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February 20, 1997

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Federal Communications Commission
Office of Secretary

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

Re: CC Docket Nos. 96-45 & 97-2

Dear Mr. Caton:

Today, Frank Gumper, Vin Callahan, Jackie McGirr-Conti, and I, representing NYNEX, and Larry Katz and Dan Harris, representing Bell Atlantic, met with members of the Joint Board Staff, regarding the item captioned above. The attached material was used during the presentation and ensuing discussion, during which the NYNEX and Bell Atlantic representatives elaborated and clarified views already a part of their comments in this matter.

Any questions on this matter should be directed to me at either the address or the telephone number shown above.

Sincerely,

Tracy K. Chaney

Attachment

cc: D. Krech, FCC (letter only)
P. Pederson, MO PSC (letter only)
B. Roberts, CA PUC (letter only)
T. Wilson, WA UTC (letter only)
E. Hoffner, FCC (letter only)
S. Makeef, IA Utilities Board (letter only)
C. Bolle, SD PUC (letter only)
B. Payne, IN OUCC (letter only)
M. Long, FL PSC (letter only)
R. Curry, TX PSC (letter only)

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NYNEX Recycles

Universal Service

An Analysis and Overview of Census Block Group Based Proxy Models

February 21, 1997

Current CBG Based Proxy Models

Need to address the following key concerns to be defensible, fair and unbiased:

- Inter-regional fund flows create winners and losers
- Proxy models create an opportunity for arbitrage
- Hatfield Model 2.2.2 cannot be used to develop a national fund size
  - Hatfield does not estimate costs for non-Bell service areas
- New releases (BCPM and Hatfield 3.0) do not adequately resolve these key issues

Preliminary View of BCPM and Hatfield 3.0

- Late releases prohibits a timely validation of the models
- Preliminary view of the latest releases prohibits:
  - national analysis
  - state-to-state comparisons
  - meaningful evaluation of the models as requested by the Commission

Concerns Regarding New Proxy Models

- **Hatfield 3.0**
  - Limited Data
- **BCPM**
  - Input Data may have been Corrupted
  - Report Generation is Error Ridden
  - Monthly Operating Expenses Overstated
  - Replicating Results

Inter-Regional Fund Flow Issue

- Census Block Group creates potential bias against Northeast and Mid-Atlantic regions
  - »uniform distribution vs. clustering

Arbitrage Issue

- Geographical mismatches between universal service funding and unbundled network elements create serious gaming opportunities

Necessary Linkage between Universal Service and Network Elements

Universal Service = Network Elements plus Retail Costs

a) Network Elements = Loop
Port
Local Switching (500-700 MOUs)
Transport and Terminating Access
Access to E911, Operator Services and Directory Assistance

b) Retail Costs = State Approved $ per line to Cover Customer Care Costs for Basic Service

Example of inconsistent deaveraging of Universal Service support and unbundled elements.

UNBUNDLED ELEMENTS

Zones	Areas	Average BCM2 Cost/Month*
1	Rural	$38.42
2	Rural/Suburban	$25.38
3	Suburban	$22.04
4	Urban	$20.12

**Assume retail costs of $4.00/month*

UNIVERSAL SERVICE COSTS

Range of costs for individuals wire centers within Zone 1:

Wire Centers	Cost/ Month	Line Served
MILTON	$23.98	12,415
ROME	$26.78	27,951
GREENFIELD CENTER	$48.91	4,914
BRAINARDSVILLE	$124.70	1,010
ST. REGIS FALLS	$122.92	1,251
PUTNAM	$149.54	482

Gaming Opportunity: *target high cost wire centers within a zone.*

Potential Solutions to Arbitrage Problem

- Only the loop provider gets USF funding
- Share USF funding between loop provider and CLEC
- Deaverage UNEs to Census Block Group
- Use UNEs for USF costing

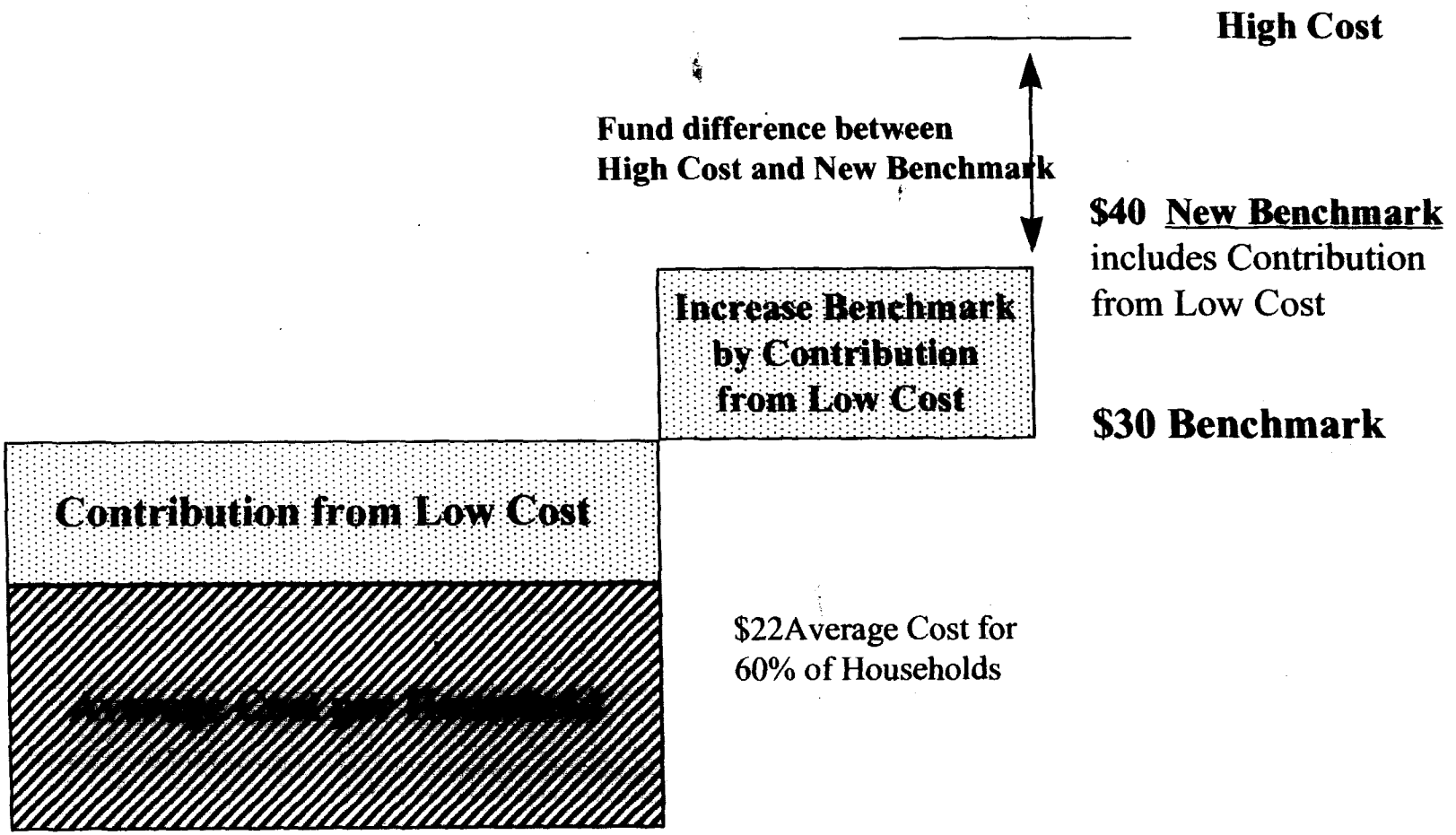
Alternative to Proxy Models - Unbundled Network Elements

- UNEs eliminate the arbitrage problem
- UNEs utilize state-approved costing methodologies
- Recommend use of actual costs for companies that are not required to make UNEs available
- Further analysis is required to quantify national fund size using UNEs

Determination of the Benchmark for UNEs

- Joint Board recommendation for average revenues would be approximately $27 per line
- Assuming a $30 benchmark, the Joint Board recommendation provides 100% of USF funding above $30
- Need to take into account the contribution from residence customers whose costs are below the benchmark

Benchmark must be Increased by Existing Subsidy



Steps Needed to Create UNE Alternative

- Determine the Benchmark
- Identify state-approved prices for UNEs
- Functionally define UNEs for universal service
- Determine, and apply the wholesale-to-retail discount rate
- Quantify USF costs.

Unbundled Network Elements Issues

- **What if:**
  - State does not deaverage UNEs: Smaller universal service funding
  - State prices too low:
    - » insufficient universal service support
    - » encourages competitors to use UNEs
  - State prices too high:
    - » excessive universal service support
    - » creates incentives for competitors to develop network facilities
- **Advantages:**
  - Solves the arbitrage issue
  - Creates level playing field for all participants
  - Provides funding where individual states are identified as high-cost