incremental allocation from the high cost assistance fund.[607] Each LEC's embedded costs determine the support payments the LEC will receive. Currently, a LEC is eligible for support if its embedded loop costs exceed 115 percent of the national average loop cost. LECs with study areas[608] of 200,000 or fewer loops receive a greater percentage of their above-average loop costs than those with study areas with more than 200,000 loops.[609] LECs with study areas of 200,000 or fewer working loops receive an additional interstate allocation of 65 percent of the unseparated cost per loop between 115 percent and 150 percent of the national average cost per loop, multiplied by the number of working loops. This 65 percent additional allocation coupled with the 25 percent allocation for all carriers means that these companies allocate 90 percent of the loop costs between 115 percent and 150 percent of the national average to the interstate jurisdiction. Those carriers receive an additional interstate allocation of 75 percent of the cost per loop that exceeds 150 percent of the national average cost per loop. That additional allocation, coupled with the 25 percent allocation for all carriers, means that carriers with loop costs greater than 150 percent of the national average receive a 100 percent allocation to the interstate jurisdiction for the costs above 150 percent of the national average. In other words, they receive a dollar from the interstate jurisdiction for each dollar of loop costs above 150 percent of the national average loop cost. For LECs with study areas of more than 200,000 working loops, the additional interstate allocation of unseparated loop costs is as follows: 10 percent of such costs between 115 percent and 160 percent of the national average, 30 percent of such costs between 160 percent and 200 percent of the national average, 60 percent of such costs between 200 percent and 250 percent of the national average, and 75 percent of such costs in excess of 250 percent of the national average. This program is funded entirely by IXCs.[610]

189. The Commission's jurisdictional separations rules include a second universal service subsidy mechanism known as DEM weighting.[611] At the time the DEM weighting subsidy was created, it was assumed that smaller telephone companies would have higher local switching costs than larger LECs because the smaller companies cannot take advantage

[607] The high cost assistance fund is currently administered by NECA.

[608] A study area is a geographic segment of a carrier's telephone operations within a state. Carriers perform jurisdictional separations at the study area level.

[609] 47 C.F.R. § 36.631(c), (d).

[610] Each IXC with at least .05 percent of presubscribed lines nationwide contributes to the fund an amount based on the number of its presubscribed lines. 47 C.F.R. § 69.116.

[611] 47 C.F.R. § 36.125(b). Dial equipment minutes, or DEM, are the minutes of holding time of local switching equipment used to originate and terminate a call. The jurisdictional separations rules allocate local switching equipment costs between the interstate and intrastate jurisdictions on the basis of each jurisdiction's relative number of dial equipment minutes of use.

of certain economies of scale. LECs with fewer than 50,000 access lines are directed to apportion a greater proportion of these local switching costs to the interstate jurisdiction than larger LECs may allocate.[612] For these small LECs, the actual DEMs are weighted (multiplied by a factor) to shift what would otherwise be intrastate costs to the interstate jurisdiction. DEM weighting applies independent of, and unrelated to, the high cost assistance fund.

190. The LTS program supports carriers with higher-than average subscriber line costs by providing carriers which are members of the NECA pool with enough support to enable them to charge IXCs only a nationwide average CCL interstate access rate.[613] Under the current LTS support system, NECA annually projects the common line revenue requirement (which includes an 11.25 percent return on investment) for ILECs that participate in the common line pool.[614] NECA then computes the total amount of LTS support needed by subtracting the amount pooling carriers will receive in SLCs and CCL charges from the pool's projected revenue requirement (after removing pay telephone costs and revenues). LTS is funded by ILECs that do not participate in the common line pool. Non-pooling ILECs' LTS contributions to the common line pool are set annually based on the total projected amount of LTS, converted to a monthly payment amount. NECA computes the monthly "draws" for the ILEC common line pool members based on the pooling carriers' submissions to NECA of reported cost data (except for average schedule companies, whose monthly payments are based on average schedule data). As a result, each participating pool member receives a draw from the "pooled" common line revenues rather than a "LTS payment."

191. The Commission initiated a rulemaking proceeding in CC Docket No. 80-286 to modify the current support mechanism for high cost and small telephone companies.[615] The primary goals of that proceeding were to eliminate barriers to competitive entry, contain the size of the fund at a reasonable level, and promote efficient investment and operation of local

[612] 47 C.F.R. § 36.125(b).

[613] Prior to 1989 all local exchange carriers were required to participate in a pool of carrier common line costs and revenues. Beginning in April 1989, LECs were permitted to withdraw from the pool, but LECs with below average subscriber line charges that choose to exit the pool are required to contribute enough so that LECs remaining in the pool would be able to charge the same industry average CCL rates they would have charged if the pool were still mandadtory for all LECs. *See MTS and WATS Market Structure; Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Report and Order, 2 FCC Rcd 2953 (1987).

[614] The actual rate of return that pooling companies earn on a monthly basis is determined by the total rate of return that the pool earns, i.e., the difference between the total costs that the pooling companies submit and the total amount of revenue in the pool, as a percentage of all pooling companies' total common line investment.

[615] *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, Notice of Inquiry, 9 FCC Rcd 7404 (1994); Order, 9 FCC Rcd 7962 (1994) (Data Request); Notice of Proposed Rulemaking and Notice of Inquiry, 10 FCC Rcd 12309 (1995) *(80-286 NPRM)*.

service networks.[616]

192. In the *80-286 NPRM*, the Commission sought comment on ways to improve the high cost assistance fund, including: (1) using credits to deliver high cost assistance in a competitively neutral manner; (2) excluding administrative costs from the loop costs that form the basis for high cost assistance; (3) basing assistance on the average number of subscriber lines; (4) increasing the threshold for receiving assistance; (5) reconsidering the distinctions in the current rules between large and small study areas; (6) adopting a permanent indexed cap; (7) using high cost credits for large carriers' study areas only; and (8) using proxy factors to compute high cost assistance.[617] The Commission also proposed to modify DEM weighting by: (1) establishing a high cost test to qualify for DEM weighting; (2) determining DEM weighting factors on the basis of average local switch size; or (3) determining DEM weighting assistance through the use of a scale sliding on the basis of the number of access lines.[618]

193. NPRM in this Proceeding. In the NPRM, the Commission sought comments to identify methods for determining the level of support required to ensure that carriers are financially able to provide universal service in rural, insular, and high cost areas.[619] The Commission specifically sought comment on whether continuing to use the Commission's jurisdictional separations rules to provide support to LECs with high loop costs, or local switching costs of small LECs, is consistent with Congress's intent "to provide for a pro-competitive, de-regulatory national policy framework . . . opening all telecommunications markets to competition,"[620] or with its intent relating to the characteristics of universal service support mechanisms to be adopted pursuant to section 254.[621] In addition, the Commission sought comment regarding the statutory requirement "that any support mechanisms continued or created under new section 254 should be explicit."[622] The Commission sought comment on whether the DEM weighting assistance mechanism should be retained in light of the principles enunciated in the 1996 Act.[623] The NPRM also asked commenters to identify the total amount

616 *80-286 NPRM* at para. 5.

617 *Id.* at paras. 17-75.

618 *Id.* at paras. 9-16.

619 NPRM at paras. 27-39.

620 *See* S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996).

621 NPRM at para. 30.

622 47 U.S.C. § 254(e).

623 NPRM at para. 30.

of support currently required for each proposed core service.[624]

194. The Commission also incorporated into this proceeding by reference the portion of the record from CC Docket No. 80-286 that relates to changing the support mechanisms found in Part 36 of its rules.[625] The Commission noted, however, that the legislative history of the 1996 Act indicates that Congress determined that CC Docket No. 80-286 was not an appropriate foundation on which to base the section 254 universal service proceeding.[626]

195. Regarding LTS, the NPRM observed that the CCL charges of ILECs not participating in the NECA pool recover LECs' LTS obligations.[627] As noted in the NPRM, LTS payments serve to equalize access charges among LECs by requiring larger LECs that no longer participate in the NECA access charge pool to contribute funds sufficient to reduce pooling companies' access charges to the national average.[628] The NPRM tentatively concluded that "LTS payments, which directly increase interstate access charges assessed by some LECs so as to reduce charges assessed by other LECs, are an identifiable support flow in the existing interstate access charge system" and "propose[d] to eliminate the recovery of LTS revenues through ILECs' interstate CCL charges."[629]

196. In the NPRM, the Commission noted that several telecommunications carriers had jointly filed a proxy model to calculate a "benchmark" cost for providing local telecommunications access in every CBG in the nation.[630] As explained in the NPRM, the purpose of that proxy model -- the BCM -- is to identify areas where the cost of service is expected to be high enough to require cost support to preserve and advance universal service.[631] The Commission incorporated the BCM into the record of this proceeding, and asked for comment on the merits of using a proxy model to calculate universal service support requirements. The Commission sought comment on, among other things, whether the model

624 *Id.* at para. 15.

625 *Id.* at para. 39.

626 *Id.* at para. 39 *(citing* S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 131 (1996)).

627 NPRM at para. 115.

628 *Id.* at para. 115.

629 *Id.* at para. 115.

630 *Id.* at para. 31 *(citing* MCI, NYNEX, Sprint/United Management, and U S West, *Benchmark Costing Model: A Joint Submission*, Copyright 1995, CC Docket No. 80-286, filed Dec. 1, 1995).

631 NPRM at para. 32.

could be made technology neutral, whether a proxy model should use embedded costs or forward-looking costs, what engineering assumptions should be used in the model, and whether the model's choice of CBGs as the geographic unit for calculating the costs of local telephone service was the best alternative. The NPRM also sought comment on a proxy model that had been developed by PacTel for use in the California state universal service proceeding -- the Cost Proxy Model (CPM).[632]

197. Public Notice. The Common Carrier Bureau's July 3 Public Notice sought comments on approximately 50 questions regarding the calculation of the cost of providing universal service. The Public Notice requested comment on whether loop costs accurately represent the actual cost of providing services such as access to directory assistance and emergency assistance, and the advanced services that commenters have proposed for inclusion among those services to be supported. To the extent that loop costs do not fully represent the costs associated with including a service in the definition of universal service, the question also asked parties to identify and quantify other costs that should be considered.[633] Parties were also asked to comment on what modifications to the existing universal service support mechanisms, if any, are required to comply with the 1996 Act.[634] The Public Notice also asked for comment on how existing support mechanisms could be better targeted for rural areas.[635]

198. Twenty-eight questions in the Public Notice dealt with proxy models -- 15 asked about proxy models in general,[636] eight asked about the BCM,[637] and five asked about the CPM.[638] Further comment was requested on what, if any, activities were being undertaken to harmonize the proposed proxy models; and, how support should be calculated for insular areas and Alaska, which were not included in the BCM.[639] Comment was sought on how the costs calculated by the BCM compare to the book costs of ILECs for the same

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[632] *Id.* at para. 33 n.81.

[633] Public Notice (DA-96-1078) (rel. July 3, 1996) question 5.

[634] *Id.*, question 26.

[635] *Id.*, question 27.

[636] *Id.*, questions 34-48.

[637] Public Notice, questions 56-63.

[638] *Id.*, questions 56-63.

[639] *Id.*, questions 36, 41, 45-48.

geographic areas; what the default inputs were for the BCM (e.g., the fill factors);[640] and, whether it is possible to integrate the grid cell structure used in the CPM into the BCM model.[641] Comment was sought on whether the CPM could be used on a nationwide basis and whether it could be modified to identify terrain and soil type by grid cell.[642]

199. Cost Models Public Notice. On July 10, 1996, the Common Carrier Bureau released another Public Notice (Cost Models Public Notice) on the proxy models that had been filed in this proceeding -- the BCM, a revised version of the BCM (BCM2), the CPM, and the Hatfield model[643] -- and gave notice on how interested parties could obtain copies of the models.[644] That Public Notice also set out procedures for interested parties to file comments on the models.[645]

200. Data Request. On August 2, 1996, the Common Carrier Bureau sent a letter to each of the proponents of the BCM2, CPM, and Hatfield models requesting additional information about the models.[646] The letter asked how the costs calculated by the model compare with actual embedded loop costs of incumbent local exchange carriers and asked each proponent to submit the results from its model for three specific study areas. The letter also requested further information needed to answer model-specific questions, such as how the current versions compared to the previous versions of these models.

2. Comments

a. Cost of Providing Universal Services

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640 A fill factor represents the percentage of the loop facility that is currently being used.

641 Public Notice, questions 56, 60, 63.

642 *Id.*, questions 65, 66.

643 The BCM was submitted by MCI, NYNEX, Sprint, and U S West. The BCM2 was submitted by Sprint and U S West. The CPM was submitted by PacTel. The Hatfield model was submitted by MCI and AT&T. *See* Public Notice, Common Carrier Bureau Seeks Further Comment on Cost Models in Universal Service Notice of Proposed Rulemaking, CC Docket 96-45, DA 96-1094 (rel. July 10, 1996)("Cost Models Public Notice").

644 *See* Cost Models Public Notice.

645 *See Id.*

646 *See* Letters from John S. Morabito, Deputy Chief, Accounting and Audits Division, Common Carrier Bureau to (1) Glenn Brown, Executive Director-Public Policy, U S West, Inc., (2) Alan Ciamporcero, Vice President-Federal Regulatory Relations, PacTel, (3) Mike Pelcovits, Chief Economist, MCI, and Joel Lubin, Vice President-Law and Government Affairs, AT&T (dated Aug. 2, 1996).

201. Loop Costs. MCI and NYNEX maintain that loop costs represent the actual costs of providing core services for the purpose of universal service.[647] Bell Atlantic argues that the local loop is the principal component of supported services, and thus, loop costs are a reasonable surrogate for the costs of all supported services in determining relative costs among exchange carriers.[648] According to Bell Atlantic, the costs of providing non-loop core services should not affect the state wide average costs enough to change the amount of universal service support flowing to the states, nor should these costs vary significantly among carriers.[649] Similarly, CompTel argues that access to supported services is provided by the loop and that loop costs do not vary according to the services the end user connects through the use of the loops.[650] USTA argues that the local loop cost is the actual cost of providing access to emergency services and directory assistance.[651]

202. NCTA and the Washington UTC contend that it is not appropriate to allocate 100 percent of loop costs to universal service because not all of loop costs are attributable to the provision of supported services, but are also used to provide toll and other services.[652] MFS argues that additional costs should not be included in loop costs for purposes of calculating universal service support unless the costs of providing a particular service vary by census block and contribute to making a census block a high cost area.[653]

203. Costs in Addition to Loop Costs. Several parties, however, contend that loop costs do not represent the total cost involved in providing core services.[654] Commenters assert

647 MCI further comments at 3 (arguing, however, that some trunking costs may also be involved for providing services such as 911); NYNEX further comments at 5.

648 Bell Atlantic further comments at 2.

649 *Id.* at 2.

650 CompTel further comments at 9.

651 USTA further comments at 8.

652 NCTA further comments at 3; Washington UTC further comments at 6 (*citing Washington Utilities and Transportation Commission v. U S West Communications, Inc.*, Docket No. UT950200, Fifteenth Supplemental Order, April 11, 1996).

653 MFS further comments at 13.

654 *See, e.g.*, Florida PSC further comments at 8; Maine PUC further comments at 5; New York DOE further comments at 5; PacTel further comments at 12; SWBT further comments at 4; Sprint further comments at 3; Time Warner further comments at 15; Vitelco further comments at 4.

that other joint, common and residual costs must be included in calculating total costs.[655] Commenters contend that switching,[656] transport[657] or transmission,[658] signaling,[659] unbundled element costs[660] and other costs[661] are implicated in the provision of a service. For example, Ameritech argues that the cost of single-party, voice grade service includes not only the cost of the loops, but also a portion of the local switch, as well as maintenance and other joint and common costs and residual costs.[662] In addition, USTA argues that the provision of voice grade access to the public switched network, touch-tone and single-party service entail switching and transport costs in addition to loop costs.[663] SWBT asserts that providing operator service requires substantial costs for facilities and the provision of customer assistance.[664] Maine PUC contends that even basic services such as the ability to connect with the interexchange network require switches and trunks at the local wire center.[665]

204. A few parties argue that support for high switching costs associated with low-volume switching, which are currently compensated through DEM weighting, should be maintained.[666] In addition, RTC maintains that the Commission should provide support for

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655 Ameritech further comments at 11.

656 AT&T further comments at 6; Citizens Utilities further comments at 4; Florida PSC further comments at 8; Maine PUC further comments at 5; RTC further comments at 10; SWBT further comments at 4; Vitelco further comments at 4.

657 Citizens Utilities further comments at 4; Maine PUC further comments at 6; RTC further comments at 10; Vitelco further comments at 4.

658 AT&T further comments at 6.

659 *Id.* at 6.

660 *Id.* at 6.

661 Florida PSC further comments at 9 (billing and collections costs); SWBT further comments at 6 (services expenses and support costs); Sprint further comments at 3 (maintenance, depreciation and overhead expenses); Vitelco further comments at 4 (information services costs and billing costs).

662 Ameritech further comments at 11.

663 USTA further comments at 8.

664 SWBT further comments at 5, 7.

665 Maine PUC further comments at 5.

666 Century further comments at 10-11 (arguing that the Joint Board should develop an explicit high cost mechanism to reduce the disparity between traffic sensitive access charges in rural and urban areas); NECA further comments at 5; USTA further comments at 8.

access charges that cause significant disparities between rural and urban areas.[667] RTC also maintains that support must be available for any network upgrades that rural telephone companies will have to undertake to offer number portability.[668] NECA argues that the current method for assigning loop costs, wherein loop costs include not only the direct costs of providing physical loop plant facilities but also a portion of other costs such as general and administrative costs, must be maintained as part of any new universal service support mechanism.[669]

205. Costs of Additional Services. Few parties commented on the costs associated with advanced services. SWBT asserts that the provision of ISDN requires special switching equipment and that the cost of that equipment should be supported.[670] USTA contends that access to some advanced services may require a different form of loop connection, such as fiber optic cable, and, thus, loop cost would not represent the actual cost of providing the service in those instances.[671] We note that a few parties state or reiterate their belief that support should be limited to core services, with no universal service support going toward advanced services.[672]

b. Existing Universal Service Support Mechanisms

i. Retain existing Universal Service mechanisms

206. In General. Commenters greatly disagree on whether to retain the current universal service support mechanisms. Most small and rural LECs insist that the existing high cost assistance fund should be retained in its current form.[673] Many IXCs, large LECs, and others, however, criticize the existing support mechanisms as contrary to the principles and

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[667] RTC further comments at 10 (arguing that such support would facilitate toll rate averaging required by 47 U.S.C. § 254(g) and promote long distance competition).

[668] RTC further comments at 11 (arguing that carriers will have to develop and install software and hardware to provide number portability even if they have no customer requesting the service from whom to recover the costs).

[669] NECA further comments at 5.

[670] SWBT further comments at 5.

[671] USTA further comments at 8.

[672] Citizens Utilities further comments at 5; GCI further comments at 3.

[673] *See, e.g.*, Century comments at 10; Mon-Cre comments at 3-4; Montana Indep. Telecom. comments at 6; John Staurulakis comments at 7; SDITC reply comments at 3; Vitelco reply comments at 1.

goals of the 1996 Act.[674] They contend that the current system encourages inefficiencies and inhibits competition.

207. Continue using embedded costs. Supporters of the current program contend that it has successfully achieved the goals of universal service.[675] They argue that the current accounting and jurisdictional separation rules are the most accurate method for computing support levels.[676] In addition, Ft. Mojave Telecom. asserts that the current program is "equitable and nondiscriminatory."[677] West Virginia Consumer Advocate insists that the existing universal service fund is an explicit support mechanism as contemplated in section 254(e).[678] While acknowledging that the current jurisdictional separations rules may not advance the cause of creating a pro-competitive, de-regulatory policy framework, Montana PSC argues that they do "advance the cause of keeping rural rates and services comparable to urban rates and services, and therefore the Commission should maintain these subsidies during the transition to a competitive market."[679] Michigan Library Ass'n offers that inefficiencies can be audited by state and Commission staff.[680] Meanwhile, SDITC states that it objects to the idea that universal service is a subsidy because it believes "it is a "quid pro quo" for artificially capping at 25 percent those common costs which are allocated between interstate and intrastate jurisdictions, implying that the interstate allocation does not sufficiently recover its costs.[681] This commenter also argues that the current system should be maintained because "local competition is unlikely to occur in rural America for some time."[682]

208. Furthermore, many commenters maintain that any new universal service support

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[674] *See, e.g.*, Ad Hoc Telecom. Users comments at 12; NARUC comments at 13-15; Texas PUC comments at 9; AT&T reply comments at 6-7.

[675] *See, e.g.*, Harris comments at 12; Minnesota Indep. Coalition comments at 13; OITA-WITA comments at 11-12.

[676] Park Region Tel. comments at 4. *See also* Mon-Cre comments at 3-4; New Hope Tel. Coop. comments at 3-4; Ragland Tel. Co. comments at 3-4.

[677] Ft. Mojave Telecom. comments at 4.

[678] West Virginia Consumer Advocate comments at 9-10.

[679] Montana PSC comments at 10.

[680] Michigan Library Ass'n comments at 10.

[681] SDITC reply comments at 10 (citing *Smith v. Illinois Bell Tele. Co.*, 282 U.S. 133 (1930) and *Decision and Order*, 96 FCC 2d 781, 789 (1984)).

[682] SDITC reply comments at 4.

mechanisms must continue to be based on embedded costs.[683] These commenters dispute the reliability of proxy models to set adequate support levels.[684] NECA argues further that allowing support levels to be set on the basis of competitive bids or proxy models would trigger a "race for the bottom" because competitors would seek to capture funding without maintaining or improving the quality of service or investing in new technology.[685] Alaska PUC, Vitelco, and Puerto Rico Tel. Co. contend the peculiar topography and extreme weather in their service areas result in high loop costs and argue that any resulting loss of revenues from the existing fund levels would greatly increase local rates.[686] In addition, some commenters assert that small rural companies will not be able to compete under a system that does not use embedded costs.[687]

209. Some commenters rely on particular interpretations of the 1996 Act to support their position that universal service mechanisms must be based on an incumbent carrier's embedded costs. Western Alliance asserts that the 1996 Act and the Fifth Amendment of the U.S. Constitution require a system of universal service supports based on embedded costs of service.[688] Alaska claims that nothing in the legislative history of the 1996 Act requires abolition of jurisdictional separations-based support mechanisms and not all support mechanisms are required to be explicit.[689] Moreover, Alaska Tel. argues that the embedded

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[683] *See, e.g.*, 360 comments at 7-8; BellSouth comments at 2; Frederick & Warinner comments at 2-3; Keystone comments at 7; LDDS comments at 11-12; Maine PUC comments at 4; Michigan PSC comments at 2; OITA-WITA comments at 11-12; Rock Port Tel. comments at 2; Rural Iowa Indep. Tel. Ass'n comments at 2; SWBT comments at 13-14; South Carolina PSC comments at 2; Staurulakis comments at 7; TCA comments at 5; Telec Consulting comments at 4; United Utilities comments at 1; Fred Williamson comments at 12-13.

[684] *See, e.g.*, Ameritech comments at 12; NECA comments at 6.

[685] NECA comments at 6. *See also* ITC comments at 4; TCA reply comments at 2, 5.

[686] Alaska PUC comments at 12; Puerto Rico Tel. Co. comments at 8-9; Vitelco reply comments at 4.

[687] *See, e.g.*, Alaska Tel. comments at 4; Harris comments at 11; OITA-WITA comments at 11-12; SDITC reply comments at 5.

[688] Western Alliance comments at 1 (citing *Duquesne Light. Co. v. Barasch*, 488 U.S. 299, 307 (1989) to argue that the implementation of any system that results in a sharp reduction of universal service support will effectively confiscate incumbent LECs' investments without just compensation in violation of the 5th Amendment).

[689] Alaska comments at 8-9 (citing § 103(d) of the Senate bill, 141 Cong. Rec. S 8570, S 8575 (daily ed. June 16, 1995) and interpreting the prefaced phrase, "To the extent possible, .." of the Joint Explanatory Statement.

costs method is necessary to meet the sufficiency requirement of section 254(b)(5).[690] In addition, Cincinnati Bell contends that the LECs' obligations under the 1996 Act as COLRs for universal service obligations mandate the recovery of their investment in facilities.[691] Alaska Tel. concludes that the requirement for cost allocation rules and accounting safeguards found in the 1996 Act clearly demonstrates Congress's intent to use historical costs as a basis for determining universal service support.[692]

210. Many commenters contend that a universal service mechanism based on embedded costs, rather than costs determined using a proxy model, will be the easiest to administer when CLECs want to serve a study area that already receives universal service support.[693] Pacific Telecom states that basing payments on the embedded costs of ILECs has the advantages of (i) being "specific, predictable and sufficient" for rural needs; (ii) being auditable; (iii) preventing over-recovery and incentives for gaming the system; (iv) being technologically neutral; and (v) serving as the best economic signal for potential competitive entry.[694] Washington UTC suggests that this method might encourage the resale of embedded LEC facilities, while allowing competition, because it argues that competitors are more likely to want to use ILEC facilities if they are compensated for doing so.[695] BellSouth further contends that, when CLECs with lower end-user rates receive the same support as the incumbent, they lower the end-user cost. BellSouth explains that the end-user rates would eventually fall due to competition and the support could be adjusted to reflect the lower rates.[696] Vitelco advocates that a CLEC that meets all COLR obligations should be entitled to high cost funds based on its own embedded costs, subject to a cap at the embedded costs of

[690] Alaska Tel. comments at 4. Section 254(b)(5) of the 1996 Act states that "[T]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."

[691] Cincinnati Bell comments at 11. *See also* Western Alliance comments at 4.

[692] Alaska Tel. reply comments at 3.

[693] *See, e.g.*, Ardmore Tel. comments at 3; BellSouth comments at 10-14; Bledsoe Tel. comments at 3; Hopper comments at 3; Ragland Tel. Co. comments at 3; Puerto Rico Tel Co further comments at 8. *But see*, USTA further comments at 20-21 (arguing that a competitive carrier in a rural area should receive support based on its own costs to discourage cream skimming and a competitive carrier in high cost areas served by non-rural telephone companies should use the incumbent's costs to encourage competition).

[694] Pacific Telecom further comments at 8-9.

[695] Washington UTC further comments at 17-18. Washington UTC, however, also notes that the disadvantages of using the incumbents embedded costs are that those costs may not reflect newer, less expensive technology and would result in over recovery by the competitors. *See also* AT&T further comments at 25-26.

[696] BellSouth further comments at 33-34.

the incumbent.[697]

211. Discontinue use of embedded costs. Commenters who maintain that LEC embedded costs are not a reasonable basis for determining support express concern that this method does not encourage companies to operate efficiently.[698] MCI contends that the ILEC's embedded costs are likely to include many inefficiencies, and thus be higher than necessary. This would result in a competitor receiving more support than required.[699] In addition, AirTouch asserts that the use of embedded costs would create incentives for inefficient bypass of ILEC networks and manipulation and inflation of the costs, as well as an increase in the burden borne by subscribers.[700] NARUC contends that an ILEC's embedded costs do not reflect the true cost of providing local service. It reports that many states have determined that cost studies produced by LECs overstate the costs significantly by assuming that the cost of a local loop is the real cost of local service, even though the loop cost is a joint cost shared among many services, and by including costs associated with redesign of network for non-basic services.[701] Ad Hoc Telecom. Users argues that the LECs have deployed more transmission capacity than required to provide one line per household.[702] Moreover, Time Warner contends that the use of embedded costs does nothing to cure what it considers the fundamental problems with using embedded costs as the basis for universal service support. These include verification of embedded costs, obsolete past engineering practices and investment decisions, past investment initiatives that were not undertaken to serve any legitimate universal service objective, and no incentive to control or reduce expenses.[703]

212. Moreover, commenters assert that the use of embedded costs does not promote competitive neutrality.[704] RUS argues that "historical costs" as a basis of support is inconsistent with the goals of the 1996 Act because this method would provide no incentive

[697] Vitelco further comments at 7.

[698] *See, e.g.*, TRA comments at 11. *But see*, Western Alliance further comments at 5 (arguing that no commenter has ever demonstrated that the high cost fund has led to abuse or inefficiency by rural carriers).

[699] MCI further comments at 12. *See also* Citizens Utilities further comments at 8.

[700] AirTouch further comments at 20-21.

[701] NARUC comments at 13-15.

[702] Ad Hoc Telecom. Users comments at 12.

[703] Time Warner further comments at 32-33.

[704] *See, e.g.*, Ad Hoc Telecom. Users comments at 6; California PUC reply comments at 5; Time Warner further comments at 31.

for competition.[705] AT&T contends that forcing the recovery of embedded costs distorts the competitive market and allows the ILEC to thwart entry by other more efficient competitors.[706] Time Warner asserts that allowing rural companies to retain universal service support based on embedded costs, in combination with the section 251(f) exceptions,[707] creates a protected environment that would operate to consumers' long-term detriment by insulating these companies from competitive pressure to lower costs.[708] In addition, MCI argues that ILECs are not entitled to a guaranteed complete recovery of their past investments, any more than is any other competitive firm.[709] Teleport further contends that prior investment is not an implicit subsidy and an ILEC's ability to recover its investment will not be hindered by the development of competition.[710]

213. ITA/EMA argue that the collection of universal service support through interstate access charges would violate the express mandate of the 1996 Act that all universal service supports be made explicit.[711] RUS also contends that the use of embedded costs fails to provide for the future evolution of telecommunications services and fails to ensure affordable service by ignoring probable revenue losses from the appearance of new entrants.[712] AT&T also argues that this method would result in state commissions having to undertake frequent, unwieldy and expensive inquiries into the value and prudence of claimed costs.[713] TCI also argues that targeting the support only to high cost areas under the embedded costs approach will be difficult because ILECs report costs on a study area basis.[714]

214. Use of ILEC costs for CLECs. Some ILEC commenters support the use of embedded costs to calculate assistance for ILECs to determine the universal service support

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[705] RUS reply comments at 1-3.

[706] AT&T further comments at 23-26.

[707] Section 251(f) of the 1996 Act exempts rural carriers with fewer than 2 percent of nationwide subscriber lines from complying with all of the interconnection requirements of subsections (b) and (c) of section 251.

[708] Time Warner further comments at 31.

[709] MCI reply comments at 11. *See also* ALTS reply comments at 1-2.

[710] Teleport reply comments at 5-6.

[711] ITA/EMA comments at 11.

[712] RUS reply comments at 1-3.

[713] AT&T further comments at 23-26. *See also* TCI further comments at 25-26.

[714] TCI further comments at 25-26.

they would receive, but oppose their use for calculating such support to CLECs.[715] Alaska Tel. claims that providing payments to a competitor based on the embedded costs of an incumbent is not lawful because it contends that the language of section 254 is explicit in limiting the use of universal service support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[716] Minnesota Indep. Coalition contends that basing the support for CLECs on the incumbent's embedded costs may lead to payments to the new competitors that are far in excess of the costs of providing service and that these payments would unreasonably subsidize new competitors and cause uneconomic investment.[717] SWBT argues that such a system of competition would not reflect the competitor's actual costs, would reduce incentives for efficiency, would disadvantage ILECs by requiring cost studies, and would require continued monitoring and regulation.[718] Several other commenters, including IXCs, large LECs, and non-wireline telecommunication companies, also oppose the use of an ILEC's embedded costs as a basis for calculating the support to be provided to a CLEC for the same reasons they criticize the use of embedded costs generally.[719] Ameritech and NCTA maintain that the incumbent's embedded costs bear no relationship to the new entrant's costs.[720] NYNEX, however, argues that the CLEC should use the ILEC's booked costs only if it offers universal service throughout the ILEC's study area.[721] Time Warner contends that, if the embedded costs methodology is maintained, CLECs should be allowed to use the ILEC's embedded costs in order for the fund to be

[715] *See, e.g.*, Minnesota Indep. Coalition comments at 13; PacTel further comments at 30; RTC further comments at 18 (it is unlawful, uneconomic and unfair to base high cost payments to CLECs on the ILEC's costs).

[716] Alaska Tel. further comments at 10.

[717] Minnesota Indep. Coalition comments at 10. *See also* NYNEX further comments at 24 (noting that because CLECs tend to concentrate initial entry on areas with loop costs below the statewide average cost, basing the support for a CLEC on the ILEC's study area average book cost would give windfall profits to the competitor); PacTel further comments at 30.

[718] SWBT further comments at 23-24. At the same time, SWBT asserts that new entrants should only receive support for an area if an ILEC receives support, but limited to costs associated with its own facilities. Moreover, SWBT states that competitors should have the same reporting requirements as ILECs and be required to justify their own costs. It maintains that the ILEC's costs should be the cap on support levels. It notes, however, that allowing a new entrant to use an ILEC's costs would be simple to administer, and each carrier would receive the same level of support.

[719] *See, e.g.*, AT&T further comments at 7; AirTouch further comments at 26; Ameritech further comments at 26; Citizens Utilities further comments at 8; MCI further comments at 12; NCTA comments at 32-33; Sprint further comments at 7; TCI further comments at 25-26; U S West further comments at 13.

[720] NCTA comments at 32-33; Ameritech further comments at 26.

[721] NYNEX further comments at 20.

competitively neutral.[722]

ii. Modify the Existing High Cost Assistance Fund

215. In General. Commenters in both the current proceeding and the CC Docket No. 80-826 proceeding have suggested modifications to the current system that would continue to use embedded costs to determine the level of support. The proposed modifications that appear to enjoy more widespread support include: adjusting the existing support formula by increasing the qualifying threshold; reducing the support percentages; eliminating specific ILECs from eligibility; excluding particular categories of administrative and overhead expenses for calculating loops; readjusting study areas; and changing the methodology of counting loops.

216. Increasing the threshold for receiving assistance. NYNEX contends that the current threshold is too low to distinguish a high cost area from an average cost area effectively.[723] AT&T, Time Warner, and Citizens Utilities join NYNEX in supporting raising the eligibility threshold from the current 115 percent to 130 percent[724] above national average loop costs per-line to target the support more effectively.[725] In response to the *80-286 NPRM*, the Maine PUC and Vermont DPS agreed with this modification because it would more accurately target funding.[726] In the 80-286 proceeding, SWBT, however, opposed increasing the per-line threshold because it claimed that this would shift over $200 million to the state jurisdiction and would harm small ILECs.[727] Century argued in the 80-286 proceeding that increasing the threshold does not better target high cost assistance, but simply reduces the size of the fund.[728]

[722] Time Warner further comments at 27.

[723] NYNEX further comments at 18-20.

[724] This would be the approximate equivalent of one standard deviation above national average loop costs per-line.

[725] *See*, AT&T further comments at 2-4, App. A; Citizens Utilities further comments at 6-7; NYNEX further comments at 18-20; Time Warner further comments at 28. These four commenters also continue to oppose the use of embedded costs in calculating the support levels. *See also* Bledsoe Tel. *80-286 NPRM* comments at 5.

[726] Maine PUC *80-286 NPRM* comments at 3; Vermont DPS *80-286 NPRM* comments at 22. *See also* Ad Hoc Telecom. Users *80-286 NPRM* comments at 12; Frontier *80-286 NPRM* comments at 6-9; Sprint *80-286 NPRM* comments at 10-14; Teleport *80-286 NPRM* comments at 16-18; Time Warner further comments at 28.

[727] SWBT *80-286 NPRM* comments at 46-52, Att. 1. *See also* Ohio PUC *80-286 NPRM* comments at 9-11.

[728] Century *80-286 NPRM* comments at 18-21

217. Lower the high cost fund payout percentages. Citizens Utilities proposes that the current payout percentages of up to 75 percent[729] recovery that applies when an ILEC with 200,000 or fewer loops has per-loop costs in excess of 150 percent of the national average be reduced in order to encourage efficiencies in operation.[730] In response to the *80-286 NPRM*, GVNW argued that reducing the payout percentage to 70 percent will reduce the size of the fund.[731] Arvig Enterprises in the 80-286 proceeding suggested that the current payout percentage be reduced to 65 percent to eliminate the perception that current cost methodologies discourage efficient operation.[732] In response to the *80-286 NPRM*, SWBT, however, contended that reducing the recovery level in this manner violated the Commission's proper targeting principle by reducing support to those companies most in need of assistance.[733]

218. Eliminate the inclusion of administrative costs. To integrate efficiency incentives, AT&T recommends eliminating the inclusion of administrative costs in the calculations of loop costs receiving high cost support.[734] Ad Hoc Telecom. Users contends that administrative expenses, such as advertising and sales, should be eliminated because they are not necessary for the provision of universal service.[735] New York DPS also advocates eliminating the inclusion of any costs not necessarily related to the provision of subscriber loops.[736] Missouri PSC proposes that, instead of using actual administrative costs, an average administrative cost per-line imputed to the carrier should be used to prevent ILECs from

[729] If a company has 200,000 or fewer lines in its study area, for its loop costs in excess of 150 percent of the national average, an additional 75 percent of the LEC's costs may be recovered from the interstate jurisdiction. As 25 percent of its loop costs are already recoverable under the regular jurisdictional separations rules, the additional 75 percent support from the high cost assistance fund allows that LEC to recover 100 percent of their incremental loop costs in excess of the national average from the interstate jurisdiction.

[730] Citizens Utilities further comments at 6-7. *See also* Great Plains *80-286 NPRM* comments at 111-12; MCI *80-286 NPRM* comments at 10-16.

[731] GVNW *80-286 NPRM* comments at 34.

[732] Arvig *80-286 NPRM* comments at 4.

[733] SWBT *80-286 NPRM* comments at 46-52, Att. 1. *See also* GTE *80-286 NPRM* comments at 43-52; North Carolina UC *80-286 NPRM* comments at 3-4.

[734] AT&T further comments at 2-4, App. A. *See also* ACTA *80-286 NPRM* comments at 9; MFS *80-286 NPRM* comments at 12; Sprint *80-286 NPRM* comments at 10-14 (arguing that this will help deter "gold plating"); Washington UTC further comments at 17.

[735] Ad Hoc Telecom. Users comments at 12. *See also* MCI *80-286 NPRM* comments at 10-16.

[736] New York DPS comments at 6. *See also* NASUCA *80-286 NPRM* comments at 11-12; Nebraska PSC *80-286 NPRM* comments at 7.

obtaining high cost support for excessive administrative costs.[737] Meanwhile, SDITC recommends replacing the compensation of administrative expenses with compensation for "telephone plant investment" to encourage development of advanced telecommunications facilities in all areas.[738] NECA, however, suggests that, if the Commission is concerned about excessive levels of general and administrative expenses in the high cost assistance fund, the Commission could consider using statistical measures, such as a two-standard-deviation test to limit the amount of such expenses.[739]

219. Eliminate *de minimis* loop cost support. AT&T and Time Warner propose that high cost assistance to LECs receiving less than $1.00 in universal service support per loop be eliminated to reduce the size of the fund.[740] Maine PUC also favors this proposal on the basis that these payments are too low to make much difference to the recipients.[741] In response to the *80-286 NPRM*, Cincinnati Bell and SWBT also supported elimination of *de minimis* assistance since applying this modification to large ILECs will pose the least potential harm to small LECs, while still reducing the size of the high cost support mechanism.[742] In their response to the *80-286 NPRM*, however, GTE, Pacific Bell, and BellSouth opposed eliminating *de minimis* loop cost support.[743] BellSouth contended that the Commission's proposal to withdraw assistance to ILECs receiving less than $1.00 per month is predicated on the "fiction" that, if the carrier is large, it can internalize the subsidies. BellSouth said this "easy way out" is no longer available and argued that, if the Commission eliminates high cost support below $1.00, the rules should be modified to permit the eliminated amount to be assessed as an end user surcharge.[744]

220. Eliminate or reduce support to large carriers. AT&T, Time Warner, and

[737] Missouri PSC comments at 9. *See also* Florida PSC *80-286 NPRM* comments at 9-10.

[738] SDITC reply comments at 3, 7.

[739] NECA further comments at 19. *See also* Pacific Bell *80-286 NPRM* comments at 6; USTA *80-286 NPRM* comments at 24-25.

[740] AT&T further comments at 2-4, App. A; Time Warner further comments at 28. *See also* MCI *80-286 NPRM* comments at 10-16.

[741] Maine PUC comments at 10. *See also* Alaska PUC *80-286 NPRM* comments at 16-17; Iowa Utilities Board *80-286 NPRM* comments at 2-5; Nebraska PSC *80-286 NPRM* comments at 7-10.

[742] Cincinnati Bell *80-286 NPRM* comments at 10; SWBT *80-286 NPRM* comments at 46-52, Att. 1.

[743] GTE *80-286 NPRM* comments at 43-52.

[744] BellSouth *80-286 NPRM* comments at 20-23.

SDITC promote the proposal of disqualifying Tier 1 LECs[745] from receiving high cost support to target the support more appropriately.[746] In response to the *80-286 NPRM*, ICORE recommends disqualifying Class 1 and Class 2 LECs from eligibility to target funding to smaller ILECs.[747] Alaska PUC supported the adoption of a sliding-scale distinction between small and large ILECs to target high cost support better.[748] Missouri PSC also supported implementing a sliding scale in the *80-286 NPRM* proceeding on the basis that it would eliminate the need to reconsider the distinction between large and small companies.[749] In addition, Montana PSC and New York DPS stated that limiting the higher levels of assistance to study areas with 100,000 lines or less might be more consistent with the goal of targeting assistance to smaller LECs.[750] Frontier recommended capping the amount of assistance to study areas with 50,000 or less lines.[751] Roseville Tel., however, opposed limiting higher levels of assistance to study areas with 100,000 or fewer lines, arguing that to suggest that large companies serving high cost areas do not need high cost support assumes the large company's ability to continue internal subsidies from rates in low cost areas to rates in high cost areas. It stated that it cannot be assumed that this situation will continue in the face of growing competition.[752]

221. Readjust study areas. NYNEX states that some large carriers have been able to qualify for assistance intended for small carriers by maintaining small study areas within a state. Thus, it recommends combining study areas within a state that are owned by the same

[745] For tariff review purposes, the term Tier 1 LEC has traditionally referred to a company having annual revenues from regulated operations of $100 million or more. For accounting purposes, the Commission uses the terms Class A and B companies as defined in 47 C.F.R. § 32.11(a)(1) and (2) to differentiate large and small carriers. Pursuant to section 402(c), the revenue threshold of Class A LECs has been indexed to inflation using the Gross Domestic Chain-Type Price Index (GDP-CPI). *See*, Implementation of the Telecommunications Act of 1996, Reform of Filing Requirements and Carrier Classifications, *Order and Notice of Proposed Rulemaking*, CC Docket 96-193, FCC 96-370 (Sept. 12, 1996).

[746] SDITC reply comments at 8; AT&T further comments at 2-4, App. A; Time Warner further comments 29. *See also* NCTA *80-286 NPRM* comments at 2, 23.

[747] ICORE *80-286 NPRM* comments at 16-17.

[748] Alaska PUC *80-286 NPRM* comments at 17-18. *See also* TCA *80-286 NPRM* comments at 15-17.

[749] Missouri PSC *80-286 NPRM* comments at 13-16.

[750] Montana PSC *80-286 NPRM* comments at 5-6; New York DPS *80-286 NPRM* comments at 7-8. *See also* Northeast Florida Tel. Coop. *80-286 NPRM* comments at para. 42.

[751] Frontier *80-286 NPRM* comments at 6-9.

[752] Roseville Tel. *80-286 NPRM* comments at 5-9. *See also* Vitelco reply comments at 10-11.

ILEC to apply the high cost assistance mechanisms uniformly and consistently.[753] Missouri PSC also promotes combining such study areas because it contends that the analysis of such broad areas will best reflect the overall circumstances of each ILEC. It explains that currently smaller study areas might permit a large ILEC to receive high cost assistance related to its high cost areas even though the ILEC's overall costs were no higher than average.[754] In response to the *80-286 NPRM*, GSA, however, opposed this proposal on the basis that it does not address the problem of internal subsidization of supporting high cost areas with revenues from low cost areas.[755] New York DPS also opposed combining loop costs for affiliated companies within a state because several small affiliated companies operate in New York and each company operates in a distinct service territory and charges rates unique to that company.[756] Pennsylvania PUC also stated that it was opposed to combining all affiliated study areas in a state because this would immediately disqualify large carriers from high cost assistance even though they have high cost areas within a study area.[757]

222. Citizens Utilities and BellSouth recommend using a smaller geographic area than a study area, such as a wire center,[758] as the basis for determining eligibility to target the support better and reduce the size of the fund.[759] Cincinnati Bell, in response to the *80-286 NPRM*, stated that wire centers are appropriate because they are a compromise between study areas and CBGs.[760] Also, Ameritech argued that collecting data by wire center may be less difficult than collecting data by CBG.[761] BellSouth asserted that the use of a wire center as the geographic basis for determining support would eliminate the need to divide carriers into

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753 NYNEX further comments at 19. *See also* Bell Atlantic *80-286 NPRM* comments at 8-11; MCI *80-286 NPRM* comments at 10-16; AT&T further comments at 2-4, App. A.

754 Missouri PSC comments at 8. *See also* Iowa Utilities Board *80-286 NPRM* comments at 2-5; Nebraska PSC *80-286 NPRM* comments at 7.

755 GSA *80-286 NPRM* comments at 6-7.

756 New York DPS *80-286 NPRM* comments at 6-7.

757 Pennsylvania PUC *80-286 NPRM* comments at 11-14.

758 A wire center is the location where the telephone company terminates subscriber outside cable plant (i.e. their local lines) with the necessary testing facilities to maintain them.

759 BellSouth further comments at 32; Citizens Utilities further comments at 7. *See also* Ameritech *80-286 NPRM* comments at 13-14; Cincinnati Bell *80-286 NPRM* comments at 6; NASUCA *80-286 NPRM* comments at 8-9, 19; SWBT *80-286 NPRM* comments at 19, Att. 1.

760 Cincinnati Bell *80-286 NPRM* comments at 6.

761 Ameritech *80-286 NPRM* comments at 13-14.

large and small categories.[762]

223. GTE proposes using a unit smaller than a wire center, such as a CBG, because, it states, this will result in better targeted support, minimize the amount of support provided, and send more accurate price signals to new entrants.[763] In response to the *80-286 NPRM*, California PUC also advocating the use of CBGs, stated that the CBG is small enough to make the costs of an area more homogenous while keeping the distribution of the fund manageable.[764] Bell Atlantic, however, opposed the use of CBGs to identify high cost areas. It argued that attempting to administer a national CBG-based high cost support mechanism would become overly complex and cumbersome.[765] BellSouth also opposed the use of CBGs. It claimed that CBGs have no relationship to a local service obligation, have nothing to do with local service areas as defined by state commissions, and have no operational significance to ILECs, and that no credible evidence exists that they bear any relationship to costs.[766]

224. Adjust Rate Structure. GTE advocates imposing a rate ceiling to achieve specific level of end-user prices. It proposes that the level of support must initially be based upon a measure of the cost of service with a rate ceiling.[767] In the *80-286 NPRM* proceeding, the California PUC stated that it is addressing rate caps in certain areas as well.[768] ALLTEL recommended implementing rate rebalancing to reduce the fund size by allowing ILECs with a per-line contribution of less than $1.00 to increase their SLCs, especially if the proposal to eliminate *de minimis* support is adopted.[769]

225. Implement additional accounting safeguards. Washington UTC proposes that

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762 BellSouth *80-286 NPRM* comments at 20-23.

763 GTE comments at 10. *See also* Jones Intercable *80-286 NPRM* comments at 4-5; Pennsylvania PUC *80-286 NPRM* comments at 7-9, 14-15; Sprint *80-286 NPRM* comments at 10-14.

764 California PUC *80-286 NPRM* comments at 4.

765 Bell Atlantic *80-286 NPRM* comments at 8-11.

766 BellSouth *80-286 NPRM* comments at 8-11, 26-28. *See also* Alaska PUC *80-286 NPRM* comments at 7-9.

767 GTE comments at 8-9. GTE also asserts that the support should fund the difference when the rate ceiling is less than the embedded costs. A competitive bidding process should replace this cost-based comparison to determine the support amount once carriers enter the market.

768 California PUC *80-286 NPRM* comments at 4.

769 ALLTEL *80-286 NPRM* comments at 7. *See also* BellSouth *80-286 NPRM* comments at 20-23; Citizens Utilities further comments at 7.

the Commission implement additional accounting safeguards to book, track, and report appropriate revenues to explicit accounts to ensure that high cost funds are used for intended purposes.[770]

226. Make the support portable. BellSouth and AT&T propose making the universal service support fully "portable" so that the support should move with the customer. They state that this will encourage competition and eventually reduce end-user rates for local service.[771]

227. Adopt an indexed cap. AT&T recommends adopting an indexed cap on the growth of the universal service support to reduce the size of the fund and encourage efficient operation.[772] In response to the *80-286 NPRM*, Alaska PUC expressed concern that a permanent cap would reduce support available to needy companies in an arbitrary manner.[773]

228. Implement usage-sensitive support. ITC and ETEX Tel. Coop. propose implementing a "usage-sensitive" universal service mechanism, based on a company's embedded costs, that lowers the high cost assistance funding as the usage per-minute for each access line increases. These commenters contend that this methodology will promote toll and resale competition in rural areas while maintaining monopoly efficiencies of low-density rural areas.[774]

229. Change current assessment structure. Many commenters recommend changing the current assessment structure to promote competitive neutrality to make the contribution mechanism more equitable. For example, ACTA in the *80-286 NPRM* proceeding argued that preserving high cost assistance should not be the burden of one segment of the telecommunications industry, namely the interexchange segment.[775] AT&T, GTE, NYNEX, and Lincoln propose that high cost support be funded on the basis of a single, uniform surcharge to all end-user telecommunications services. Thus, all telecommunications service

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[770] Washington UTC further comments at 16.

[771] BellSouth comments at 10-14; AT&T further comments at 20. *See also* Sprint *80-286 NPRM* comments at 10-14.

[772] AT&T further comments at 2-4, App. A. *See also* Frontier *80-286 NPRM* comments at 6-9; MCI *80-286 NPRM* comments at 10-16; Sprint *80-286 NPRM* comments at 10-14.

[773] Alaska PUC *80-286 NPRM* comments at 17-18. *See also* USTA *80-286 NPRM* comments at 31-32; Vermont DPS *80-286 NPRM* comments at 27-28.

[774] ITC comments at 10; ETEX Tel. Coop. reply comments at 2.

[775] ACTA *80-286 NPRM* comments at 9.

providers, including IXCs, ILECs, CLECs, wireless carriers, and resellers, would finance high cost support.[776] AT&T contends that this surcharge will foster greater efficiency and new entry that will result in lower prices for customers.[777] Citizens Utilities recommends creating a contribution mechanism that assesses all interstate carriers, instead of just IXCs.[778] In response to the *80-286 NPRM*, Nebraska PSC proposed that the current threshold should be eliminated and all telecommunications carriers should contribute to support high cost assistance based on a percentage of gross revenues that would "establish that large carriers support the fund but small carriers would also invest in the fund."[779]

230. Redefine current small and large company distinction. In response to the *80-286 NPRM*, Pennsylvania PUC and BellSouth supported changing the definition of a small study area to be one with 100,000 loops or fewer to target the support better.[780] In order to achieve the goals of high cost support, however, Maine PUC recommends eliminating the 200,000 line distinction between large and small companies in defining the level of support.[781]

231. Use of average loop counts. In response to the *80-286 NPRM*, Florida PSC, Montana PSC, and Nebraska PSC supported the determination of high cost support eligibility based on the average lines per year rather than on a count at the end of the year as a more accurate method to calculate loop costs.[782] In that proceeding, USTA contended that using the average number of lines over a year instead of the year end number would impose a substantial administrative burden on small exchange carriers that do not have mechanized line counts.[783] USTA argued that this could also understate loop counts for carriers that are declining in size and overstate loop costs for growing carriers. USTA maintained that a better approach would be to permit exchange carriers involved in mergers and acquisitions to adjust

[776] AT&T comments at 7; GTE comments at 8-9; Lincoln reply comments at 7; NYNEX further comments at 20.

[777] AT&T comments at 8.

[778] Citizens Utilities further comments at 7.

[779] Nebraska PSC *80-286 NPRM* comments at 6.

[780] BellSouth *80-286 NPRM* comments at 20-23; Pennsylvania PUC *80-286 NPRM* comments at 11-14. *See also* MCI *80-286 NPRM* comments at 10-16.

[781] Maine PUC comments at 9. *See also* Ohio PUC *80-286 NPRM* comments at 9-11; SWBT *80-286 NPRM* comments at 46-52, Att. 1; Vermont DPS *80-286 NPRM* comments at 22-27.

[782] Florida PSC *80-286 NPRM* comments at 9-11; Montana PSC *80-286 NPRM* comments at 5; Nebraska PSC *80-286 NPRM* comments at 7. *See also* ACTA *80-286 NPRM* comments at 12-13.

[783] USTA *80-286 NPRM* comments at 25.

expense levels for the year in which a transaction occurred to produce a consistent match between expenses and loops investment data.[784]

iii. DEM Weighting Program

232. Maintain existing DEM weighting program. Several commenters, including many small and rural ILECs, want the existing DEM weighting program to continue.[785] Siskiyou argues that the DEM weighting program is a valid and appropriately focused program because switching costs are three or more times higher per access line in small rural exchanges than they are in larger exchanges.[786] OITA-WITA explain that switching costs are higher for small ILECs because they are forced to buy components of a switch sized for 10,000 customers, even though they might be serving only 1,000 customers. Moreover, these commenters state that they are disadvantaged because they are too small to implement volume discounts.[787] Some commenters argue that eliminating the DEM weighting program or combining it with the Federal universal service support would raise rural rates.[788] Century also asserts that eliminating or modifying this program would make universal service support methods less specific and violate the 1996 Act "by creating an internal cross-subsidy between distinct service elements that [flies] in the face of the Act's preference for unbundling in a competitive environment."[789] In addition, ICORE contends that the DEM weighting program is not a subsidy or assistance mechanism.[790]

233. Modify the current DEM weighting rule. Commenters proposed several modifications to the current rule. NYNEX, Maine PUC, Citizens Utilities, BellSouth, and New York DPS recommend combining switching and loop costs in one high cost "fund" to make the support for switching costs explicit by removing the revenue requirements associated

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[784] *Id.* at 25.

[785] *See, e.g.*, Mon-Cre comments at 3-4; New Hope Tel. comments at 3-4; RTC comments at 15; Telec Consulting comments at 6-8; West Virginia Consumer Advocate comments at 9-10.

[786] Siskiyou reply comments at 3.

[787] OITA-WITA comments at 7-10. *See also* Northeast Florida Tel. Co. *80-286 NPRM* comments at para. 10; Rural Iowa Indep.Tel. Ass'n *80-286 NPRM* comments at 1.

[788] Century comments at 12. *See also* Alaska Tel. comments at 4; ICORE comments at 10-12; Mid-Rivers Tel. Coop. *80-286 NPRM* comments at 2-6.

[789] Century comments at 14 (*citing* 47 U.S.C. § 251 (c)(3)).

[790] ICORE comments at 10-12.

with it from smaller ILECs' interstate switched access rates.[791] Maine PUC also adds that this will reduce the size of the fund because companies with high loop costs but low switching costs will not receive as much assistance.[792] In response to the *80-286 NPRM*, Colorado PUC, however, opposed combining DEM weighting with high cost support. It claimed that this action would merely shift the targeted support among recipients and it would be particularly harmful to small ILECs.[793] NECA and ICORE also argue that DEM weighting should not be combined with the universal service support mechanisms because they serve different purposes and the administration of both programs would be burdensome.[794] Instead, they advocate replacing the current stepped formulas to calculate DEM weighting amounts for study areas between 10,000 and 50,000 access lines using a "sliding-scale" approach.[795] United Utilities argues that the current program should be changed to more accurately reflect the use of Category 3 switching costs,[796] the amount of Category 3 switching costs eligible for universal service support should be determined and the DEM weighting factors should be revised.[797]

234. Eliminate the DEM weighting program. New Jersey Advocate, Time Warner, AT&T, and Lincoln contend that the DEM weighting mechanism creates an implicit subsidy because it is embedded in interstate access charges, and is therefore, contrary to the 1996 Act's mandate that all subsidies be explicit.[798] AT&T further argues that the current DEM weighting mechanism has "no economically sound cost-based or need-based eligibility requirement" and recommended eliminating the DEM weighting program altogether.[799] Time

[791] BellSouth comments at 10-14; Maine PUC comments at 11; New York DPS comments at 7; Citizens Utilities further comments at 6-7; NYNEX further comments at 22. *See also* GSA *80-286 NPRM* comments at 3-4; Pacific Bell *80-286 NPRM* comments at 1; Staurulakis comments at 7; Texas PUC *80-286 NPRM* comments at 3-4; Lincoln reply comments at 4.

[792] Maine PUC comments at 11.

[793] Colorado PUC *80-286 NPRM* comments at 7-8.

[794] ICORE comments at 10-12; NECA further comments at 18-19.

[795] ICORE comments at 10-12; NECA further comments at 18-19. *See also* Missouri PSC *80-286 NPRM* comments at 6-7; South Dakota PUC *80-286 NPRM* comments at 1; USTA *80-286 NPRM* comments at 41.

[796] Category 3 switching costs are the costs associated with operating local switching equipment. *See* 47 C.F.R. § 36.125.

[797] United Utilities comments at 3-4.

[798] New Jersey Advocate comments at 12; Lincoln reply comments at 4; AT&T further comments at 2-4, App. A; Time Warner further comments at 28.

[799] AT&T further comments at 2-4, App. A. *See also* Frontier *80-286 NPRM* comments at 3; MCI *80-286 NPRM* comments at 3-7.