

under the Joint Board's recommendation with the contributions these carriers would make based on their shares of total retail revenues.

**CHART 3**  
**Contributions Based on Interstate and Intrastate Revenues**

Measure of Revenues	LEC	IXC	Other
Retail Revenues Less Residence Local	38%	50%	12%
Retail Revenues	47%	43%	10%
Gross Revenues Less Payments to Other Carriers	63%	25%	12%

*Source: calculated from TRS Fund Worksheet data, Tables 3-22; FCC Industry Analysis Division, February 1996.*

The Joint Board recommendation cannot be considered consistent with the intent of Congress. The LECs, who are generally understood to be local carriers, would contribute 63% to the fund, and the IXCs, who most people would identify as "interstate" carriers, would contribute only 25%. This would leave little room for the states to develop their own funds.

**B. The Commission Should Provide A Reasonable Means For Carriers To Recover Their Universal Service Contributions.**

In addition to specifying how carriers will contribute to the universal service fund, the Commission must determine how the carriers will recover their contributions. The Commission cannot impose contributions on regulated carriers without providing a means for the carriers to recover those contributions. The issue of recovery raises jurisdictional issues in the event that the Commission assesses contributions based on a carrier's intrastate revenues.

Contributions to a federal universal service fund, whether based on interstate revenues or total interstate and intrastate revenues, would be recorded by the carriers as interstate costs. Since the Commission has no authority to prescribe intrastate rates, or to prescribe the method of recovering costs that are assigned to the intrastate jurisdiction, it cannot provide a recovery mechanism for universal service costs that applies to the provision of intrastate services. The Commission needs to enlist the cooperation of the states in order to allow the carriers to recover contributions that are based on intrastate revenues.

The Fifth Amendment of the Constitution prohibits the government from "taking" private property for public use without "just compensation." To avoid running afoul of this constitutional principle, a regulatory agency must permit a carrier to charge rates that will "maintain its financial integrity, to attract capital, and to compensate its investors for the risk [they have] assumed."<sup>29</sup> Courts are obliged to interpret statutes in such a way as to avoid constitutional infirmities.<sup>30</sup> Accordingly, Section 254(d) should not be interpreted to allow the Commission to "take" the carriers' contributions to the universal service fund without providing them with a means of recovering those contributions in their rates. Where, as in the case of the LECs, the carriers' rates are subject to regulatory

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<sup>29</sup> Duquense Light Co. v. Barasch, 488 U.S. 299, 310 (1989), quoting FPC v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944).

<sup>30</sup> See TCI of North Dakota, Inc. v. Schriock Holding Co., 11 F.3d 812, 815 (8th Cir. 1993).

controls, the regulatory agencies must allow some sort of rate adjustment so that the carriers can be compensated.<sup>31</sup>

There are several alternatives for providing such compensation to the LECs. If the Commission assessed contributions based on a LEC's interstate access charges, the Commission could allow an exogenous cost increase for carriers subject to price caps.<sup>32</sup> The Commission could establish new rate elements, such as a surcharge on interstate revenues, which the LECs could apply to their access services as well as to their interexchange services (such as their corridor services and their interstate intraLATA services).<sup>33</sup> The Commission could also establish new rate elements that were not surcharges, such as per-PSL charges or per-subscriber charges.<sup>34</sup> Regardless of which

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<sup>31</sup> Since the Commission does not regulate the rates of nondominant carriers, which includes all of the existing IXCs, the Commission need not provide for a specific recovery mechanism for these carriers. As nondominant carriers, they are free to raise their rates, or to establish new rate elements, to recover their contributions.

<sup>32</sup> For rate of return carriers, the Commission could simply allow the carriers to file a general rate increase.

<sup>33</sup> The Joint Board recommended that the Commission refrain from increasing the residential and single line business SLC in funding universal service. *Recommended Decision*, para. 769. Accordingly, the Joint Board recommended that the Commission adjust the SLC downward to offset the effect of an assessment for contributions to the universal service fund that includes both interstate and intrastate revenues. *See id.*, paras. 772-773.

<sup>34</sup> NYNEX believes that surcharges on retail rates would be most consistent with the statutory requirement that universal service support be "equitable," "nondiscriminatory," and "explicit." *See* Sections 254(d), (e); Joint Explanatory Statement, p. 131. The Commission should also consider the use of per-PSL charges in the access reform proceeding as a means of reducing the uneconomic effects caused by current rules that require recovery of nontraffic sensitive costs through usage-sensitive access charges.

method the Commission chose, it would have to adopt new rules, since the LECs cannot make exogenous cost changes or implement new switched access rate elements without rule changes.

NYNEX recommends that the Commission allow interstate carriers to recover their contributions to the interstate universal service fund through a surcharge on their retail interstate rates. A surcharge on a customer's bill for interstate services would make universal service support explicit, which would improve accountability and help to control unnecessary growth of the fund. This method of funding has the support of several IXC's, LECs, state PUCs and public officials.<sup>35</sup> As the Wyoming PSC explained:

This method could explicitly identify subsidies by showing universal service fund charges and payments directly on customer bills. End users would thereby be informed of the costs of the system. The charges and credits could be clearly identified and equally shared among providers and end users. This will help competition to develop rationally in a more informed marketplace.<sup>36</sup>

The surcharge amount should be calculated without regard to the amount of any "offset" that a carrier could claim under Section 254(h)(1)(A) of the Act. The Joint Board recommended that carriers who provide services to health care providers at "reasonably comparable" rates under the provisions of Section

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<sup>35</sup> See Comments on universal service filed with the Commission on April 12, 1996 by AT&T at p. 7; NYNEX at pp. 23-24; Sprint at p. 4; Ameritech at p. 23; BellSouth at p. 15; Southwestern Bell at p. (I); US West at p. 16; California PUC at p. 21; Wyoming PSC at pp. 4-5.

<sup>36</sup> See Wyoming PSC Comments at pp. 4-5.

254(h)(1)(A) of the Act should treat the amount eligible for support as an offset towards that carrier's universal service support obligation, and that they should not be allowed to seek direct reimbursement from the fund.<sup>37</sup> This mandatory offset rule is contrary to the Act, which allows a carrier the option of offset or reimbursement from the fund.<sup>38</sup> Moreover, offsets to a carrier's obligation to contribute to the fund should not be confused with a carrier's right to seek recovery of its contributions from ratepayers. For example, suppose a carrier provided a \$500 discount in its rate to a rural health care provider in order to match the level of the carrier's urban rate. Normally, the carrier would be entitled to seek a \$500 reimbursement from the fund administrator to compensate it for the discount. The carrier would also be required to make whatever contribution to the fund that the administrator calculated based on the funding methodology adopted by the Commission in this proceeding. As is discussed above, the carrier would recover its contribution to the fund through a surcharge, a rate increase, or some other mechanism, such that the amount of its contribution and its surcharge revenues would be in balance. If the carrier followed the Joint Board recommendation and reduced its contribution to the fund by \$500 by treating the discount as an offset, the carrier would suffer a net loss of \$500 on the services to that health care provider if it did not recover that amount through some other rate element. That would be confiscatory. The only

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<sup>37</sup> See *Recommended Decision*, para. 716.

<sup>38</sup> See 47 U.S.C. Section 254(h)(1)(B)(i) and (ii).

way to make the carrier whole would be to allow it to recover \$500 more in surcharge revenues than it contributed directly to the fund. Therefore, if the Commission adopted the Joint Board recommendation on offsets, it would have to ensure that the surcharge revenues included the sum of the carrier's payments to the universal service fund and the amount of offsets that it claimed for services to health care providers at a discount.<sup>39</sup>

The Commission cannot prescribe a surcharge or a rate increase that would apply to the purchase of intrastate telecommunications service. Section 2(b) of the Act establishes the general rule that the Commission has no jurisdiction over the "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service." Once costs are assigned to the State jurisdiction, the State has exclusive jurisdiction to regulate the rates to recover those costs.<sup>40</sup> The Commission can regulate intrastate rates only if another provision of the Act unambiguously provides such authority.<sup>41</sup> Section 254 does not provide such an unambiguous statement. Therefore, the mechanism that the Commission establishes for recovery of a

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<sup>39</sup> In addition, the fund administrator would have to include the amount of offsets in the total amount to be contributed to the fund based on each carrier's revenue share. Otherwise, the amount that carriers contributed to the fund would not cover the amount to be reimbursed to the carriers that did not use offsets.

<sup>40</sup> See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 375 (1986).

<sup>41</sup> See *id.* at p. 377.

carrier's contribution to the federal universal service fund can apply only to the carrier's rates for interstate services.

Contributions to a universal service fund established by the Commission, whether based on interstate revenues, interstate and intrastate revenues, or any other allocation method, would be considered an interstate cost. As such, the Commission must provide for an interstate recovery mechanism. That mechanism cannot apply to the use or provision of intrastate communications services without running afoul of the statutory restrictions on the Commission's jurisdiction.

For this reason, the Joint Board's recommendation to allocate universal service contributions on both interstate and intrastate revenues would produce a burdensome recovery mechanism. As is shown above, most of the contributions would be allocated to the LECs, based on their extensive intrastate revenues, but they would have to recover all of these contributions through surcharges or increases applied to their interstate rates. This would cause disproportionate burdens on the LECs' interstate rates. For example, assume two carriers each had total revenues of \$10 billion, but that the first carrier was an IXC with 80% of its revenues in the interstate jurisdiction, and that the second was a LEC with 20% of its revenues in the interstate jurisdiction. If the Commission assessed contributions based on 5% of total revenues, each carrier would have to contribute \$500 million to the fund. Assuming all of these contributions were

treated as interstate costs, the carriers could only raise their interstate rates to recover their contributions. The IXC would have to raise its interstate rates by 6.25%, and the LEC would have to raise its interstate rates by 25%. This gross disparity would be contrary to the statutory goal that all providers of telecommunications services shall make an "equitable and nondiscriminatory contribution" to universal service,<sup>42</sup> and to the "competitive neutrality" principle proposed by the Joint Board.<sup>43</sup>

However, if the states participated in the federal fund, they could allow surcharges on intrastate rates that would spread the rate impact evenly among interstate and intrastate carriers. In the example above, both the IXC and the LEC could apply a surcharge of 5% to their total rates to recover their \$500 million contributions. Thus, state participation in the funding mechanism is essential to achieving the goal of competitive equality.

**C. The Commission Should Specify The Rate Adjustments That Carriers Will Make When They Receive Universal Service Funds.**

The *Recommended Decision* largely ignores the question of what the carriers will do when they receive universal service funds. Since the purpose of Section 254 is to ensure that universal service support is "explicit, rather than implicit as many support mechanisms are today,"<sup>44</sup> the Commission should identify the

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<sup>42</sup> See 47 U.S.C. Section 254(b)(4).

<sup>43</sup> See Section II *supra*.

<sup>44</sup> Joint Explanatory Statement, p. 131.

implicit support mechanisms that would be reduced or eliminated to the extent that a carrier received explicit support from the universal service fund. For instance, it is generally agreed that existing interstate access charges are priced above cost in order to support below cost rates for local exchange service. If a carrier received high-cost support directly from the fund, it should be required to use part or all of those funds to reduce interstate access charges.

In specifying the necessary rate adjustments, the Commission may run into jurisdictional problems. The Joint Board recommended use of a proxy model and national affordability benchmarks that look at costs and revenues on a total company basis.<sup>45</sup> The difference between costs and the revenue benchmark in high-cost areas (however defined) would determine the amount of support each carrier would get. The Commission could require that the carriers use all of their high-cost support to reduce interstate access charges. However, if the Commission decided to assign a portion of high-cost support to the intrastate jurisdiction, the states would have to determine which state rates the carriers would have to reduce to offset those amounts. Other funds raise similar issues. Schools and libraries will receive support in the form of discounts from

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<sup>45</sup> The revenue benchmark would be based on nationwide average revenue-per-line, including local, access and other telecommunications revenues. See *Recommended Decision*, paras. 310-311. The *Recommended Decision* does not indicate what would be included in "access revenues." To be consistent with the description of services that are included in "core" universal service, the Commission should only include revenues from the CCL charge and the SLC in the benchmark.

competitively-bid prices or the carriers' lowest corresponding price.<sup>46</sup> Carriers will be reimbursed from the fund administrator for the amount of the discount. However, the state regulatory agency must approve tariff changes for discounts on state services that are offered by regulated carriers.<sup>47</sup> Offsets to state rates for Lifeline support and health care providers in rural areas raise similar jurisdictional issues.

Simply providing funds to the intrastate jurisdiction, without specifying the appropriate rate adjustments, might not accomplish the Commission's goals. The Commission has no authority to order a state to make any particular rate adjustments, regardless of the purpose underlying the funding mechanism. A state may decide that a carrier receiving high-cost support should allocate part of that support to a reduction in local telephone rates, rather than a reduction in the rates for services that currently are priced above cost. This could perpetuate the system of implicit subsidies in state rates. For this reason, cooperation and coordination with the state commissions is critical.

**D. If The Commission Wants To Include Intrastate Revenues In Assessing Universal Service Fund Contributions, It Should Make State Participation Voluntary.**

Clearly, there are significant jurisdictional impediments to a universal service fund that is based on both interstate and intrastate costs, and that is based

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<sup>46</sup> See *Recommended Decision*, paras. 535-546.

<sup>47</sup> The Act also provides that the State will determine the amount of the discount for intrastate services. See 47 U.S.C. Section 254(h)(1)(B).

on carrier revenues in both jurisdictions. If the Commission wants to broaden the base of support for the fund, it should solicit the voluntary cooperation of the states. The Commission could provide federal support for schools, libraries, health care providers, low income subscribers and high-cost areas that would support services and costs in the state jurisdiction provided that a state commission took the actions necessary to implement the fund as intended by the Commission.

For instance, the Commission could provide that eligible carriers would be compensated for discounts that they provide to schools to purchase services out of the carriers' state tariffs if (1) the discounts were within the ranges specified in the Commission's order; (2) the state required all intrastate carriers to contribute to the fund based on the method of assessment adopted by the Commission; (3) the state permitted intrastate carriers to recover their contributions to the fund through the application of a surcharge on their intrastate retail revenues.

The high-cost fund could operate in a similar way. The Commission could adopt a funding mechanism based on the difference between the cost of loops in high-cost areas and an affordability benchmark.<sup>48</sup> Since 70 to 80 percent

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<sup>48</sup> The Joint Board recommended that the Commission provide high-cost support for single line business lines in addition to primary residence lines. *See Recommended Decision*, para. 91. The Joint Board properly recognized that a higher revenue benchmark would apply to business lines, because they generally are provided at higher rates. *See id.*, para. 312.

of total costs are assigned to the state jurisdiction,<sup>49</sup> an eligible carrier would receive the full amount of the difference between the cost and the benchmark only if the state agreed to participate in the federal fund. All carriers would contribute based on their retail revenues, and they would recover those contributions through surcharges in their federal and state tariffs. An eligible carrier receiving such funds would be required to reduce the rates that currently are implicitly supporting high-cost areas. The interstate portion of those funds would be used to reduce interstate access charges, and the intrastate portion would be used to reduce state rates that currently provide contribution – such as intrastate access rates, intrastate toll rates, and rates for vertical features.

If a state did not want to take part in the federal fund according to the Commission's standards, the state could establish its own fund under Section 254(f) of the Act. It is likely, however, that most states would want to participate in the federal fund. The states generally share the Congressional goal of providing additional funding for schools, libraries, and health care providers, they want to increase subscribership by low income customers, and they understand that the current method of supporting high-cost areas through implicit subsidies and rate averaging is not viable in a market which is open to competition. In addition, the states may want to reduce the burden on purchasers of local telephone service by capturing a greater contribution to

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<sup>49</sup> See 47 C.F.R. Section 36.154.

universal service from interstate carriers through the federal funding mechanism.

**V. The Commission Should Coordinate The Geographic Area That Determines The Level Of High-cost Support With The Geographic Area Used For Deaveraging Unbundled Network Elements.**

The Joint Board recommended that the Commission urge the states, in exercising their responsibility under Section 214(e) of the Act to define the "service area" in which an eligible carrier must provide core universal service, to designate non-rural telephone company areas that are sufficiently small in geographic scope to permit efficient targeting of high-cost support and to facilitate entry by competing carriers.<sup>50</sup> The Joint Board also found that the Commission could designate areas smaller than a "service area" for purposes of determining the level of high-cost support payments that an eligible carrier would receive.<sup>51</sup> Some parties have suggested computing universal service support based on discrete geographic areas as small as 300 foot grids or census block groups.<sup>52</sup>

If the Commission decides to use geographic areas smaller than a study area for the purpose of developing high-cost support, it should ensure that the

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<sup>50</sup> See *Recommended Decision*, para. 175.

<sup>51</sup> See *id.*, para. 178. High-cost support would be calculated for a specific "geographic area" pursuant to a proxy costing model. See *id.*, para. 277.

<sup>52</sup> See *id.*, paras. 170-171.

level of geographic deaveraging is consistent with the level of geographic deaveraging of unbundled network elements. In the *Local Competition Order*, the Commission required the LECs to geographically deaverage their rates for unbundled network elements and interconnection into at least three zones.<sup>53</sup> Although that requirement has been stayed by the Court pending appeal,<sup>54</sup> some states are following the Commission's lead by requiring certain rate elements to be deaveraged by zone. However, it is unlikely that rates for unbundled elements and interconnection will be geographically deaveraged at the level proposed in this proceeding for high-cost support. Consequently, the prices for unbundled elements and interconnection could be far less than the amount of universal service support for high-cost areas. This would encourage new entrants to purchase unbundled elements solely for the purpose of receiving universal service support, and it would remove the support that the LEC needs to continue serving high cost areas.

The arbitrage problem can best be explained through example. If NYNEX's New York study area were divided into four zones (urban, suburban, rural/suburban, and rural), the costs for unbundled elements in the rural zone

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<sup>53</sup> See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325, released August 8, 1996 ("*Local Competition Order*"), para. 765; 47 C.F.R. Section 51.507(f).

<sup>54</sup> See *Iowa Utilities Board v. FCC*, Case No. 96-3321, United States Court of Appeals for the 8th Circuit, Order Granting Stay Pending Judicial Review, filed October 15, 1996.

would be approximately \$38.42 per month, based on data from the Benchmark Cost Model 2 ("BCM2") filed in this docket.<sup>55</sup> Within the rural zone, costs for individual wire centers range from \$23.98 to \$149.54 per month, as shown below for representative wire centers.

<u>Wire Center (CLLI)</u>	<u>Cost/Month</u>	<u>Lines Served</u>
Milton	\$23.98	12,415
Rome	\$26.78	27,951
New Paltz	\$36.81	6,800
Greenfield Center	\$48.91	4,914
Brainardsville	\$124.70	1,010
St. Regis Falls	\$122.92	1,251
Putnam	\$149.54	482

If the affordability benchmark were set at \$30.00, the amount of universal service support in the St. Regis Falls and Putnam wire centers would be more than double the price of unbundled elements, encouraging new entrants to purchase elements solely for the profits to be derived from the universal service fund.

Furthermore, if universal service support were disaggregated within a wire center, even average cost wire centers would become opportunities for arbitrage. For example, the BCM2 costs for the New Paltz wire center, which has an average cost of \$36.81 per month, range from \$17.00 to \$75.82 per month. By

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<sup>55</sup> These costs are not NYNEX's actual booked costs, since NYNEX does not keep costs by wire center.

purchasing unbundled elements at \$38.42 per month only for the high cost census block groups within New Paltz, a new entrant could use the universal service fund as a source of unearned profits. In fact, the new entrant could give service away for free in the highest cost census block groups and still make a profit.

Although the Act requires a carrier that has been designated as an "eligible carrier" to offer universal service throughout its "service area,"<sup>56</sup> this is not an adequate remedy for arbitrage. The Act permits an eligible carrier to provide universal service using a combination of its own facilities and resale. In the example of New Paltz, a new entrant could meet this requirement by using its own facilities in the areas where loop costs are \$17.00 (well below the LEC's price of \$38.42 for unbundled elements) and use resale of the LEC's unbundled elements in the highest cost areas, where universal service support is likely to be over twice the cost of unbundled elements.

For these reasons, the Commission should ensure that the level of geographic deaveraging for universal service matches the level of geographic deaveraging for unbundled network elements and interconnection. If the Commission does not, it should provide high-cost support only to carriers that use their own facilities to serve a customer in a high-cost area. If a carrier used resale or unbundled network elements to serve a customer, the underlying

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<sup>56</sup> See 47 U.S.C. Section 214(e)(1); *Recommended Decision*, paras. 155-164.

facilities-based carrier should receive the universal service subsidy.<sup>57</sup> This would prevent purchasers of unbundled elements from receiving unjustified subsidies, and it would enable the facilities-based carrier to obtain the support it needs to serve high cost areas.

**VI. If The Commission Adopts The Joint Board Recommendation For Calculating High Cost Support, It Should Reconcile It With The Issue Of Embedded Costs In The Access Reform Proceeding.**

The Joint Board recommended that high-cost support be based on a model of forward-looking "economic" costs, including a reasonable allocation of joint and common costs, but excluding the LECs' embedded costs.<sup>58</sup> This is similar to the costing model that the Commission adopted in the *Local Competition Order* for the pricing of interconnection, unbundled network elements, and reciprocal compensation under Section 251 of the Act.<sup>59</sup> In the *Local Competition Order*, the Commission recognized that the LECs have significant embedded costs that they would not be able to recover through rates based on forward-looking costs, and

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<sup>57</sup> The Joint Board recommended that carriers who provide service solely through resale should not be eligible for universal service support. See *Recommended Decision*, para. 161. The Commission should make it clear that this would be applied on a customer-by-customer basis. Thus, even if a carrier was "eligible" to receive universal service support because it used both resale and its own facilities in its service area, it should not receive universal service support for those customers that it served through resale. Rates for resale would already include the amount of implicit subsidy that are incorporated in the LEC's retail rates, and there is no need to provide an additional subsidy to the reseller.

<sup>58</sup> See *Recommended Decision*, paras. 275-277.

<sup>59</sup> See *Local Competition Order*, paras. 690-705.

it indicated that the recovery of embedded costs would be considered in the universal service proceeding and in the upcoming access reform proceeding.<sup>60</sup> The Commission also rejected LEC arguments that the exclusion of embedded costs from the rates under Section 251 would be an unconstitutional "taking," because the Commission might allow some recovery of embedded costs in the access reform proceeding.<sup>61</sup>

If the Commission adopted the Joint Board recommendation to use forward-looking costs to calculate high-cost support, the LECs would not recover their embedded costs from the universal service fund. This may be a reasonable approach if the Commission decides to allow new entrants to receive the same amount of universal service support as the LECs, since the new entrants do not have the same level of embedded costs, and since their costs of installing new facilities in high-cost areas should be similar to the costs developed through forward-looking proxy models. Therefore, the Commission should deal with the issue of embedded costs in the access reform proceeding.

## **VII. The Commission Should Adopt A Smaller Target Fund For Schools and Libraries.**

The Joint Board recommended a fund for providing discounted services to schools and libraries that would be capped at \$2.25 billion a year, with a provision to carry over undisbursed funds to the following year without regard

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<sup>60</sup> See *id.*, para. 707.

<sup>61</sup> See *id.*, para. 739.

to the cap.<sup>62</sup> The Joint Board based its fund calculations on McKinsey's full classroom model, under which all of the nation's classrooms would be connected with networked computers by the year 2000. The model was adjusted downward for several factors, including connections installed since the study was completed, volume discounts, and "netdays," and it was adjusted upward for the number of non-public schools and the cost of Internet access. The full classroom model assumes that schools and libraries will be able to raise, in an extremely short period of time, an additional \$39 billion in initial costs, and \$12.5 billion in ongoing costs needed for the implementation of the ambitious full classroom goal.<sup>63</sup>

The Joint Board's proposal is too ambitious. Shortly after the *Recommended Decision* was issued, Rep. Jack Fields, retiring chairman of the House Telecommunications Subcommittee, observed that the \$2.25 billion proposal was far above what Congress had in mind when it drafted Section 254. Not only is the size of the fund unwieldy, but it will add significantly to the burden on the carriers, which will ultimately be passed on to consumers.

Moreover, the \$2.25 billion estimate appears excessive even for the full classroom model. The Joint Board's calculations are not presented in any detail, nor in their entirety, and it is not clear whether this estimate reflects initial costs

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<sup>62</sup> See *Recommended Decision*, para. 556.

<sup>63</sup> McKinsey & Co., Connecting K-12 Schools to the Information Highway (1995), Appendix A, p. 57, Exh. 16. The McKinsey figures do not reflect the additional billions of dollars needed when private schools are included.

or ongoing costs. McKinsey estimated the annual ongoing costs per average school for connections to and within the school under the full classroom model at \$18,150.<sup>64</sup> If those costs were applied to the forecasted number of total public and non-public schools (113,000), and the Joint Board's recommended discount program using the percentage of students in the school lunch program were superimposed, the unadjusted ongoing cost of the McKinsey full classroom model, without the cost of Internet access, would be \$1.1 billion. It is hard to see how, once that amount is adjusted downward for the above mentioned factors, and upward for the cost of Internet access, the cost would more than double to \$2.25 billion.

NYNEX proposes a more modest and workable goal of achieving the full classroom model by the year 2005. This would result in the fund being set initially at a level of approximately \$1.5 billion, where it would remain for 10 years, and then be re-evaluated.

The Commission should not adopt the Joint Board proposal to carry over undisbursed funds to the following year, without regard to the cap. Given the size of the fund, and the fact that many schools and libraries probably would not be able to fund the associated equipment and training for advanced services for

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<sup>64</sup> *Id.*, Exh 17, using percentages in Exh. 7, p. 28. McKinsey estimates the ongoing costs of connecting within and to the average school under the full classroom model as 11% of \$165,000, or \$18,150.

some time, a carry-over provision is likely to make the fund increasingly burdensome as time goes on.

The Joint Board recommended that providers of inside wire services and Internet services to schools and libraries be eligible for universal service support.<sup>65</sup> We disagree. These providers are not eligible to receive universal service support under Section 214(e) because they are not “telecommunications carriers” that provide universal service through their own facilities. In addition, they will not contribute to the universal service fund, since they are not “interstate telecommunications providers” under Section 254(d). The Joint Board’s reliance on the principle of “competitive neutrality” to justify including providers of inside wire and Internet services cannot overcome these statutory definitions. In addition, it is not clear how allowing a provider to receive universal service support, without requiring it to contribute to the fund as will telecommunications carriers that provide inside wiring and Internet access, is consistent with the concept of competitive neutrality.

The Joint Board recommended that schools be entitled to receive discounts on internal connections, which may include such items as routers, hubs, network file servers, and wireless local area networks, but specifically excluding personal computers.<sup>66</sup> Since a network file server is a computer, the Commission should

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<sup>65</sup> See *Recommended Decision*, paras. 463, 484.

<sup>66</sup> See *id.*, para. 477.

adopt rules to prevent a school from avoiding the personal computer limitation by shifting computer functions to the network file server.

**VIII. The Commission Should Consider NECA As The Universal Service Fund Administrator If NECA Separates Its Advocacy Functions From Its Administrative Functions.**

The Joint Board recommended that the Commission appoint a universal service advisory board to designate a neutral, third-party administrator for the universal service fund.<sup>67</sup> The Joint Board recommended against appointing the National Exchange Carrier Association ("NECA") as the fund administrator, because NECA's current Board of Directors is composed primarily of incumbent LEC representatives, and because NECA's advocacy in several Commission proceedings may have created the impression among non-LECs that NECA is not impartial.<sup>68</sup>

NYNEX agrees that NECA's advocacy functions, which tend to represent the views of small LECs, would detract from the perception that it would be a neutral administrator of the universal service fund. However, NECA has personnel, processes, and data systems that were developed at industry expense as a result of its current industry funding activities that could be a valuable resource to those charged with administering the new fund. The Joint Board recommended that the Commission allow NECA to bid for the position of fund

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<sup>67</sup> See *id.*, para. 829.

<sup>68</sup> See *id.*, para. 832.

administrator if it made changes to its membership and governance that would eliminate the perception that it is biased towards the LECs.<sup>69</sup> We agree. A new governance structure is needed that would provide major representation to the carriers that provide major amounts of contribution to the universal service fund. In addition, to reinforce the perception of neutrality, NECA should separate its tariff advocacy function from any activities it engages in support of the administration of the universal service fund. The small LECs could establish a policy/advocacy organization that would represent the interests of the common line and traffic sensitive pools. This would allow NECA to perform a separate, neutral service function for the universal service fund.

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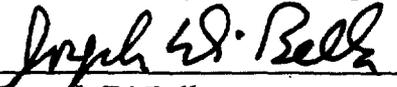
<sup>69</sup> *See id.*

## IX. Conclusion

The Commission should determine the funding and cost recovery issues that were left open in the *Recommended Decision*. It should also ensure that it stays within the jurisdictional boundaries of the Act, while providing an incentive for state commissions to participate in the federal universal service funding mechanisms.

Respectfully submitted,

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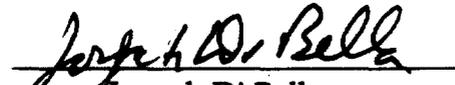
Their Attorney

Dated: December 19, 1996

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## CERTIFICATE OF SERVICE

I hereby certify that copies of this pleading were mailed this date, first class postage prepaid, upon the persons listed on the attached service list.

  
\_\_\_\_\_  
Joseph Di Bella

Dated: December 19, 1996