many commenters support retaining the current study areas for rural telephone companies as the service area for universal service support.<sup>545</sup> Commenters contend that the intent of the statute in retaining existing study areas is to protect rural companies from the effects of competitors entering a market and serving only the lowest cost portion of a rural telephone company's territory.<sup>546</sup> Century asserts that simply retaining a rural telephone company's study area as its new service area may not be sufficient to protect against this sort of "cream skimming" by new entrants. It proposes that, once a new entrant is allowed to compete in a rural telephone company's area, the rural telephone company should be allowed to redistribute its universal service high cost compensation to any geographically disaggregated area within its study area. At the

---

<sup>541</sup> A "study area" is generally an incumbent LEC's pre-existing service area in a given state. The study area boundaries are fixed as of November 15, 1984. *MTS and WATS Market Structure: Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order*, 50 Fed. Reg. 939 (1985 *Lifeline Order*) (adopting with minor modifications the Joint Board recommendations issued in *MTS and WATS Market Structure: Amendment of the Commission's Rules and Establishment of a Joint Board, Recommended Decision and Order*, 49 Fed. Reg. 48,325 (1984)).

<sup>542</sup> NPRM at para. 45.

<sup>543</sup> Joint Explanatory Statement at 113.

<sup>544</sup> NPRM at para. 45.

<sup>545</sup> See, e.g., Century comments at 14-15; Evans Tel. comments at 14; Pacific Telecom comments at 2; Pennsylvania PUC comments at 20; RTC comments at 10; Rural Iowa Indep. Tel. Ass'n. comments at 4; Sprint comments at 15; USTA comments at 18; Fred Williamson comments at 12-13; SDITC reply comments at 6.

<sup>546</sup> See, e.g., Evans Tel. comments at 14; SDITC reply comments at 6.

same time, Century argues, the new entrant should receive support only for its own demonstrably high cost, facilities-based locations.<sup>547</sup> Montana Indep. Telecom. similarly argues that areas smaller than study areas will be needed if a competitor begins serving only a portion of incumbent's study area. It recommends that the service area be based on the area of the incumbent's wire centers or exchanges, at least initially.<sup>548</sup> It further asserts that an area smaller than a wire center should be used as the service area in rural areas only upon a finding by the state that using such a smaller area is in the public interest.<sup>549</sup> RTC also argues that, in a competitive environment, incumbents must have the option to disaggregate per-unit costs to areas smaller than the study area in order to address "cream skimming" concerns.<sup>550</sup> RTC contends that these smaller areas would be used solely for the purpose of targeting support and would not affect the size of the service area that a competitor must serve in order to receive funding as an eligible carrier.<sup>551</sup> It proposes that the support amounts for these smaller areas would be derived from the known and existing "actual cost levels already established for the larger, total study area."<sup>552</sup>

168. Service areas in general. Most commenters addressing the question regarding the appropriate geographic service area for eligibility did not limit their comments to areas served by rural telephone companies. Instead, they address the question of appropriate service area size for all universal service support purposes. Potential competitors argue that, to ensure that the new universal program is competitively neutral, service areas in which new entrants would be designated to serve should not be based on the existing study areas of the incumbent LECs.<sup>553</sup> Beyond this, industry and state commenters differed sharply on the appropriate size of the service area.

169. Missouri PSC recommends using a LEC's entire service area within a state or

---

<sup>547</sup> Century comments at 14-15.

<sup>548</sup> Montana Indep. Telecom. comments at 8.

<sup>549</sup> Montana Indep. Telecom. comments at 8.

<sup>550</sup> RTC comments at 13-14.

<sup>551</sup> RTC comments at 14 n.27.

<sup>552</sup> RTC comments at 13-14.

<sup>553</sup> See, e.g., 360 comments at 7-8; ALTS reply comments at 4; Commnet Cellular reply comments at 7 (arguing that the Commission should design service areas so that it would be technically and economically feasible for CMRS providers to serve the subscribers in that service area); MFS reply comments at 6-7 (contending that it would be anticompetitive to require new entrant's service areas to mimic an incumbent's study area or certified area).

local access and transport area (LATA).<sup>554</sup> It contends that analysis of costs in such a large area best reflects the overall circumstance of each LEC and will prevent a large LEC from receiving universal service funding related to its high cost areas even though the LEC's overall costs are no higher than average.<sup>555</sup> SWBT, however, argues that continuing to use statewide areas would retain the current implicit subsidy flows between low cost areas and high cost areas served by a LEC within a state and will discourage competitive entry into high cost areas while concentrating entry in urban population centers.<sup>556</sup> Others oppose using study areas because they are too large to accurately distribute high cost support.<sup>557</sup> AirTouch maintains that the use of large areas, such as statewide study areas, to determine eligibility will have the effect of "freezing out" new entrants that initially may need to enter a market in more limited areas.<sup>558</sup>

170. Most commenters support using areas smaller than existing study areas as the service area. New Jersey BPU, for example suggests using county-wide areas.<sup>559</sup> NECA asserts that carriers should have the option to disaggregate costs below the study area level.<sup>560</sup> Various commenters support using census block groups (CBGs)<sup>561</sup> as the appropriate service

---

<sup>554</sup> Missouri PSC comments at 8. A LATA generally is defined as a "contiguous geographic area" established by a Bell Operating Company (BOC) before the date of enactment of the 1996 Act or an area established or modified after the date of enactment by a BOC and approved by the Commission. 47 U.S.C. § 153(25).

<sup>555</sup> Missouri PSC comments at 8. *See also* Dell Tel. reply comments at 3-4 (suggesting inclusion of all operations within a state in order to remove support for large companies).

<sup>556</sup> SWBT comments at 12-13.

<sup>557</sup> Cincinnati Bell comments at 8.

<sup>558</sup> AirTouch reply comments at 6.

<sup>559</sup> New Jersey BPU comments at 3.

<sup>560</sup> NECA comments at 9.

<sup>561</sup> The proponents of the BCM define a census block group as "a geographic unit defined by the Bureau of Census which contains approximately 400 households." MCI, NYNEX, Sprint/United Management Co., and U S West, Benchmark Costing Model: A Joint Submission, Copyright 1995, CC Docket No. 80-826, filed December 1, 1995, at I-1. The Bureau of the Census defines "census blocks" as "small areas bounded on all sides by visible features such as streets, roads, streams, and railroad tracks, and by invisible boundaries such as city, town, township, and county limits, property lines, and short, imaginary extensions of streets and roads." Bureau of the Census, United States Department of Commerce, 1990 Census of Population and Housing A-3 (1992). It further defines a "geographic block group" as "generally contain[ing] between 250 and 550 housing units, with the ideal size being 400 housing units." *Id.*

area.<sup>562</sup> Sprint, for example, argues that the use of CBGs will better target high cost areas and will keep service areas in line with how costs are developed through the use of cost proxy models.<sup>563</sup> Sprint also contends that using CBGs will eliminate the implicit subsidy that occurs when costs are averaged over wire centers, exchanges or larger areas that contain both high cost and low costs areas.<sup>564</sup> Opponents of using CBGs contend that they are inaccurate because they bear no relation to the actual telecommunications network and associated costs<sup>565</sup> and, in very sparsely populated areas, CBGs may be so large that cost may vary greatly within a CBG.<sup>566</sup> GVNW argues that using CBGs will be administratively burdensome.<sup>567</sup>

171. Some commenters suggest that the service area be based on LEC wire centers (or areas no smaller than wire centers)<sup>568</sup> or exchanges (or areas no larger than exchanges).<sup>569</sup> USTA recommends using an area no larger than a wire center for non-rural telephone companies to determine costs.<sup>570</sup> Proponents of using wire center areas to determine costs contend that such areas are small enough to represent reasonably homogenous cost characteristics and that LECs can disaggregate their costs to those areas much more readily than they can disaggregate costs to the CBG level.<sup>571</sup> They argue that wire center boundaries have evolved to reflect the specific characteristics of the telephone plant required to serve an area and thus are a much more accurate area to determine costs than are CBGs, which bear no direct relationship with how the telephone plant is designed or installed.<sup>572</sup> Teleport

---

<sup>562</sup> See, e.g., California PUC comments at 9-10 (noting that it will develop costs on a CBG level for intrastate services); PacTel comments at 18 n.33; Sprint comments at 15; Wyoming PSC comments at 8.

<sup>563</sup> Sprint comments at 15.

<sup>564</sup> Sprint reply comments at 13.

<sup>565</sup> See, e.g., GSA comments at 8-10; GVNW reply comments at 14 (arguing that CBGs are inherently inaccurate and administratively costly to use).

<sup>566</sup> Alaska PUC comments at 13-14; Citizens Utilities comments at 12.

<sup>567</sup> GVNW reply comments at 14.

<sup>568</sup> BellSouth comments at 14 (proposing wire centers or groups of wire centers); GSA comments at 9-10.

<sup>569</sup> See, e.g., Citizens Utilities comments at 12-13 (suggesting that exchanges or wire centers would be appropriate); Montana Indep. Telecom. comments at 8 (same); GVNW reply comments at 14.

<sup>570</sup> USTA comments at 18.

<sup>571</sup> Citizens Utilities comments at 12-13.

<sup>572</sup> GSA comments at 9-10; GVNW reply comments at 14.

recommends using areas no larger than a wire center and no smaller than a CBG to establish costs. It contends that establishing service areas at this level will encourage competition by facilitating entry.<sup>573</sup> GVNW proposes that, for non-rural companies, support areas smaller than wire centers should be used only after a showing that competition exists only in a portion of a wire center. For rural companies, the decision to use areas smaller than a wire center should be part of the state's public interest determination.<sup>574</sup>

### 3. Discussion

172. Service areas for areas served by rural telephone companies. We recommend that the Commission retain the current study areas of rural telephone companies as the service areas for such companies. Section 214(e)(5) provides that for an area served by a rural telephone company, the term "service area" means such company's study area "unless or until the Commission and the States, after taking into account the recommendations of a Federal-State Joint Board instituted under section 410(c), establish a different definition of service area for such company."<sup>575</sup> We find no persuasive rationale in the record for adopting, at this time, a service area that differs from a rural telephone company's present study area.<sup>576</sup> We note that some commenters argue that Congress presumptively retained study areas as the service area for rural telephone companies in order to minimize "cream skimming" by potential competitors.<sup>577</sup> Potential "cream skimming" is minimized because competitors, as a condition of eligibility, must provide services throughout the rural telephone company's study area. Competitors would thus not be eligible for universal service support if they sought to serve only the lowest cost portions of a rural telephone company's study area.

173. We note that the 1996 Act in many respects places rural telephone companies on a different competitive footing from other local exchange companies. For example, rural telephone companies are initially exempt from the interconnection, unbundling, and resale requirements of 47 U.S.C. § 251(c). The 1996 Act continues this exemption until the relevant state commission finds, *inter alia*, that a request of a rural telephone company for interconnection, unbundling, or resale would not be unduly economically burdensome, would

---

<sup>573</sup> Teleport comments at 15-16.

<sup>574</sup> GVNW reply comments at 14.

<sup>575</sup> 47 U.S.C. § 214(e)(5).

<sup>576</sup> See, e.g., Century comments at 14-15; Evans Tel. comments at 14; Pacific Telecom comments at 2; Pennsylvania PUC comments at 20; RTC comments at 10; Rural Iowa Indep. Tel. Ass'n comments at 4; Sprint comments at 15; USTA comments at 18; Fred Williamson comments at 12-13; SDITC reply comments at 6.

<sup>577</sup> See, e.g., Evans Tel. comments at 14; SDITC reply comments at 6.

be technically feasible, and would be consistent with section 254.<sup>578</sup> Moreover, while a state commission must designate other eligible carriers for non-rural areas, states may designate additional eligible carriers for areas served by a rural telephone company only upon a specific finding that such a designation is in the public interest.<sup>579</sup>

174. Another reason to retain existing study areas is that it is consistent with our recommendation that the determination of the costs of providing universal service by a rural telephone company should be based, at least initially, on that company's embedded costs. Rural telephone companies currently determine such costs at the study-area level. We conclude, therefore, that it is reasonable to adopt the current study areas as the service areas for rural telephone companies rather than impose the administrative burden of requiring rural telephone companies to determine embedded costs on a basis other than study areas.

175. Service areas for areas not served by rural telephone companies. We find that sections 214(e)(2) and 214(e)(5) grant to the state commissions the authority and responsibility to designate the area throughout which a carrier must provide the defined core services in order to be eligible for universal service support. We further conclude that, while this authority is explicitly delegated to the state commissions, states should exercise this authority in a manner that promotes the pro-competitive goals of the 1996 Act as well as the universal service principles of section 254. The Joint Board thus recommends that the Commission urge the states to designate service areas for non-rural telephone company areas that are of sufficiently small geographic scope to permit efficient targeting of high cost support and to facilitate entry by competing carriers.

176. We recommend that the Commission encourage states, where appropriate to foster competition, to designate service areas that do not disadvantage new entrants. Consequently, we recommend that the geographic size of the state designated service areas should not be unreasonably large. An unreasonably large area may deter entry because fewer competitors may be able to cover start-up costs that increase as the size of the area they must serve increases. This would be especially true if the states adopt as the service area the existing study areas of larger local exchange companies, such as the BOCs, which usually include most of the geographic area of a state, urban as well as rural. Additionally, if states simply structure service areas to fit the contours of an incumbent's facilities, a new entrant, especially a CMRS-based provider, might find it difficult to conform its signal or service area to the precise contours of the incumbent's area.<sup>580</sup>

---

<sup>578</sup> 47 U.S.C. § 251(f)(1).

<sup>579</sup> 47 U.S.C. § 214(e)(2).

<sup>580</sup> See, e.g., 360 comments at 7-8; ALTS reply comments at 4; Commnet Cellular reply comments at 7.

177. We note that state adoption of unreasonably large service areas could potentially violate section 254(f), which prohibits states from adopting regulations that are "inconsistent with the Commission's rules to preserve and advance universal service."<sup>581</sup> State designation of an unreasonably large service area could also implicate section 253 if it "prohibit[s] or ha[s] the effect of prohibiting the ability of an entity to provide any interstate or intrastate telecommunications service,"<sup>582</sup> and is not "competitively neutral" and "necessary to preserve and advance universal service."<sup>583</sup>

178. Even if the state commission were to designate a large service area, however, we believe that it would be consistent with the 1996 Act to base the actual level of support, if any, that non-rural telephone company carriers would receive for the service area on the costs to provide service in sub-units of that area. We recommend that the Commission, where necessary to permit efficient targeting of universal support, establish the level of universal service support based on areas that may be smaller than the service area designated by the state. The service area designated by the state is the geographic area used for "the purpose of determining universal support obligations and support mechanisms."<sup>584</sup> We find that this language refers to the designation of the area throughout which a carrier is obligated to offer and advertise universal service. It defines the overall area for which the carrier will receive support from the "specific, predictable, and sufficient mechanism established by the Commission to preserve and advance universal service."<sup>585</sup> We conclude that this language would not bar the Commission from disaggregating the state-designated service area into smaller areas in order to: (1) identify high cost areas within the service area; and (2) determine the level of support payments that a carrier would receive for the overall service area based on the sum of the support levels as determined by the costs of serving each of the disaggregated areas.

## D. Unserved Areas

### 1. Background

179. Section 214(e)(3) provides that, if no common carrier is willing to provide the services supported by universal service support mechanisms to a community or portion of a community that requests such services, "the Commission, with respect to interstate services, or

---

<sup>581</sup> 47 U.S.C. § 254(f).

<sup>582</sup> 47 U.S.C. § 253(a).

<sup>583</sup> 47 U.S.C. § 253(b).

<sup>584</sup> 47 U.S.C. § 214(e)(5).

<sup>585</sup> 47 U.S.C. § 254(d).

a State, with respect to intrastate services, shall determine which common carrier or carriers are best able to provide such service to the requesting unserved community or portion thereof and shall order such carrier or carriers to provide such services for that unserved community or portion thereof.<sup>586</sup> Any carrier so ordered shall be designated as the eligible telecommunications carrier for that community or portion of a community.<sup>587</sup> The Joint Explanatory Statement states that section 214(e)(3) "makes explicit the implicit authority of the Commission, with respect to interstate services, and a State, with respect to intrastate services, to order a common carrier to provide [the supported services]."<sup>588</sup>

180. The NPRM solicited comment on how the Commission should implement its responsibilities under section 214(e)(3) to designate carriers for unserved areas and whether the Commission and the state commissioners should develop a cooperative program to ensure that all areas receive each of the services supported by federal universal support mechanisms.<sup>589</sup>

## 2. Comments

181. Few commenters responded to the Commission's request for comments on whether the Commission and the states should develop a cooperative program to ensure service for unserved areas. Some of these commenters support the concept of a cooperative program between the Commission and the states.<sup>590</sup> Some commenters recommend using a competitive bidding system to select carriers to provide universal service to customers in areas that no carrier is serving.<sup>591</sup> USTA argues that unserved areas should be defined as those areas no carrier is willing to serve voluntarily. Such areas, USTA maintains, should be

---

<sup>586</sup> 47 U.S.C. § 214(e)(3).

<sup>587</sup> 47 U.S.C. § 214(e)(3).

<sup>588</sup> Joint Explanatory Statement at 141.

<sup>589</sup> NPRM at para. 47.

<sup>590</sup> Alaska Library comments at 5; California PUC comments at 13-14; Missouri PSC comments at 9.

<sup>591</sup> California PUC comments at 13-14. Under California's proposal, the carrier with the lowest bid, or subsidy request, would win and become the carrier of last resort for the area. California PUC comments at 13-14. *See also* MCI comments at 18-19 (advocating use of competitive bidding to select carriers in those few areas that no carrier is willing to serve at the established support level); USTA comments at 19-20. USTA recommends that the Commission should adopt a voluntary bidding process to identify carriers willing to serve unserved areas at the lowest cost per line. The carrier submitting the lowest bid would be declared the eligible carrier for both interstate and intrastate services and would receive the universal service support targeted to that area from the high cost support mechanism. USTA comments at 19-20.

unique and not combined with any established universal service area.<sup>592</sup> Some cellular carriers argue that wireless technology can play an important role in ensuring that remote areas receive basic telephone service and that they should be given an opportunity to provide such service in these areas.<sup>593</sup> AMSC urges the Commission to permit LECs to receive universal service support for the costs of using Mobile Satellite Service technology to provide universal service to remote areas, just as the Commission allows LECs that provide basic exchange telecommunications radio systems (BETRS)<sup>594</sup> as a substitute for wireline local service in rural areas to be eligible for high cost assistance.<sup>595</sup> Washington UTC cautions against adopting rules that will require universal support to every community, no matter how expensive providing that service would be.<sup>596</sup> Washington UTC offers an example of a small community of about a dozen families located on the eastern side of the Cascade Mountains that currently is not receiving even basic telephone service because the installation of facilities would cost about \$8,000.00 per customer and would cost approximately \$260.00 per access line per month after installation.<sup>597</sup>

### 3. Discussion

182. Other than the requirements contained in section 214(e)(3), we recommend that the Commission not adopt any particular rules to govern how carriers for unserved areas are designated. While a few commenters support the concept of a cooperative state and federal program to select such carriers,<sup>598</sup> no specific program was proposed. Similarly, while several commenters support using competitive bidding to select carriers for unserved areas, no detailed proposal was submitted for use of competitive bidding for this limited purpose.

---

<sup>592</sup> USTA comments at 19-20.

<sup>593</sup> See, e.g., Vanguard comments at 7-8; Western comments at 5-7, 14.

<sup>594</sup> BETRS uses radio frequencies to connect subscribers at fixed locations to LEC central offices. AMSC comments at 6 (citing *Basic Exchange Telecommunications Radio Service*, 3 FCC Rcd 214 (1988)).

<sup>595</sup> AMSC comments at 6.

<sup>596</sup> Washington UTC reply comments at 3.

<sup>597</sup> Washington UTC reply comments at 3.

<sup>598</sup> See e.g., Alaska Library comments at 5; California PUC comments at 13-14.

## VII. RURAL, INSULAR, AND HIGH COST

### A. Overview

183. In this section of the Recommended Decision, we discuss the universal service support mechanisms for rural, insular, and high cost areas. There are three pieces of information required to calculate the amount of support an eligible telecommunications carrier may draw from federal universal service support mechanisms. The first is the number of subscribers that the carrier is serving in the high cost area. The second is the cost of providing the supported services to those subscribers. The third is the amount of that cost that the carrier must recover from sources other than the federal universal support mechanisms. In this section the Joint Board presents its recommendations concerning the process that should be used to determine the level of support to be provided for the supported services and related issues. We also present our recommendations on how the amount the carrier needs to recover from other sources should be set.

184. We first discuss how to determine the cost of providing the supported services to subscribers. We conclude that the proper measure of "cost" for purposes of calculating universal service support is the forward-looking economic cost of developing and operating the network facility and functions used to provide services supported under section 254(c)(1). The Joint Board recommends that the Commission work with the state commissions to develop a proxy cost model for calculating these forward-looking economic costs, and what support, if any, that a carrier should receive for serving a particular geographic area. We believe that all of the costs of the network and retail costs that are incurred to provide the supported services should be included in the cost calculation. We recognize, however, that the use of a proxy model could cause some small carriers to receive levels of support different from what they currently receive. In order to allow those carriers a reasonable period to adjust to the use of proxy models, we recommend that "rural telephone companies," as defined in the Communications Act, as amended,<sup>599</sup> be allowed to continue using embedded costs as the basis for calculating their universal service support levels for three years after non-rural carriers begin to use proxy models.<sup>600</sup> We recommend that, during that period, high cost assistance, DEM weighting, and LTS benefits for rural carriers be frozen based on historical per-line amounts. At the end of that three-year period, rural companies will transition to a proxy model over three years. Because of the nature of providing service in Alaska and the insular areas, we recommend that rural carriers serving those areas continue to use embedded costs until further review.

---

<sup>599</sup> 47 U.S.C. § 153(37).

<sup>600</sup> Many of the commenters use the term "embedded costs" when referring to a carrier's historic loop or switching costs. For the purpose of our discussion in this proceeding, we will also use the term "embedded costs," but note that we mean it to be synonymous with the terms "booked costs" and "reported costs."

185. We next discuss the benchmark amount or share of carrier proxy-derived cost that must be recovered from other sources. We believe it is desirable that the benchmark be based on the amount the carrier would expect to recover from other services to cover the cost of providing supported services, but final determination of the methodology for selecting the benchmark must also consider the revenue base for universal service contributions. The amount of support a carrier would receive would be calculated by subtracting this benchmark amount from the cost of service determined for that carrier.

186. Finally, we look at an alternative means of establishing support levels. Competitive bidding would allow the marketplace to determine the level of support by having competing carriers bid for the support level they need to serve high cost areas. We recommend that the Commission, together with the state commissions, continue to explore the possibility of using competitive bidding in the future.

## B. Calculation of Cost

### 1. Background

187. The existing universal service support mechanisms. Currently there are three mechanisms designed expressly to provide support for high cost and small telephone companies: the Universal Service Fund (high cost assistance fund),<sup>601</sup> the DEM weighting program,<sup>602</sup> and LTS.<sup>603</sup>

188. The jurisdictional separations rules currently assign 25 percent of each LEC's loop costs<sup>604</sup> to the interstate jurisdiction.<sup>605</sup> As a result, a portion of each LEC's local loop costs are recovered through rates charged to its customers for interstate services.<sup>606</sup> For LECs with above-average loop costs, the existing high cost assistance fund shifts a larger percentage of the loop costs to the interstate jurisdiction and permits those LECs to recover this

---

<sup>601</sup> 47 C.F.R. § 36.601 *et. seq.*

<sup>602</sup> 47 C.F.R. § 36.125(b).

<sup>603</sup> 47 C.F.R. §§ 69.105, 69.502, 69.603(e), 69.612.

<sup>604</sup> Loop cost is the fixed cost of connecting customers to the LEC central office. LECs' local loop costs vary widely due to many factors, including subscriber density, terrain, local exchange size, and labor costs.

<sup>605</sup> 47 C.F.R. Part 36.

<sup>606</sup> Currently, the Commission's access charge rules require that these costs be recovered through subscriber line charges and carrier common line charges. The operation of both types of charges is discussed *infra* in section XII.