methodology. In the year 2001, support would be based on 75 percent frozen levels and 25 percent proxy; in 2002 support will be based on 50 percent frozen levels and 50 percent proxy; in 2003 support will be based on 25 percent frozen levels and 75 percent proxy. Beginning in 2004 support will be 100 percent based on a proxy methodology. The total period for transition for rural carriers to a proxy based system is six years.

290. Freezing support will encourage rural carriers to operate efficiently because no additional support will be provided for increased costs. We recognize that the number of subscribers served by rural carriers could increase and associated with such increases is an increase in costs. Therefore, we recommend that support not be frozen at a total dollar amount, but instead, at a per line amount. Rural carriers would receive additional support at the same amount per line as the number of subscribers increase. A frozen level of high cost support will prepare these LECs for both their move to a proxy model and the advent of a more competitive marketplace.

291. High cost assistance to carriers with high loop costs that will be paid during 1997 are based on those carriers' 1995 embedded costs. Additionally, loop counts to determine the 1995 average costs per loop for each carrier are based on year-end 1995 loop counts. To determine the amount of frozen high cost support per line for carriers with high loop costs, we recommend that the total amount paid to each carrier during 1997, based on 1995 embedded costs, be divided by the number of loops served at the end of 1995. The amount of high cost assistance to be paid in 1998 will then be the same per line amount paid in 1997 multiplied by the year end loop count for 1996. Calculation of payments would continue in this manner throughout the transition period.

292. Currently, DEM weighting assistance is an implicit support mechanism that is recovered through the switched access rates charged to interexchange carriers by those carriers serving less than 50,000 lines. In order to calculate the per-line DEM weighting benefit, we recommend that the amount of additional revenues collected by each carrier above what would be collected without DEM weighting, be calculated for the calendar year 1996. That amount, divided by the number of loops served at the year-end 1996 would be the basis for the frozen per line support to be paid beginning in 1998. Until December 31, 1997, DEM weighting benefits would continue under the present rules. Although we could have recommended the calendar year 1997 as the basis for determining the frozen per-line amount for DEM weighting benefits during the transition period, we find that sufficient time will be needed for the fund administrator to gather the data and calculate payments before frozen DEM weighting benefits begin in 1998. We chose to use year-end 1996 loop counts because this calculation would have already been made for loop high cost assistance purposes. For 1999, the amount of frozen DEM weighting support would be based on the frozen per line amount multiplied by the number of lines served for the year-end 1997. Calculation of payments would continue in this manner throughout the transition period.

293. LTS payments are currently determined by comparing the amount pool members will receive in SLCs and CCL charges to the pool's projected revenues requirement. In order to determine the frozen LTS payment for the Common Line pool members, we recommend that each member be allocated a percentage of the total LTS contribution from the non-pooling LECs. We recommend that the allocation be made on the basis of each member's common line revenue requirement relative to the total common line pool revenue requirement. We recommend that the frozen LTS payments to pool members during the year ending 1996 and the loop counts at year-end 1996 be used as the historical basis for computing the frozen per line LTS payment beginning in 1998. For 1999, the amount of frozen LTS payments would be based on the frozen per line amount multiplied by the number of lines served for the year-end 1997. Calculation of payments would continue in this manner throughout the transition period.

294. We recognize that, unlike the current LTS system, the frozen LTS mechanism will not result in CCL charges for ILECs participating in the NECA pool being set equal to the national average CCL charge for all ILECs. Currently, LECs that contribute to LTS support recover those funds by increasing their own CCL charges. Under the frozen LTS mechanism, the funds for this support will come instead from all carriers providing interstate telecommunications services based on their revenues.

295. We also recognize that we have limited participation in the frozen LTS mechanism to rural telephone companies, as defined in the 1996 Act, that currently participate in the NECA pool. We find that this limitation is proper because we have also recommended that ILECs not qualifying as rural telephone companies should receive high cost universal service support based on a proxy model for costs, including loop costs. Because the proxy model includes the total unseparated loop costs, non-rural ILECs would receive double compensation if they also received frozen LTS payments.

296. Support Levels for Competitive Carriers. We recommend that the Commission make frozen support payments portable. A CLEC should be allowed to receive support payments to the extent that it is able to capture subscribers formerly served by carriers eligible for frozen support payments or to add new customers in the ILEC's study area. Because we have recommended that frozen support payments be computed on the basis of working loops, ILECs will, under our recommendation, automatically lose frozen support payments for loops serving subscribers lost to a competitor. We find that competition would best be served if the frozen support payment attributable to that line were paid instead to the CLEC that won the subscriber. Likewise, a CLEC should receive support for new customers that it serves in the ILECs study area. In order to avoid creating a competitive disadvantage for alternative facilities-based LECs, we recommend that frozen support payments shift to the CLEC

irrespective of whether the CLEC actually uses the ILEC's loop to serve the subscriber.[952] Since rural ILECs have the option at any time to convert their support basis to a proxy methodology, we find that a CLEC should also have the opportunity to choose proxy-based support when it enters a rural ILEC's study area.

297. We conclude that using the rural ILECs' embedded costs to calculate universal service support for all eligible telecommunications carriers serving customers within that rural LEC's study area will be the easiest way to administer the support mechanism. Besides using a proxy or embedded costs system, the alternative for calculating support levels for such CLECs consists of requiring the CLECs to submit cost studies. Compelling a CLEC to use a proxy methodology without requiring the ILEC's support to be calculated in the same manner, however, could place either the ILEC or the CLEC at a competitive disadvantage. Also, requiring CLECs to submit cost studies would be problematic because CLECs are not required to follow Commission accounting and jurisdictional separations rules and thus would be unlikely to produce information by which a meaningful comparison could be made. We thus disagree with Alaska Tel.'s claim that providing support to CLECs based on the incumbents' embedded costs would violate Section 254(e). CLECs, as well as ILECs, will be expected to adhere to Section 254(e) which provides that "[a] carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." We also disagree with the Minnesota Indep. Coalition's claim that basing support to CLECs on the incumbents' embedded costs may compensate the CLEC in excess of its costs. Because CLECs must provide service to and advertise its service throughout the entire study area, consistent with section 254(e), the CLEC cannot "cream skim" or only serve low cost areas. If the CLEC can serve the entire study area at a much lower cost than the incumbent, this may be an indication of a less than efficient operation of the ILEC. Because support would be provided on a per line basis, if a customer chooses to receive service from a CLEC rather than an ILEC, only the CLEC would receive the support.

298. Alaska and Insular areas. We propose that rural carriers in Alaska and in insular areas not be required to shift to a support system in which support levels are calculated based on a proxy model at this time. Many commenters explain why rural carriers in Alaska and insular areas face circumstances unlike those encountered by other rural carriers in the continental United States.[953] For example, the extreme remoteness of many communities in Alaska and the unique climatological problems Alaskan carriers encounter, such as permafrost, limit the period in which carriers can construct and perform maintenance on their facilities, and thus make the cost of providing service in those areas different than in

[952] The CLEC might use the ILEC's loop to serve the customer by obtaining access to that loop through unbundling or resale. *See* 47 U.S.C. § 251. *See also Local Competition Order*.

[953] *See, e.g.*, Alaska PUC cost model comments at 3; Alaska Tel. comments at 5; Matanuska Tel. Ass'n comments at 2-3.

other rural areas.[954] In addition, the proxy models did not originally include Alaska and insular areas, and even now only BCM2 claims to be able to consider the unique cost calculations that rural carriers in Alaska and insular areas face.[955] Therefore, while we believe that proxy models may provide an appropriate determination of costs on which to base high cost support, we are less certain that they may do so for rural carriers in Alaska and insular areas. Consequently, we recommend that rural carriers serving Alaska and insular areas should be able to continue to use embedded costs to determine their costs of offering universal service. We further recommend that this system for rural carriers in Alaska and insular areas be revisited in the future to determine whether changes in proxy models allow them to be utilized effectively in Alaska and insular areas.

C. Determining the Level of Support Using a Benchmark

299. We recommend that the Commission establish a benchmark to calculate the support that eligible telecommunications providers will receive when a proxy model is used to calculate the costs of providing services designated for support from universal service mechanisms. We believe it is desirable that the benchmark be based on the amount the carrier would expect to recover from other services to cover the cost of providing supported services in rural, insular, and high cost areas, but final determination of the methodology for selecting the benchmark must also consider the revenue base for universal service contributions. Those eligible telecommunications providers for which the cost of providing supported services exceeds the benchmark would be permitted to receive universal service support.

1. Background

300. Under the Commission's existing high cost support assistance rules,[956] LECs with unseparated loop costs greater than 115 percent of the nationwide average loop cost may

[954] *See* Alaska PUC, Public Hearing, Aug. 22, 1996.

[955] PacTel has provided cost calculations from the CPM model for Alaska, but not for the insular areas other than Hawaii. *See* letter from Alan Ciamporcero, Vice President, Pacific Telesis, to William F. Caton, Acting Secretary, FCC (dated Oct. 17, 1996). MCI has provided estimates of the universal service support that would be required for Alaska, Hawaii, Puerto Rico, Guam, and the Mariana Islands. MCI notes, however, that the cost per line was approximated by taking the weighted average for the RBOCs in the Hatfield model, and are not specific to those areas. Consequently, according to MCI, the estimates for these areas are only "ballpark estimates." Letter from Kimberly M. Kirby, Senior Manager, FCC Affairs, MCI, to William F. Caton, Acting Secretary, FCC (dated Oct. 25, 1996).

[956] 47 C.F.R. Part 36.

allocate an additional share of their local loop costs to the interstate jurisdiction.[957] The threshold amount equal to 115 percent of nationwide average loop costs operates like a benchmark with the main difference being carriers receive support under the current system if their costs exceed the threshold, whereas under a proxy model approach, the level of universal service support is determined by the difference between forward-looking costs and the benchmark.

301. The NPRM also requested comment on how to ensure that any new universal service support mechanism is simple to administer, technology-neutral, and designed to identify the minimum subsidy required to achieve the statutory goal of affordable and reasonably comparable rates throughout the nation.[958] The NPRM also sought comment on the relationship between affordability and the benchmark that would be one component of a proxy model approach to calculating support for eligible telecommunications carriers serving rural, high cost or insular areas. In its Public Notice, the Commission's Common Carrier Bureau asked, *inter alia*, for comment on the advantages and disadvantages of using a specific national benchmark rate for services designated for support with a proxy model to calculate high cost support as the standard for determining whether core service rates meet the "affordability" requirement of section 254(i).[959]

2. Comments

302. Nationwide Benchmark Based on Affordability. Several parties advocate the establishment of an "affordability benchmark" that would also be used to calculate high cost support.[960] Many of these commenters support the creation of a federal benchmark that would set the maximum rate an average residential subscriber would pay for local service[961] and the level above which a carrier can seek universal service support.[962] For example, GTE proposes a plan wherein an initial threshold level that is equal to the maximum desired rate for core services triggers the availability of funding for core services.[963] Sprint maintains that such a

[957] 47 C.F.R. § 36.631.

[958] NPRM at para. 27.

[959] Public Notice, question 3.

[960] *See, e.g.*, USTA comments at 14-16; MCI further comments at 2.

[961] Time Warner comments at 7.

[962] Ameritech comments at 10; PacTel comments at 20; Sprint comments at 9; USTA comments at 14-15; U S West comments at 8; NCTA further comments at 2.

[963] GTE comments at 7-8.

benchmark would enable the Commission to assure a reasonable rate to consumers regardless of where they live.[964] AT&T argues that a national benchmark will prevent states from attempting to obtain additional federal support by setting their own benchmarks at unduly low levels.[965] Some parties believe a national affordability benchmark would be easy to administer.[966] BellSouth also favors the administrative simplicity of a national benchmark, but contends that the federal benchmark should reflect average state incomes.[967] TCI contends that business planning for carriers will become simpler and less expensive under a national benchmark than it would be under a more complex, localized system.[968] In addition, Florida PSC maintains that because all the information necessary to derive a national affordability benchmark is in the public domain, such information would be easy to obtain and use.[969]

303. Some commenters oppose basing a national benchmark on affordability because, they argue, such a benchmark would not account for local circumstances that affect affordability.[970] For example, the Alaska Tel. argues that a national benchmark based on affordability cannot be reflective of small companies and circumstances found in rural areas.[971] In addition, the Media Access Project contends that a single national affordability benchmark would leave services unaffordable for many low-income customers while providing an unnecessary subsidy for wealthier consumers.[972] Teleport suggests that, instead of establishing a nationwide affordability benchmark, the Commission should establish guidelines for the states to follow in prescribing rates within their jurisdictions.[973]

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[964] Sprint further comments at 2.

[965] AT&T further comments at 4. *See also* Florida PSC further comments at 5-6.

[966] *See, e.g.,* CompTel further comments at 6-7; GCI further comments at 2; MCI further comments at 2; TCI further comments at 8.

[967] BellSouth further comments at 3.

[968] TCI further comments at 9.

[969] Florida PSC further comments at 6.

[970] *See, e.g.,* Citizens Utilities further comments at 3; ITC further comments at 2; MFS further comments at 11; NECA further comments at 3; NYNEX further comments at 1-2; RTC further comments at 8; Time Warner further comments at 10; Washington UTC further comments at 5.

[971] Alaska Tel. further comments at 6.

[972] MAP further comments at 2-3.

[973] Teleport further comments at 3.

304. Other opponents of a national affordability benchmark include PacTel, which argues that the plain language of the statute calls into question any effort to establish a national affordability standard.[974] Further, PacTel contends that states might raise their local rates to the national benchmark in order to qualify for federal universal service support.[975] PacTel maintains that, if a national affordability benchmark were to be compared to the results of a proxy model for purposes of determining how much interstate support a carrier should receive, as it believes the third question of the Public Notice implies, jurisdictional separations problems could result.[976] NECA contends that the establishment of a nationwide affordability benchmark might be viewed as a significant expansion of federal regulation into an area traditionally regulated by state commissions.[977] In addition, MFS argues that the Joint Board should not attempt to incorporate an affordability benchmark into a proxy model, but, instead, should base support amounts on the costs generated by the models.[978] Washington UTC argues that a nationwide benchmark rate might be higher than those rates produced in a competitive market.[979]

305. Methodologies. Commenters propose various methods for setting an affordability benchmark, linked either to loop costs, telephone rates, or consumer income. For example, USTA advocates an interstate affordability benchmark that is equal to the nationwide average loop cost.[980] Ameritech argues in favor of basing an affordability benchmark on statewide average rates or costs for "core" services, or a specified percentage of statewide median income.[981] Citizens Utilities advocates the establishment of a national price affordability standard for each universal service "basket" of similar services.[982] Under Citizens Utilities' plan, a national price affordability standard would be based on the total unseparated

[974] PacTel further comments at 8.

[975] *Id.* at 11.

[976] PacTel further comments at 8-9 (arguing that changes in jurisdictional separations, a true-up of other interstate prices, or restricting a company's high cost federal funding to current levels of federal CCL and universal service funding would be required if support was determined by comparing a national benchmark rate with proxy costs).

[977] NECA further comments at 4.

[978] MFS further comments at 6-7.

[979] Washington UTC further comments at 4.

[980] USTA comments at 15.

[981] Ameritech comments at 10.

[982] Citizens Utilities comments at 10.

cost to end users for the service, and would be set at one standard deviation above the national average for the services within a given "basket" plus the federal subscriber line charge.[983]

306. Some commenters advocate basing an "affordability benchmark" on existing rates. For example, Florida PSC asserts that an initial affordability benchmark should be the nationwide average rate for residential service, which, it states, equals approximately $20.00.[984] West Virginia Consumer Advocate concludes that either existing rates or an amount equal to 115 percent of the national average rates should be designated as the affordability benchmark.[985] OITA-WITA suggests that a benchmark be developed from existing rates on a nationwide or statewide basis.[986] Similarly, Time Warner proposes establishing an affordability benchmark at the highest rate currently being charged by the ILEC, on a local basis.[987] Under Time Warner's plan, service would be deemed affordable if the price is set at or below the highest rate level applicable for any exchange within a given jurisdiction for which residential penetration is within five percentage points of the jurisdiction-wide average.[988] Sprint supports creating a benchmark based on the national average for basic residential telecommunications service in urban areas.[989] Siskiyou argues that any affordability benchmark for rural areas should be based on urban rates.[990] AT&T favors a nationwide affordability benchmark based on the weighted average of current local rates for Tier 1 territories, plus the SLC.[991]

307. Revenue-Based Benchmark. Some parties suggest that the benchmark be based

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[983] *Id.* at 10-11.

[984] Florida PSC further comments at 4 (*citing* FCC publication entitled *Reference Book: Rates, Price Indexes and Household Expenditures for Telephone Service*).

[985] West Virginia Consumer Advocate comments at 9.

[986] OITA-WITA comments at 15-16.

[987] Time Warner comments at 7. *See also,* Time Warner further comments at 10 (opposing the establishment of a nationwide affordability benchmark).

[988] Time Warner comments at 7.

[989] Sprint comments at 4, 9 (arguing that the urban rate may be determined by considering the Commission's residential service prices in *Trends in Telephone Service* or the service prices collected by Balker and published by NARUC in *Exchange Service Telephone Rates*).

[990] Siskiyou reply comments at 2.

[991] AT&T comments at 16-17 (also arguing in favor of increasing the SLC).

on the revenues-per-line earned by the carrier. AARP argues that all sources of revenue should be considered in determining how to establish the amount a carrier may receive from the universal service support fund.[992] AARP states that carriers generate revenues from a variety of services, such as CLASS services, and that, since those services use the loop, they should help cover its costs. Therefore, AARP asserts that the revenues from all services that use the loop should be included when determining whether carriers in high cost areas need support to maintain the loop.[993] Ad Hoc Telecom Users also contends that total revenues must be considered in determining the amount of support a carrier should receive.[994] Ad Hoc Telecom Users suggests that the Commission look at yellow pages revenues, as well as the revenues from the entire package of service purchased by residential customers in connection with the purchase of the dialtone line.[995]

308. Other. Maine PUC maintains that proxy models are engineering models that estimate costs, but do not use rates as an input nor predict rates as an output.[996] Maine PUC recommends that the Commission base universal service support on the costs of providing universal service support, not upon rates.[997] NYNEX states that high cost support should be provided through the use of a benchmark level. It states that the Commission could decide, for instance, to use a number of levels of support based on the cost of providing service in a CBG. For example, carriers could be given $10.00 per month in support for CBGs that have total monthly cost of $60.00 to $70.00, $15.00 per month for CBGs that have costs of $70.00 to $80.00, and so on.[998] U S West suggests the establishment of a Federal Funding Benchmark (FFB), and recommends that FFB be set at $30.00 per month since that would result in a fund of approximately $5 billion according to the original BCM with the ARMIS expense factor.[999] In addition, several parties argue that, regardless of whether an affordability benchmark is established, current amounts of high cost support must be retained to ensure

[992] AARP comments at 19.

[993] *Id.* at 19-20.

[994] Ad Hoc Telecom. Users comments at 13.

[995] *Id.* at 17.

[996] Maine PUC further comments at 4.

[997] *Id.* at 4.

[998] NYNEX comments at 14.

[999] U S West comments at 12.

affordable rates in rural areas.[1000]

3. Discussion

309. We believe that it is desirable for the Commission to set a nationwide benchmark to use in calculating the amount of support eligible telecommunications providers will receive. This is consistent with comments filed by several parties. Final determination of this issue, however, must also take into consideration the contribution base for the federal universal service mechanisms. We recommend that the benchmark the Commission adopts should be easy to administer and should be set to minimize the probability that residential rates would increase while the new support mechanisms are being implemented. The carrier's draw from the federal universal service support mechanism for serving a customer would be based on the difference between the costs of serving a subscriber calculated using a proxy model and the benchmark. A carrier could draw from the fund for providing supported services to a subscriber only if the cost of serving the subscriber, as calculated by a proxy model, exceeds the benchmark.

310. There are essentially three approaches to setting such a nationwide benchmark to be used with the proxy model for calculating support. In setting a benchmark, the Commission could use average revenues per line, average rates, or relative cost. We recommend that the Commission adopt a benchmark based on the nationwide average revenue-per-line. We agree with those commenters who argue that revenues from local exchange and access services should be considered in determining support payments. They argue effectively that revenues from discretionary services are tied to the purchase of supported services.[1001] Revenues-per-line are the sum of the revenue generated by local, discretionary,[1002] access services and others as found appropriate divided by the number of loops served. In determining the level of the benchmark, we must be cognizant of the potential effect from competition on these anticipated revenues. In particular, competition could drive the rates for local, discretionary and exchange access services towards incremental cost, thereby reducing the revenues per line; alternatively, it could spur carriers to offer new services that could increase their revenues. We therefore also recommend that the Commission review the benchmark on a periodic basis, and consider the need to make appropriate adjustments.

[1000] *See, e.g.*, NECA comments at 11-12; New Hope Tel. comments at 1; Ragland Tel. Co. comments at 1; SDITC reply comments at 4-5; Minnesota Indep. Coalition further comments at 6-7.

[1001] AARP comments at 19-20; Ad Hoc Telecom. Users comments at 17; CPI *ex parte* at 6 (dated Oct. 4, 1996)

[1002] Discretionary services include services that are added on to basic local service, e.g., call waiting, call forwarding or caller ID.

311. We believe that setting the benchmark at the nationwide average revenue-per-line is desirable because that average reflects a reasonable expectation of the revenues that a telecommunications carrier would be reasonably expected to offset its cost, as estimated in the proxy model. A revenue benchmark should be based on local, access, and other telecommunications revenues. The cost estimated by the proxy models includes the cost of the facilities used to provide those services.[1003] For example, the total forward-looking cost of the loop is included in the costs estimated by the proxy models rather than assigned to the various services that use the loop. The proposed proxy models' switch costs include the cost of the software that allows the switch not only to process a local call but also to provide the entire array of discretionary services. But other costs are not included in the proposed proxy models, such as the cost of tandem switches used to provide interexchange toll service or other costs of a toll network, and thus revenue from toll services should not be included in the benchmark. A revenue-per-line benchmark, therefore, would be consistent with the cost estimation process used to determine the cost of service in high cost support areas.

312. We find that it is advisable to construct two benchmarks, one for residential service and a second for single line business service, since we are recommending that primary residential and single business lines be supported. The residential benchmark, if ultimately adopted by the Commission, should be set equal to the sum of the revenue generated by local, discretionary, and access services provided to residential subscribers divided by the number of residential lines. The single line business benchmark should be set equal to the sum of the revenue generated by local, discretionary, and access services provided to single line business subscribers divided by the number of single line business lines.

313. Once the form of revenue benchmark is selected, a decision must be made as to whether the benchmark is set at the nationwide average or by some other method. Using the nationwide average revenue would encourage carriers to market and introduce new services in high cost areas. Carriers that successfully introduce and market new services will benefit from doing so, and those carriers that fail to introduce new services or who lose customers to their competitors will not receive universal service support funds to replace the foregone revenue. This decision will provide carriers the incentive to upgrade their service offerings in high cost areas, and therefore, maintain high quality service in rural areas that is comparable to the service offered in urban areas.

314. We are unpersuaded by the argument of some commenters that the benchmark should vary in accordance with the average household income in each state.[1004] We note that the telephone penetration rate is relatively constant across large ranges of income, except that

[1003] Letter from Glenn Brown, U S West, to William F. Caton, Acting Secretary, FCC (dated Sept. 4, 1996). Letter from Richard N. Clarke, AT&T, to William F. Caton, Acting Secretary, FCC (dated Sept. 10, 1996).

[1004] SWBT comments at 9-12; BellSouth further comments at 3.

telephone penetration decreases significantly for low-income households.[1005] Therefore, we conclude that the impact of household income should be addressed through programs directed at helping low-income households obtain and retain telephone service, rather than as part of our high cost mechanism.[1006] We agree with commenters' arguments that a national benchmark would enable the Commission to assure a reasonable support level to all carriers, and would be easier to administer than state or local benchmarks.[1007] Final determination of this issue, however, must also take into consideration the revenue base for universal service contributions.

315. We also do not support tying the benchmark to average rates for residential and single line business service because residential and single business service are only two of the services provided over the facilities for which costs are included in the proxy model cost estimates.[1008] Therefore, a rate benchmark would be inconsistent with the method we are recommending for determining the cost of providing the network used to provide the supported services. The average rate benchmark ignores the revenue generated from the customer that contributes to the joint and common costs of providing both that service and those services designated for support. Setting the benchmark equal to average residential and single line business rates would allow carriers to recover revenue for some discretionary services twice, once from the customer and once from the universal service fund. We are also concerned with proposals that tie the benchmark to rates because some proposals are tied to the highest available residential rate and others are tied to the weighted average of all residential rates.[1009]

316. Using a national benchmark set at the average local rate will also result in a outcome that is inappropriate in conjunction with a proxy cost model. Use of such an amount will tend to produce a universal service fund that will over compensate the provider of service. Such an amount could create a large universal service fund that ultimately will be

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[1005] Monitoring Report, CC Docket No. 87-339, May 1996, Prepared by Federal and State Staff for the Federal-State Joint Board in CC Docket No. 80-286, Table 1.4.

[1006] *See infra* section VIII.

[1007] *See, e.g.*, CompTel further comments at 6-7; GCI further comments at 2; MCI further comments at 2; Sprint further comments at 2; TCI further comments at 8.

[1008] The average residential flat service rate including the SLC and excluding taxes, 911, and other surcharges is currently approximately $17.20, while the average lowest generally available rate is $10.14. Monitoring Report, CC Docket No. 87-339, May 1996, Prepared by Federal and State Staff for the Federal-State Joint Board in CC Docket No. 80-286, Table 5.7. (The table shows average rates, including SLC and taxes and other surcharges, for 95 urban areas across the nation.)

[1009] *See, e.g.*, OITA-WITA comments at 15-16; Time Warner comments at 7; West Virginia Consumer Advocate comments at 9; Florida PSC further comments at 4.

recovered from customers through higher rates, and may result in some customers having to drop off the network.

317. We do not believe that a benchmark that is tied to average cost calculated by the proxy models should be relied on at this time.[1010] In order to establish the need for support it is best to compare revenue to cost rather than to examine only the cost side of the equation. Other service revenue can offset the high cost so that residential and single business rates remain affordable even in above average cost areas.[1011] We recognize, however, that in the future the use of nationwide average revenues may no longer be appropriate because of the changing nature of the telecommunications marketplace. Some carriers may package local and long distance services as part of their array of service offerings to the public in order to distinguish themselves from other providers of telecommunications services. At such time it might be necessary to reevaluate the use of a benchmark based on average nationwide revenues per line for local, discretionary, and access services. We note that the California PUC recently decided to use such a cost benchmark to determine support levels for the California state universal service fund.[1012]

D. Competitive Bidding

1. Background

318. The NPRM sought comment on whether competitive bidding could be used to set the level of universal service support in rural, insular, and high cost areas.[1013] Specifically, the Commission asked whether relying on competitive bidding would be consistent with section 214(e), the provision that specifies the circumstances under which telecommunications carriers are eligible to receive universal service support.[1014] The NPRM sought comment on a competitive bidding system in which carriers offering all of the services supported by universal service mechanisms would bid on the level of assistance per line that they would need to provide such services. The NPRM explained that such an approach would attempt to harness competitive forces to minimize the cost of universal service. The NPRM suggested that the level of support that any eligible carrier could receive would be set by the lowest bid. To induce competitors to underbid one another, rather than merely accepting the established level of assistance, the NPRM suggested that the low bidder might receive an "incentive

[1010] Ameritech comments at 10; USTA comments at 15.

[1011] For example, rural telephone companies often have low local exchange rates, but high access revenues.

[1012] *See* Cal. P.U.C. R.95-01-020/I.95-01-021 (Oct. 25, 1996).

[1013] NPRM at para. 35.

[1014] *Id.*

bonus."[1015] Finally, the Commission acknowledged that the level of competition in high cost areas may not warrant using competitive bidding yet.[1016]

319. In its Public Notice, the Common Carrier Bureau sought further comment about implementing a competitive bidding system. The Bureau sought comment on whether a competitive bidding plan should be altered when applied to areas in which there is little competition; what safeguards, if any, should be adopted to prevent collusion or the use of competitive bidding by large carriers to drive out small incumbents; what safeguards, if any, are needed to ensure quality of service; how to provide incentives to ensure aggressive bidding; and how to determine the appropriate geographic area for which eligible carriers bid for universal service support.[1017]

2. Comments

320. General comments. The commenters are divided in their views on whether to adopt a competitive bidding system. A few LECs and some industries that would potentially compete with ILECs to provide local service, such as wireless and cable companies, support the use of competitive bidding.[1018] Opponents of using a competitive bidding system include most LECs and some IXCs, such as AT&T and MCI.[1019] PacTel argues that competitive bidding could be used to adjust the level of universal support to any given area once the initial support level has been set using the CPM.[1020] PacTel recommends that the Commission

[1015] *Id.* at para. 36.

[1016] *Id.* at para. 37.

[1017] Public Notice at 7.

[1018] *See, e.g.*, ALTS comments at 12; AirTouch comments at 12-13; Frontier comments at 9; GTE comments at 11; NCTA comments at 11; PCIA comments at 15-16; Time Warner comments at 10-11; Western comments at 12-13; Comnet Cellular reply comments at 6. *See also* CSE Foundation comments at 11-12; LDDS comments at 12-13 (arguing that bidding cannot take place until competitors enter the market -- until then, the Commission should continue to rely on the ILEC's underlying costs of service); Alliance of Public Technology further comments at 12 (contending that competitive bidding can speed the development of advanced networks).

[1019] *See, e.g.*, ACTA comments at 7; Alabama-Mississippi Tel. Ass'n comments at 6; Alaska Tel. comments at 8; BellSouth comments, Att. 1 at 35-35; GVNW comments at 13; NYNEX comments at 10 n.15; OITA-WITA comments at 14-15; RTC comments at 17; SWBT comments at 16-17; Telec Consulting at 11-12; Teleport comments at 9-10; United Utilities comments at 2; Fred Williamson comments at 14; NECA reply comments at 13; AT&T further comments at 36; Ameritech further comments at 37; MCI further comments at 24; MFS further comments at 44; Minnesota Indep. Coalition further comments at 15-16; TCI further comments at 31-32; USTA further comments at 29-30; U S West further comments at 23; Western Alliance further comments at 13.

[1020] PacTel further comments at 44.

open a further proceeding to address questions on how competitive bidding could be structured fairly and appropriately.[1021] GSA believes that the Commission should approve the concept of competitive bidding and should leave its implementation to the individual state commissions.[1022] The few state agencies that commented on this issue also have divergent views.[1023] California PUC, for example, agrees with the Commission's statement in the NPRM that market conditions may not warrant the introduction of a competitive bidding plan at present.[1024] Florida PSC, although finding merit in competitive bidding after entry has occurred, expresses concern that any bidding plan that explicitly or implicitly results in exclusion of carriers may be inconsistent with section 214(e). Florida PSC concludes that this question need not be resolved now.[1025]

321. Several commenters recommend that a competitive bidding system be used only for the more limited purpose of selecting carriers to serve areas that no carrier is serving or for areas that no carrier is willing to serve at the subsidy level established through another mechanism.[1026] California PUC contends that such a limited use of competitive bidding is appropriate and administratively feasible.[1027] AT&T contends that unserved areas are likely to have few customers, making it economical for service to be offered by only one carrier that can be selected through a bidding process.[1028] MCI suggests that bidding be used only in "those few areas" where a carrier becomes unwilling or unable to offer service at the price and universal service support level determined by the proxy model.[1029]

[1021] *Id.* at 44.

[1022] GSA reply comments at 13.

[1023] *Compare* New York CPB comments at 11 (arguing that the Commission should consider a bidding process in areas where more than one provider is willing to offer core services); Wisconsin PSC comments at 10 (contending that bidding should be considered where competition is evolving between legitimate, established and comparable providers), *with* CNMI comments at 18 (maintaining that markets most in need of support are unlikely to see competition and bidding would be of no utility in uncompetitive markets); New Jersey Advocate comments at 13 (suggesting that bidding may not focus on problems requiring support).

[1024] California PUC comments at 12.

[1025] Florida PSC comments at 11-12.

[1026] *See, e.g.*, California PUC comments at 13-14; USTA comments at 20; AT&T further comments at 37; MCI further comments at 21-22.

[1027] California PUC comments at 14.

[1028] AT&T further comments at 37.

[1029] MCI further comments at 21.

322. Supporters of adopting a competitive bidding system argue that it best comports with the pro-competitive principles of the 1996 Act because it is a market-based approach.[1030] Many commenters that support a competitive bidding system contend that it would reduce the costs of universal services support.[1031] CSE Foundation argues that, because of the importance of understanding the true costs of providing service, the appropriate level of support for high cost areas should be determined whenever possible through a process of competitive bidding for a specific geographical area, possibly CBGs.[1032] Time Warner asserts that, with an appropriately structured incentive, competitive bidding can best assure that areas are served by telecommunications carriers in the most economically efficient manner possible.[1033] GTE contends that competitive bidding has advantages over the use of proxy cost models. These advantages include the elimination of the need to modify cost models over time and the incorporation of non-price considerations, such as regulatory burdens, that are not captured by the models.[1034]

323. Some commenters supporting a competitive bidding proposal argue that only carriers willing to accept COLR obligations[1035] should be allowed to bid to serve an area.[1036]

[1030] *See, e.g.*, Frontier comments at 9; GTE comments at 11 (arguing that bidding is consistent with intent of the 1996 Act to maximize reliance on market forces and minimize regulation); Western comments at 12-13. *See also* NCTA comments at 11 (arguing that competitive bidding would give new entrants a reasonable opportunity to receive funds); CSE Foundation reply comments at 6 (maintaining that bidding would encourage competition); Comnet Cellular reply comments at 6 (contending that competitive bidding would put all prospective eligible carriers on an equal footing).

[1031] *See, e.g.*, ALTS comments at 12; AirTouch comments at 12-13; Frontier comments at 9; GTE comments at 11; NCTA comments at 11; PCIA comments at 15; Western comments at 12-13; Comnet Cellular reply comments at 6.

[1032] CSE Foundation comments at 11-12.

[1033] Time Warner comments at 10-11.

[1034] GTE comments at 11.

[1035] GTE defines a COLR as a carrier eligible for universal support that undertakes the obligations established by a state agency, within federal guidelines, as a condition of receipt of federal universal service support. GTE comments at 8 n.19. GTE suggests that such obligations might include a ceiling on the rate the COLR can charge, terms and conditions of service and quality standards, limits on the carrier's ability to exit, and an obligation to serve all customers in the area. GTE further comments at 46-48.

[1036] *See, e.g.*, CSE Foundation comments at 12; GTE comments at 8-9; GTE further comments at 46-47. *See also* Ameritech Ex Parte Materials Regarding Competitive Bidding Processes, July 31, 1996 at 6 (arguing that universal support must be portable only to other COLRs); GSA further comments at 11-12; SWBT further comments (erratum) at ii (stating that, although it opposes use of competitive bidding system, if one is adopted, all winning bidders must be willing to be bound by all of the carrier of last resort and other obligations imposed

GTE argues that a COLR requirement is essential to establishing a competitive bidding plan that would be consistent with the 1996 Act. It contends that a bidding plan would not be competitively neutral if one carrier, most likely the incumbent, were required to meet COLR obligations, while a new entrant would receive the same level of universal service support without those same obligations.[1037] Moreover, GTE asserts, a competitive bidding plan that does not have a COLR requirement would never be "sufficient" to preserve universal service as required by the 1996 Act. It maintains that the incumbent, subject to COLR requirements, would never be able to sustain its obligation to serve all customers in the service area in the face of entry by other carriers that could selectively serve only the customers they wished, yet receive the same level of funding.[1038] Finally, GTE contends that, although section 214 requires as a condition for receiving universal service support that a carrier agree to provide the core universal services to all customers in the service area,[1039] the Commission and the states must specify the terms and conditions of that obligation. GTE maintains that the most important of these conditions is that all carriers receiving support be required to meet the same obligations.[1040] GSA argues that a competitive bidding system is beneficial only if it supports universal service, minimizes the level of support payments and maintains competitive neutrality -- which can be accomplished only if universal service support is restricted to carriers agreeing to be COLRs.[1041]

324. The commenters opposing adoption of a competitive bidding system raise various arguments. Some commenters argue that competitive bidding would degrade service quality because carriers would achieve low bids by reducing quality.[1042] Other commenters contend that a competitive bidding system would be costly, difficult to administer, and not likely to be an improvement over other methods of establishing costs.[1043] Several commenters

on the incumbent LEC).

[1037] GTE further comments at 46.

[1038] *Id.* at 46-47.

[1039] *See* 47 U.S.C § 214(e)(1) & (2).

[1040] GTE further comments at 47-48.

[1041] GSA further comments at 11-12.

[1042] *See, e.g.*, Ardmore Tel. comments at 4-5; Mon-Cre comments at 3-4; NECA comments at 11; RTC comments at 17; Western Alliance comments at 6-7; NECA further comments at 29.

[1043] *See, e.g.*, BellSouth comments, Att. 1 at 35-36; NYNEX comments at 10 n.15 (contending that bidding would be costly and not necessarily better than proxy system); SWBT comments at 16-17 (maintaining that the costs of properly structuring a bidding process, even if could be done, could best be spent elsewhere); Teleport comments at 9-10 (arguing that auctions are inferior to using cost proxy models to set support levels).

contend that a competitive bidding system would be susceptible to "gaming,"[1044] either by the ILEC who might set artificially low bids to keep competitors out,[1045] or by large carriers with ample resources that might underbid smaller incumbents in order to drive them out.[1046] BellSouth argues that a new entrant, a major IXC for example, that would provide service primarily through resale, could enter a very low bid in order to effectively eliminate support to the underlying facilities-based competitor.[1047] SWBT contends that a new entrant might construct facilities only to serve the lowest cost customers and serve the remainder by resale of the ILEC's services or by use of the ILEC's network elements.[1048] It argues that the new entrant would have an unfair advantage in the bidding process because, as a result of its lower facilities costs to serve a select few customers, it can underbid the ILEC that must provide facilities for all remaining higher cost customers.[1049]

325. Many rural and smaller LECs assert that setting support levels through competitive bidding would be disastrous for ILECs that have deployed significant infrastructure to serve high cost areas and that rely on the current level of support for financial viability.[1050] Fred Williamson argues that bidding could be unfair to ILECs that have been required by regulatory authorities to build facilities for future use and might not be able to obtain funds for those facilities if a competitive bidding system were used.[1051] NECA contends that issues of confiscation could arise if ILECs are required to provide facilities or services at non-compensatory rates established by unrealistic bids submitted by new entrants.[1052] NECA also argues that competitive bidding would require "unprecedented Commission involvement in intrastate issues such as local service quality and monitoring.[1053]

[1044] *See, e.g.*, SWBT comments at 17 n.29.

[1045] *See, e.g.*, Merit comments at 3; United Utilities comments at 2.

[1046] *See, e.g.*, OITA-WITA comments at 14-15; RUS comments at 5; United Utilities comments at 2-3.

[1047] BellSouth further comments at 45-46.

[1048] SWBT further comments at 36.

[1049] *Id.*

[1050] *See, e.g.*, GVNW comments at 13 (arguing that bidding process might result in "death spiral" for incumbent LECs that have deployed significant infrastructure and rely on current level of support for financial viability); Montana Indep. Telecom. comments at 9-10 (same).

[1051] Fred Williamson comments at 13-14.

[1052] NECA further comments at 29-30.

[1053] *Id.* at 29.

326. Opponents of competitive bidding also argue that it is inconsistent with the 1996 Act.[1054] RTC, for example, contends that, because the 1996 Act grants to the states the authority to designate carriers eligible for universal service support, the Commission does not have the authority to compel states to use a competitive bidding process.[1055] Century contends that the Commission does not have authority to establish the size of a service area for competitive bidding purposes that would differ from the size of the service area established by the state pursuant to section 214(e)(5).[1056] GVNW argues that a bidding process will likely not meet the 1996 Act's mandate for the establishment of specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service as required by sections 254(b) and 254(d).[1057] AT&T contends that competitive bidding is fundamentally at odds with the 1996 Act's pro-competitive goals if its result is the award of exclusive rights to one carrier, thus denying consumers the choice of service providers.[1058]

327. Competitive bidding proposals. Among commenters offering competitive bidding proposals, GTE submitted the most comprehensive, detailed competitive bidding plan. Under GTE's proposal, the initial level of support for the incumbent would be based on the difference between the rates the incumbent COLR is allowed to charge and the "estimate of the market rate derived from a proxy cost model."[1059] Under this plan, once other carriers want to enter a given market and are willing to accept all the COLR obligations imposed on the incumbent LEC, a competitive bidding process would replace the proxy-based system used to establish universal service support levels in that market. Competitors that wish to become COLRs in a given area would submit a notice of intent to bid to the state commission.[1060] The notice would trigger for that area an auction process that GTE proposes be held at regular

[1054] *See* Alabama-Mississippi Tel. Ass'n comments at 6 (arguing that bidding is of "doubtful legality").

[1055] RTC comments at 17. *See also* United Utilities comments at 2 (supporting a federal competitive bidding scheme that has the Commission designating carriers eligible for support by awarding high-cost assistance to the successful bidder usurps the role assigned to the states in section 214).

[1056] Century further comments at 28.

[1057] GVNW comments at 13-14. *See also* ITC further comments at 21 (arguing that the result of any auction will not fulfill the requirement of "predictable" support); NECA further comments at 29 (contending that the levels set by bidding would likely result in insufficient support payments, in violation of section 254); RTC further comments at 26 (maintaining that bidding would not be a predictable mechanism).

[1058] AT&T further comments at 36-37.

[1059] GTE further comments at 44.

[1060] *Id.* at 44.

intervals, perhaps twice a year.[1061] The form of the auction would be a sealed bid, single-round auction.[1062] The auction process would be administered by the states subject to Federal guidelines.[1063] GTE proposes that an entrant could nominate a set of CBGs as the area it wishes to serve.[1064] Those companies making nominations would be required to establish their qualifications to satisfy the COLR requirement.[1065] Subject to penalties, bidders would be permitted to withdraw winning bids.[1066]

328. GTE proposes that, initially, the Commission or the states would establish a maximum support rate for the area to be auctioned based on a multiple of the predicted cost under an adopted proxy cost model.[1067] In order to induce aggressive and low bidding, only those carriers that bid within a specified range of the lowest bidder would be eligible to receive support.[1068] The support levels would be the same for each of the carriers in this range and would be set equal to the highest accepted bid in that range.[1069] If the auction results in a new COLR for the area, either in addition to the incumbent or in place of the incumbent, the support levels and obligations for that area would be frozen for three years. No new entrants could receive universal support during this time, although they could enter and provide service without such support. After the three-year period, the area could be bid upon again.[1070]

329. MCI contends that GTE's proposal will reduce both actual and potential competition because subsidies would not be available to carriers that lose the auction or do

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[1061] *Id.* at 44.

[1062] *Id.* at 45. Under this form of auction, each bidder tenders a single sealed bid. Bidders would not know what others are bidding and the bidders would have only one opportunity to submit a bid for an area. GTE further comments, Att. 1 at 21-22.

[1063] GTE reply comments at 19.

[1064] GTE further comments at 54-55.

[1065] GTE further comments, Att. 1 at 18.

[1066] GTE further comments, Att. 1 at 19.

[1067] GTE further comments, Att. 1 at 17.

[1068] GTE comments at 11-12.

[1069] GTE further comments, Att. 1 at 4.

[1070] GTE further comments, Att. 1 at 18.

not bid.[1071] It also argues that the proposal hampers the ability of carriers to enter multiple markets and thus recognize potential cost synergies and interferes with their ability to implement their entry strategies. This could occur, states MCI, if a bidder is among the winners for some areas, but not in others, that the carrier deems important to its entry strategy. MCI contends that GTE's solution to this problem -- allowing bidders to withdraw bids if the failure to win in one or more areas interferes with the entrant's global entry strategy -- would not be effective. MCI also argues that, by forcing new entrants to participate in an auction for each market it wants to enter, GTE's proposal would raise new entrants' costs and thus would create a barrier to entry. MCI also raises questions about how GTE's auction proposal would affect the rates charged for unbundled network elements. Finally, MCI asserts that, as "in any regulatory regime that prohibits entry," regulators would have to monitor carriers to ensure a specified level of performance. MCI asks what remedies regulators would have if the carrier fails to adequately perform if other carriers do not have access to universal service support for that market. MCI concludes that, if all firms have access to such support, the need to monitor performance would be substantially reduced.[1072]

330. A few other commenters offered general proposals or suggestions on how to structure a competitive bidding process. CSE Foundation, while generally supportive of the competitive system initially outlined in GTE's comments,[1073] identified certain potential problems with GTE's proposal and suggested possible solutions. It argues that basing bids on small areas like CBGs, as GTE proposes, might prevent carriers from enjoying the economies of scale or scope that could be obtained from bidding on larger areas. To assist carriers in bidding for larger areas, CSE Foundation suggests an open, multiple-round auction that would allow bidders to gain information about the costs of providing services to different areas as the carrier learns what other carriers have bid on those areas.[1074] It also recognizes that incentives must be developed to encourage low cost providers to bid aggressively. CSE Foundation asserts that GTE's proposal to provide universal support payments only to bidders within a specified range of the low bid could provide such an incentive, but may be problematic if it restricts entry.[1075] Alternatively, CSE Foundation suggests that higher bidders

[1071] Letter from Kimberly M. Kirby, Senior Manager of FCC Affairs for MCI, to William F. Caton, Secretary, FCC, October 25, 1996.

[1072] Letter from Kimberly M. Kirby, Senior Manager of FCC Affairs for MCI, to William F. Caton, Secretary, FCC, October 25, 1996.

[1073] GTE's proposal underwent modifications after filing the initial comments upon which CSE Foundation's analysis is based.

[1074] CSE Foundation reply comments at 8-9.

[1075] *Id.* at 11.

obtain reduced universal service support.[1076] Finally, because the need to finance an investment over many years is particularly important when large-scale, capital-intensive projects are involved, CSE Foundation argues that it is important that the universal service support be guaranteed over some period of time, perhaps five years. It expresses concern, however, over GTE's proposal to exclude from support any new provider during the period of time the support level is guaranteed. As a solution, CSE Foundation tentatively suggests that the right to receive support for a particular market be made transferable.[1077]

331. Time Warner proposes that the ILEC or any other certificated LEC could submit bids on areas identified by a proxy cost model as high cost areas.[1078] Time Warner notes that the 1996 Act appears to preclude using an auction to award exclusive rights to receive universal support for serving a high cost area. Therefore, an incentive to encourage low bids other than exclusive rights must be designed. Time Warner proposes an incentive bonus structure in which the winning (lowest) bidder would receive 100 percent high cost support while all other bidders would receive a smaller percentage.[1079] Time Warner also contends that a competitive system cannot work unless all participants have equal access to relevant information. Time Warner thus proposes to require ILECs to disclose fully information about the market, including costs and revenues.[1080] Finally, Time Warner recommends periodic rebidding of areas to ensure support levels reflect current costs and

[1076] CSE Foundation suggests reducing the subsidy for higher bidders by an amount equal to the difference between their submission and the lowest bid. Thus, if the lowest bid is for $30.00 in support, then eligible providers bidding $40.00 would receive $10.00 less than the winner's amount of support, for total per-subscriber support of $20.00 ($30.00 minus $10.00). CSE Foundation reply comments at 11.

[1077] CSE Foundation reply comments at 12-14. Under its proposal, a recipient (or multiple recipients) would still receive a set subsidy for each subscriber it serves. If an alternative carrier without such a subsidy discovers a lower-cost means to provide the same service, the alternative carrier could buy the subsidy rights from any currently eligible provider. CSE Foundation reply comments at 13-14.

[1078] Time Warner comments at 9-11.

[1079] *Id.* at 11. *See also* TCE further comments at 3 (stating that an incentive payment to the lowest bidder could be considered but would add cost and complexity to the bidding scheme). Time Warner argues that its bonus approach could be enhanced by combining a percentage-based penalty for LECs with non-winning bids with a variable penalty, based on the difference between the low bid and the other LEC's high bid. Time Warner offers this example: Assume a contest in which the low bid, by Carrier A, is $10.00, and the two other participants, Carriers B and C, bid $12.00 and $15.00, respectively. As a starting point, Carriers B and C should receive no more than 80 percent of the winning (low) support amount. Then, in addition, there should be an incremental discount to that support, based on how much the bids by Carriers B and C exceeded the low bid (i.e., some portion of the $3.00 and $5.00 dollar differential between their bids and Carrier A's $10.00 bid). Time Warner further comments at 42.

[1080] Time Warner further comments at 42.

competitive conditions.[1081]

332. Century opposes a bonus incentive plan. It argues that a winner's premium to induce low bidding would conflict with the 1996 Act's requirements for high cost compensation that is sufficient and that does not allocate an excessive share of costs to universal service.[1082] Century also contends that a winner's premium would be shifted to ratepayers, would give the winning bidder an unwarranted competitive advantage, and would ensure that losing bidders would not recover the amount they had bid as necessary and sufficient to provide universal service.[1083]

333. MCI proposes a bidding system only for those few areas that are not served or areas where a carrier becomes unwilling to serve at the established universal support level.[1084] MCI suggests that the Commission and the state should together hold the auction that will determine the level of support available in the area.[1085] The state would certify the carriers eligible to participate in the auction, and the eligible carriers would bid the amount of support they require to serve the area.[1086] Any carrier willing to provide service in that area would then be eligible to receive support at the level submitted by the lowest bidder. If the incumbent was not the winning (low) bidder, it would have to make its network available for resale at net book value to the winning bidder.[1087]

334. Other commenters addressed, in general, the question of how to provide incentives for carriers to submit low bids. CFA proposes that the lowest bidder should be the only carrier permitted to obtain universal support in the area.[1088] MCI, on the other hand, notes that a competitive bidding system is effective in a winner-take-all situation but may be less effective in this situation because, under section 214(e), all eligible carriers would be entitled to receive universal support at the level determined by the lowest bid.[1089] NCTA

[1081] *Id.* at 42-43.

[1082] Century further comments at 26 (*citing* 47 U.S.C. § 254(e), (k).

[1083] Century further comments at 26.

[1084] MCI comments at 18-19; MCI reply comments at 2.

[1085] MCI comments at 18-19.

[1086] *Id.* at 19.

[1087] MCI further comments at 21-22.

[1088] CFA further comments at 21.

[1089] MCI further comments at 24.

contends that carriers would have sufficient incentives to offer lower bids because the total level of funding will be reduced for all parties, not just the low bidder.[1090] NCTA also argues that the bidding system should be structured so that the total funding level would not increase over that of today.[1091]

335. Areas without competition. Some commenters argue that competitive bidding should not be allowed, or would not be feasible, in areas with no competition.[1092] Others propose alternative ways to set the level of support in these circumstances: use the level set by the adopted proxy model;[1093] use the level set by competitive bidding in comparable areas;[1094] use some combination of these;[1095] or use the level bid by the sole bidder.[1096]

336. Safeguards. The Public Notice asked what safeguards, if any, should be adopted to ensure that large carriers do not submit excessively low bids as a way to drive out competition.[1097] Most commenters responding to this question argue that specific safeguards are unnecessary.[1098] Some commenters argue that there would be no incentive for large

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[1090] NCTA further comments at 16.

[1091] *Id.* at 16.

[1092] *See, e.g.*, Century further comments at 25-26; GSA further comments at 11; MCI further comments at 23-24; NCTA further comments at 16; RTC further comments at 26 (arguing that bidding in a non-competitive area violates the 1996 Act).

[1093] *See, e.g.*, CFA further comments at 21; GTE further comments at 45; Time Warner further comments at 41.

[1094] *See, e.g.*, Bell Atlantic further comments at 14.

[1095] *See, e.g.*, AirTouch further comments at 24.

[1096] *See, e.g.*, Ameritech further comments at 37-38. Ameritech further argues that if only one company bids, it should be the sole recipient of universal support if it is the only carrier taking on carrier of last resort obligations. Ameritech further comments at 37-38.

[1097] Public Notice at 7.

[1098] *See, e.g.*, AirTouch further comments at 25; Alliance for Public Technology further comments at 13 (contending that existing antitrust laws are sufficient); Ameritech further comments at 38; Bell Atlantic further comments at 14 (arguing that there is no reason to believe large companies would bid so low as to lose money and, if they submit compensatory bids, smaller companies, which may have lower costs, should be able to compete); MCI further comments at 24-25; NCTA further comments at 16 (suggesting that, if there is a concern about predatory pricing in a particular case, the courts and regulatory agencies should be available to address such concerns); Time Warner further comments at 44.

companies to submit excessively low bids.[1099] AirTouch asserts that predation would be unlikely,[1100] and it argues that any form of a price floor on bidding would undermine the central goal of a bidding process -- to reduce support levels by encouraging companies to bid down to the underlying service costs and to engage in innovation.[1101] Time Warner agrees, arguing that, if a company is willing to serve an area with little or no support, support levels should not be increased for the purpose of attracting other providers who are not willing to provide service without higher subsidies.[1102] AirTouch and others contend that one potential problem might involve winning bidders that underbid and then try to renegotiate their support levels upward after the auction closes. To address this problem, they propose precluding winning bidders from renegotiating their bids.[1103] ITC recommends comparing bid costs with either actual costs or a proxy and investigating significant deviations as a way to expose predatory conduct.[1104] Finally, Century asserts that this question exposes a problem with competitive bidding not limited to circumstances of predation, namely that high cost compensation based on the winning (low) bidder's cost is likely to eliminate the ability of the losing companies to provide universal service and to leave their actually-incurred costs uncompensated.[1105] The result, argues Century, would be to reduce competition and defeat the 1996 Act's intent to make universal service support available to multiple carriers in large and urban LEC service areas.[1106]

337. The Bureau asked what safeguards should be adopted to ensure service quality under a competitive bidding system.[1107] Many commenters addressing this question suggest that quality standards should be part of the bidding process so that bidders would know in advance what level of quality was required and then bid accordingly.[1108] Additionally, some commenters suggest that carriers be penalized, perhaps by a reduction in support, for failure

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[1099] *See, e.g.*, Ameritech further comments at 38-39; Time Warner further comments at 44.

[1100] AirTouch further comments at 25-26.

[1101] *Id.* at 25.

[1102] Time Warner further comments at 44.

[1103] AirTouch further comments at 25-26; CFA further comments at 21.

[1104] ITC further comments at 22.

[1105] Century further comments at 26-27.

[1106] *Id.* at 27.

[1107] Public Notice at 7.

[1108] *See, e.g.*, AirTouch further comments at 26; Ameritech further comments at 39; CFA further comments at 22; MCI further comments at 25.