

BEFORE THE
Federal Communications Commission
WASHINGTON, DC 20554

In the Matter of)
)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)
)

RECEIVED
AUG 18 1997
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

AIRTOUCH COMMUNICATIONS, INC.
OPPOSITION TO PETITIONS FOR RECONSIDERATION

AIRTOUCH COMMUNICATIONS, INC.
Kathleen Q. Abernathy
David A. Gross
AirTouch Communications, Inc.
1818 N Street, N.W.
Washington, D.C. 20036

Charles D. Cosson
Lynn Van Housen
AirTouch Communications, Inc.
One California Street, 29th Floor
San Francisco, CA 94111

August 18, 1997

No. of Copies rec'd 0711
List ABCDE

TABLE OF CONTENTS

| | Page |
|---|-------------|
| SUMMARY | 1 |
| INTRODUCTION | 1 |
| DISCUSSION | 2 |
| I. THE 1996 ACT AUTHORIZES THE COMPETITIVE NEUTRALITY PRINCIPLE AND THE COMMISSION HAS NOT SHOWN BIAS IN FAVOR OF WIRELESS CARRIERS | 2 |
| II. THE COMMISSION WAS CORRECT IN DECIDING TO MAKE UNIVERSAL SERVICE SUPPORT PORTABLE | 5 |
| III. THE COMMISSION SHOULD EXPRESSLY PREEMPT STATE LAW TO ACCOMMODATE CONTRACT ADJUSTMENT | 7 |
| IV. THE COMMISSION SHOULD REJECT PETITIONS SEEKING TO INCREASE THE SIZE OF THE FEDERAL HIGH-COST FUND | 10 |
| A. It Would Be Premature for the Commission to Determine that the Federal High-Cost Fund Should Fund More than 25% of the Cost of Universal Service | 11 |
| B. The Commission Correctly Determined that Universal Service Subsidy Distributions Should be Based on Forward-Looking Economic Costs Rather than on Embedded Costs | 15 |
| C. The Commission Should Reject the Arguments to Increase the Subsidies Available to Rural Carriers Before It Adopts a New High-Cost Program | 18 |
| CONCLUSION | 23 |

SUMMARY

The Commission should deny Western Alliance and Rural Telephone Coalition petitions to reconsider the competitive neutrality principle. The competitive neutrality principle is consistent with congressional intent and there is no basis for the contention that it contravenes Section 254. The Commission has not misapplied the competitive neutrality principle such that ILECs are disadvantaged vis-a-vis competitive carriers, including wireless carriers.

The Commission should deny RTC's and the Alaska Telephone Association's petitions to reconsider the portability of universal service support. The Commission was correct in deciding to make support portable, and continuation of the *status quo* would give ILECs an unfair advantage.

The Commission should deny the petitions of the Ad Hoc Telecommunications Users Committee and American Petroleum Institute and expressly preempt state law to accommodate contract adjustment. The Communications Act authorizes the Commission to change or terminate a private contract to implement or enforce the Act. Contract adjustment is directly related to the Commission's authority to regulate rates, terms and conditions of interstate service. Furthermore, at least CMRS carriers should be allowed to recover their contributions based on intrastate revenues from their intrastate customers.

The Commission should reject arguments submitted by various state commissions to increase the size of the federal high-cost fund. The Commission's 25% limit is supported by the record, and it is questionable whether the Commission has authority to fund the high-cost program in excess of 25% using interstate revenues. States should be afforded a meaningful opportunity to develop a state universal service program to fund the 75% of high costs, and it is premature for the Commission to revisit this issue at this time.

The Commission should reject rural telephone company petitioners' arguments that distributions should be based on incumbents' embedded costs. The Commission properly determined that support should instead be based on forward-looking economic costs. Furthermore, the Commission will not consider the adoption of a forward-looking cost model for rural carriers for over a year; therefore, it is premature to determine whether the *Universal Service Order* violates the sufficiency and predictable principles.

In addition, the Commission should reject rural telephone company petitioners' challenges to its modest adjustments to the current high-cost fund program. The Commission should limit the amount of corporate operations expense that may be recovered through the federal subsidy program. Also, subsidies for newly-acquired exchanges paid to rural incumbents should be limited to per-line support so as to prevent the large incumbent seller from receiving windfall profits funded by competitive carriers. Finally, the Commission should maintain the cap on the growth of the universal support fund, and petitioners have provided no factual basis for their

allegation that continuation will result in an insufficient fund. The cap will promote efficiency among eligible carriers, prevent excessive growth in the size of the fund, and make the transition to forward-looking support mechanisms more manageable.

BEFORE THE
Federal Communications Commission
WASHINGTON, DC 20554

In the Matter of)
)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)
)

**AIRTOUCH COMMUNICATIONS, INC.
OPPOSITION TO PETITIONS FOR RECONSIDERATION**

AirTouch Communications, Inc. (“AirTouch”) hereby submits its opposition to certain petitions for reconsideration of the Commission’s *Report and Order* in the above-referenced proceeding.¹

INTRODUCTION

The Commission has recognized in this and other proceedings the important role that wireless providers will play in promoting local competition and bringing quality, cost-efficient service to rural areas.² Throughout the universal service

¹ *Federal-State Joint Board on Universal Service, Report and Order*, CC Docket No. 96-45, FCC 97-157 (released May 8, 1997) (“*Universal Service Order*”), *Erratum*, FCC 97-157 (June 4, 1997); *Order on Reconsideration*, FCC 97-246 (July 10, 1997) (“*Reconsideration Order*”).

² *Amendment of the Commission’s Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Services, Notice of Proposed Rulemaking, Order on Remand and Waiver Order*, 11 FCC Rcd. 16639, 16664 (1996) (CMRS is widely expected to provide potential local loop competition); *In the Matter of Telephone Number Portability, First Report and Order and Further Notice of Proposed Rulemaking*, 11 FCC Rcd. 8352, 8433, 8436-37 (1996) (number portability will promote competition between CMRS and wireline providers); *Amendment of the Commission’s Rules To Permit*
(continued...)

proceeding, AirTouch has advocated support mechanisms and eligibility requirements which both provide a level playing field for competitive local telecommunications carriers and prevent incumbent local exchange carriers (“LECs”) from maintaining unwarranted competitive advantages over competitive carriers, including wireless providers. By this filing, AirTouch opposes certain petitions for reconsideration of the *Universal Service Order* that would undermine these important policy objectives.

DISCUSSION

I. THE 1996 ACT AUTHORIZES THE COMPETITIVE NEUTRALITY PRINCIPLE AND THE COMMISSION HAS NOT SHOWN BIAS IN FAVOR OF WIRELESS CARRIERS

The Joint Board recommended and the Commission adopted “competitive neutrality” as a cardinal principle on which universal service policies should be based.³ The Commission took this action pursuant to Section 254(b)(7), which expressly authorizes it to adopt “such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience and necessity and are consistent with the Act.”⁴ The Joint Board and Commission

² (...continued)

Flexible Service Offerings in the Commercial Mobile Radio Services, Notice of Proposed Rulemaking, 11 FCC Rcd. 2445, 2447-48 (FCC always intended that wireless local loop would be a service that meets the definition of PCS), *First Report and Order and Further Notice of Proposed Rulemaking*, 11 FCC Rcd. 8965, 8967, 8969-73 (1996) (CMRS Flex proceeding will promote wireless competition in local exchange market).

³ *Universal Service Order* ¶¶ 46-51; Federal-State Joint Bd. on Universal Service, *Recommended Decision*, 12 FCC Rcd at 87, 101 (Jt. Bd. 1996) (“*Recommended Decision*”).

⁴ 47 U.S.C. § 254(b)(7); *Universal Service Order* ¶ 46.

each noted that a competitive neutrality principle was consistent with “congressional intent and necessary to promote ‘a pro-competitive, de-regulatory national policy framework.’”⁵

Western Alliance (“Western”) now contends that the Commission’s adoption of the competitive neutrality principle “violates the letter and the spirit of Section 254.”⁶ According to Western, Section 254 acts “as a safeguard against competitive market failures” and is designed “to alleviate the shortcomings of competition” (although Western never explains how consumers are harmed by having a choice).⁷

Western’s argument is flatly inconsistent with the plain language of the statute.⁸ The amended Communications Act *requires* state commissions to designate competitive carriers serving non-rural areas (meeting specified requirements) as eligible to receive universal service support.⁹ Similarly, state commissions are also *authorized* to

⁵ *Universal Service Order* ¶ 48; *see also Recommended Decision*, 12 FCC Rcd at 101.

⁶ Petition for Reconsideration of the Western Alliance in CC Docket No. 96-45, filed July 17, 1997, at 3 (“Western Petition”).

⁷ *Id.* at 4, 6.

⁸ Consequently, even if Western’s references to legislative history supported its argument (and they do not), the references are irrelevant. *See Guzilon v. Comm’r of Internal Revenue*, 985 F.2d 819, 823-24, n.11 (5th Cir. 1993), *United States v. Neville*, 985 F.2d 992, 995 (9th Cir.), *cert. denied*, 113 S.Ct. 2425 (1993) (where Congress’ intent is clear from unambiguous statutory language, resort to legislative history is unnecessary).

⁹ 47 U.S.C. § 214(e)(2).

designate competitive carriers serving rural areas as eligible to receive universal service support.¹⁰

Consequently, there is no basis to Western's assertion that Section 254 insulates incumbent LECs, including those serving rural areas, from competition. As the Commission has noted, "we reject assertions that competitive neutrality has no application in rural areas or is otherwise inconsistent with section 254":

We believe [rural incumbent] commenters present a false choice between competition and universal service. A principle purpose of section 254 is to create mechanisms that will sustain universal service as competitive emerges. We expect that apply the policy of competitive neutrality will promote emerging technologies that over time, may provide competitive alternatives in rural, insular, and high cost areas and thereby benefit rural consumers.¹¹

Western alternatively contends that the Commission misapplied the competitive neutrality principle, asserting that "[t]he most egregious instance of this is [the Commission's] refusal to include 'equal access to interexchange service' . . . as a core service solely because wireless carriers currently are not *required* to provide the service":

This ruling grossly violates Section 254(b)(3) by placing the interests of potential wireless competitors over the needs of rural residents for a service that is readily available in virtually all urban areas.¹²

¹⁰ *Id.*

¹¹ *Universal Service Order* at ¶ 50.

¹² Western Petition at 6-7 (citations omitted). The Rural Telephone Coalition ("RTC") makes a similar assertion, citing as evidence "[t]he Commission's acceptance of wireless carriers' suggestion that the states should designate portions of noncontiguous rural telephone company study areas as 'service

Western, however, completely ignores that Section 332(c)(8) expressly *prohibits* the Commission from requiring CMRS providers to offer equal access to interexchange carriers (“IXCs”).¹³ Equal access was important when consumers had no choice but to use the services of the local incumbent LEC because it at least gave consumers choices for some of their toll services. As Congress determined, however, equal access is no longer necessary when consumers have a choice of local service providers, because consumers then have a choice for both their local *and* toll services.

The Western Alliance obviously prefers the days when its members were insulated from any meaningful competition, and it obviously would prefer that its members have the exclusive right to receive universal service subsidies. However, the 1996 Act makes abundantly clear that consumer interests are better promoted by consumer choice rather than by regulated monopolies and that the best way to stem the growth of costly universal service subsidies is to introduce competition in markets.¹⁴

II. THE COMMISSION WAS CORRECT IN DECIDING TO MAKE UNIVERSAL SERVICE SUPPORT PORTABLE

¹² (...continued)
areas.” Petition for Reconsideration of the Rural Telephone Coalition in CC Docket No. 96-45, filed July 17, 1997, at 21-22 (“RTC Petition”). While the Commission noted the concern expressed by wireless carriers and found the concern to be well founded, it only “encouraged” state commissions to consider designating rural service areas that consist only of contiguous portions of incumbent LEC study areas. See *Universal Service Order* ¶ 189.

¹³ *Universal Service Order* ¶¶ 78-79, citing 47 U.S.C. § 332(c)(8).

¹⁴ If anything, the *Universal Service Order* shows a bias *against* competitive carriers, which are not entitled to subsidies for existing lines. See Petition for Reconsideration of AirTouch Communications, Inc. in CC Docket No. 96-45, filed July 17, 1997, at 5-6.

The amended Communications Act expressly permits carriers other than incumbent LECs to receive universal service support.¹⁵ Following the recommendations of the Joint Board,¹⁶ the Commission decided that the universal service subsidy payment should be portable:

When a line is served by an eligible telecommunications carriers, either an ILEC or a CLEC, through the carrier's owned and constructed facilities, the support flows to the carrier because that carrier is incurring the economic costs of serving that line.¹⁷

Two petitioners, of the more than 50 petitions filed, ask the Commission to reconsider its decision to make universal service support portable. These rural telephone company petitioners argue that making support portable "invites cream skimming" and would give "the competitor an unfair advantage since it will be able to use this windfall of unnecessary support to undercut the incumbent."¹⁸ The cream-skimming argument is baseless given the requirement in Section 214(e) that a competitive carrier must both provide and advertise its universal services "throughout the service area for which the [universal service] designation is received."¹⁹ Moreover, portability

¹⁵ See 47 U.S.C. § 214(e)(2).

¹⁶ See *Recommended Decision*, 12 FCC Rcd at 238-39, 471 n.2469.

¹⁷ *Universal Service Order* ¶ 286; see also *id.* ¶ 311.

¹⁸ RTC Petition at 8-9; Petition for Reconsideration of the Alaska Telephone Ass'n in CC Docket No. 96-45, filed July 17, 1997, at 3 (Alaska Ass'n Petition).

¹⁹ 47 U.S.C. § 214(e)(1); see also *Universal Service Order* ¶ 289. Noting this requirement, RTC intimates that a competitive carrier will game the system "by advertising a higher rate than the ILEC." RTC Petition at 8 n.11. However, RTC never explains the obvious: how a competitive carrier can hope to obtain customers (and, thereby, universal service support) by advertising a higher rate than the

(continued...)

does not result in a “windfall” or “unfair advantage;” to the contrary, it merely results in all carriers being treated equally.

What would constitute an “unfair advantage” — and be contrary to the amended Communications Act — would be to continue the *status quo*, whereby only incumbent LECs receive universal service support to the exclusion of competitive carriers like AirTouch. AirTouch cannot possibly compete with the incumbent in such a competitively unequal environment.

III. THE COMMISSION SHOULD EXPRESSLY PREEMPT STATE LAW TO ACCOMMODATE CONTRACT ADJUSTMENT

The Commission recognized in the *Universal Service Order* that “[b]y assessing a new contribution requirement, we create an expense or cost of doing business that was not anticipated at the time contracts were signed.”²⁰ Accordingly, the Commission concluded that “the public interest would be served by allowing carriers to make changes to existing service contracts in order to adjust for this new cost of doing business.”²¹

The Ad Hoc Telecommunications Users Committee (“Ad Hoc”) and American Petroleum Institute (“API”) contend that the Commission does not have the authority to permit carriers to change contracts to add a universal service assessment.²²

¹⁹ (...continued)
incumbent.

²⁰ *Universal Service Order* ¶ 851.

²¹ *Id.*

²² Petition for Reconsideration of the Ad Hoc Telecommunications Users Commit-
(continued...)

According to these petitioners, customers with contracts should receive a windfall not available to other consumers — that is, their carriers should be unable to pass-through their universal service contributions which are based on the services used by contract customers.

Ad Hoc and API recite authority in support of their “no pay” argument. This authority, however, does not support the proposition for which it is cited. Specifically, the precedent cited by Ad Hoc and API relates to legal doctrines intended to prevent tariffed carriers from unilaterally abrogating private contracts through the filed-rate doctrine, a doctrine which has no applicability to the proceeding at hand.²³ The Communications Act clearly authorizes the Commission to change (or even terminate) a private contract where necessary to implement or enforce the provisions of the Act and promote the public interest.²⁴ Contract adjustment to account for the impact of universal

²² (...continued)
tee in CC Docket No. 96-45, filed July 17, 1997, at 4-9; Petition for Reconsideration of the American Petroleum Institute in CC Docket No. 96-45, filed July 16, 1997, at 4-7.

²³ See *Bell Tel. Co. of Pa v. FCC*, 503 F.2d 1250, 1275-82 (3d Cir. 1974), *AT&T Reclassification Order*, 11 FCC Rcd. 3271, 3338, 3341-43 (1995) (discussing *Sierra-Mobile* doctrine and “substantial cause” test in context of filed-rate doctrine).

²⁴ See *Connolly v. PBGC*, 475 U.S. 211, 223-224 (1986) (“when contracts deal with a subject matter which lies within the control of Congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them.”); *FCC v. Florida Power Corp.*, 480 U.S. 245 (1987); *United States v. Midwest Video Corp.*, 406 U.S. 649, 674 n.31 (1972); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order*, 11 FCC Rcd. 15499, 15583 (1996), *vacated in other part, Iowa Utilities Bd. et al. v. FCC*, No. 96-3321, slip op. n.39 (8th Cir. July 18, 1997) (“[w]hen Congress sought to exclude preexisting contracts from provisions of the [1996 Act], it did so expressly.”);
(continued...)

service is directly related to the Commission's authority to regulate the rates, terms, and conditions of interstate service.²⁵

The Commission in discussing this subject ruled that its finding "is not intended to preempt state contract laws."²⁶ The Commission should reconsider this decision as recommended by CTIA.²⁷ The federal mandates contained in the 1996 Act cannot be implemented if state law is allowed to stand as a barrier. Section 332(c)(3) gives the Commission ample authority to preempt state law for CMRS providers, although the Commission should exercise its clear authority to preempt state law for all carriers.

The Commission should also reconsider its decision prohibiting carriers from recovering their contributions based on intrastate revenues from their intrastate customers.²⁸ Assessing contributions on both intrastate and interstate revenues but allowing recovery solely through rates charged for interstate services is not competitively neutral.²⁹ In addition, as CTIA points out, the concerns that lead the Commission to

²⁴ (...continued)
Amendment of the Commission's Rules Relative to Allocation of the 849-851/894-896 MHz Bands, Memorandum Opinion and Order, 6 FCC Rcd. 4582, 4583-84 (1991) (invalidating air-ground contracts between GTE and airlines).

²⁵ 47 U.S.C. §§ 201, 202, 203. Indeed, the Commission has exclusive authority to regulate the rates of CMRS providers. *Id.* § 332(c)(3).

²⁶ *Universal Service Order* ¶ 851.

²⁷ Petition for Reconsideration of CTIA in CC Docket No. 96-45, filed July 17, 1997, at 24 ("CTIA Petition").

²⁸ *Universal Service Order* ¶¶ 825, 838.

²⁹ Assume two carriers with the same retail revenues and, consequently, the same
(continued...)

adopt this prohibition do not apply to CMRS providers because, under Section 332(c)(3), they are not subject to state rate regulation.³⁰ At a minimum, the Commission should clarify that CMRS providers may apply pass-throughs to all of their services — although, again for competitive neutrality reasons, the Commission should allow complete pass-throughs for all carriers.

IV. THE COMMISSION SHOULD REJECT PETITIONS SEEKING TO INCREASE THE SIZE OF THE FEDERAL HIGH-COST FUND

The *Universal Service Order* is an attempt by the Commission to strike a balance between two conflicting goals of the 1996 Act: (1) to promote competition so consumers can enjoy the widest array of choices at the lowest possible prices, and yet (2) to increase the prices paid by many consumers, so the prices paid by others (*e.g.*, those residing in high-cost areas) are lower than they otherwise would be. Several petitioners now argue that the Commission struck an unreasonable balance. They contend that the subsidies provided by the federal high-cost program should be increased — so they, or the carriers in their state, become eligible for larger federal subsidies.

These “increase the size of the federal program” arguments lack merit and indeed suffer from a more generic flaw — specifically, they address only half the equation. While these petitioners assert their entitlement to more subsidy dollars, they do

²⁹ (...continued)
universal service contribution level. These two carriers will invariably have a different mix of intrastate and interstate services. The carrier with the greater percentage of interstate services will have a competitive advantage over the other carrier because it will be able to assess proportionally fewer contribution dollars to its interstate customers.

³⁰ CTIA Petition at 9-10.

not address the costs of funding these additional dollars, nor do they address the impact these increased costs will have on consumers and on the economy.

The Commission knows full well that universal service subsidies will be paid not by carriers but by consumers in the form of higher prices. Commissioner Chong was correct in her observation that “[w]e Commissioners are the guardians of the telephone ratepayers.”³¹ AirTouch, on behalf of its present and future customers, submits that the funding of the new universal service program — which will exceed \$3.5 billion in 1998 alone — should not be increased at this time. There is ample time to consider adjusting funding requirements once the industry has implemented the current plan and has gained some experience with the new program.

A. It Would Be Premature for the Commission to Determine that the Federal High-Cost Fund Should Fund More than 25% of the Cost of Universal Service

The Commission, largely at the urging of the States, has decided that universal service should be initially funded *via* a federal/state partnership, with the federal high-cost program funding the interstate portion of high-cost service and the state high-cost programs funding the balance.³² The Commission has determined that once the new forward-looking economic cost mechanism is implemented — January 1, 1999 for non-rural carriers and perhaps as early as January 1, 2001 for rural carriers — the federal program should support 25% of high costs with the state programs funding the remaining

³¹ Separate Statement of Commission Rachele B. Chong, CC Docket No. 96-45, at 6 (May 7, 1997).

³² See *Universal Service Order* ¶¶ 3, 268, 353, 806, 818, 826, 831, 835; see also *Recommended Decision*, 12 FCC Rcd at 500.

75%.³³ The federal program, after all, is designed “only [to] support interstate [high] costs.”³⁴

Several petitioners argue that a federal program covering only 25% of high costs will not be sufficient. State commission petitioners note that the current federal high-cost fund often subsidizes more than one-fourth of an incumbent’s high costs,³⁵ while rural incumbents question the Commission’s assumption that states will adopt a complementary program which funds the state portion of high costs (the remaining 75%).³⁶ One petitioner goes so far as to assert that the decision to fund only 25% of a carrier’s high-cost “is not supported in the record and does not have a reasonable basis.”³⁷

³³ *Universal Service Order* ¶ 269.

³⁴ *Id.* ¶ 268.

³⁵ Petition for Reconsideration of Alaska Public Utilities Commission in CC Docket 96-45, filed July 17, 1997, at 5-9; Petition for Reconsideration of Arkansas Public Service Commission in CC Docket 96-45, filed July 17, 1997, at 1-3; Petition for Reconsideration of The Public Utility Commission of Texas (“Texas PUC”) at 1-2; Petition for Reconsideration of the Vermont Public Service Board in CC Docket 96-45, filed July 17, 1997, at 2-6 (“Vermont PSB”); and Petition for Reconsideration of Wyoming Public Service Commission in CC Docket 96-45, filed July 17, 1997, at 2-4.

³⁶ RTC Petition at 6 (“It is simply not reasonable to assume that even the most rural, high cost states . . . ‘will fulfill their role in providing for the high cost support mechanism.’”)(citations omitted); Western Petition at 20 (“The *USF Order*’s optimism that the states will make up the 75 percent shortfall, *USF Order* para. 271, is wishful thinking.”); *see also* Alaska Ass’n Petition at 1-2; Petition for Reconsideration of GVNW Inc./Management in CC Docket 96-45, filed July 17, 1997, at 1-9.

³⁷ Vermont PSB at 4. Completely unwarranted is the assertion of a few petitioners that the Commission acted without the benefit of the Joint Board. *See, e.g.*, Western Petition at 19. In fact, the Joint Board decided it was precluded from making a recommendation because the record that had been submitted (including by the petitioners) was inadequate to make a recommendation. *See Recom-*

The Commission's decision is adequately supported by the record. In a federal/ state partnership, the role of the federal government is to fund the interstate portion of high costs. The Commission cogently explained that 25% is:

the current interstate allocation factor applied to loop costs in the Part 36 separations process, and because loops costs will be the predominant costs that varies between high cost and non-high cost areas, this factor best approximates the interstate portion of universal service costs.³⁸

No one disputes this proposition; indeed, the petitioners readily "agree" that loop costs are "the largest single driver of cost differential between the high cost areas and the lower or average cost areas."³⁹ What is more, none of the petitioners even submits an alternative factor for the Commission's evaluation (although any allocation factor other than 25% would be arbitrary and capricious).

Moreover, it is dangerous to compare funding of a program using forward-looking economic costs designed for a competitive environment, with the past program based on embedded costs and utilized in a monopoly environment. Congress made clear its desire that an entirely different universal service program is needed for the competitive environment it established.⁴⁰ Furthermore, the "gloom and doom" predicted by these

³⁷ (...continued)
mended Decision, 12 FCC 229-31. The Joint Board encouraged the Commission to address the subject once an adequate record had been developed. *See id.* at 230-31.

³⁸ *Universal Service Order* ¶ 269.

³⁹ GVNW Petition at 6.

⁴⁰ *See* H.R. Conf. Rep. No. 104-458, 104th Cong., 2d Sess., at 131 (1996)("[T]he conferees do not view the existing proceeding under Common Carrier Docket 80-286 . . . as an appropriate foundation on which to base the proceeding required by new section 254(a).").

petitioners is reminiscent of the “gloom and doom” predicted over a decade ago when the industry moved from the frozen Subscriber Plant Factor (“SPF”) — where up to 85% of all costs in some states were assigned to the interstate jurisdiction and paid for by interstate customers — to the current flat 25% allocator.⁴¹ The prediction of “gloom and doom” proved unfounded 10 years ago, and the current predictions will almost certainly prove equally unfounded.

AirTouch also questions whether the Commission has the authority to fund the high-cost program in excess of 25% using interstate revenues. It is AirTouch’s understanding that interstate revenues constitute less than 25% of gross telecommunications revenues — although, as the Commission notes, 25% is the allocation factor used in separating the cost of local loops. If the federal program were to contribute more than 25% of a carrier’s high costs, interstate revenues (and, therefore, interstate customers) would be subsidizing costs appropriately assigned to the intrastate jurisdiction (and appropriately paid for by intrastate service customers).⁴² AirTouch believes that such an interstate-to-intrastate subsidy is no longer permitted under the newly amended Communications Act — at least so long as contributions to the federal program are limited to interstate revenues.

The criticism that state commissions will not attempt to develop a state universal service program to fund the 75% of high costs is unfair, given that states have

⁴¹ See *Amendment of Part 67 of the Commission’s Rules*, CC Docket No. 80-286, *Decision and Order*, 96 F.C.C.2d 781 (1984). Similar unfounded allegations of “gloom and doom” were predicted when the Commission moved from SPF to frozen SPF.

⁴² See, e.g., *Smith v. Illinois Bell*, 282 U.S. 133 (1930).

not yet had a meaningful opportunity to develop their own programs with the benefit of the Commission's *Universal Service Order*. The Commission has made clear repeatedly, however, that it will re-evaluate the situation once states have an opportunity to develop cost studies and establish their programs. Indeed, the Commission reaffirmed only one month ago:

[I]t is premature for us to reexamine our decision to fund 25 percent of universal service at this time. Our action today does not, however, foreclose the possibility that, as state replace their programs with explicit support mechanisms, the Commission will reassess whether there is a need for additional federal support.⁴³

Consequently, assuming *arguendo* that petitioners' arguments had merit, it would still be premature for the Commission to address them. No one can assess the sufficiency of universal service until both the federal and the state high-cost programs are developed.

B. The Commission Correctly Determined that Universal Service Subsidy Distributions Should be Based on Forward-Looking Economic Costs Rather than on Embedded Costs

Rural telephone company interests argue that the Commission's decision to distribute, some time in the future, universal service funds based on forward-looking

⁴³ *Reconsideration Order* ¶ 28; *see also Universal Service Order* ¶ 271 (“Although we are not, at the outset, providing federal support for intrastate, as well as interstate, costs associated with providing universal services, we will monitor the high cost mechanisms to ensure that they are sufficient to ensure just, reasonable, and affordable rates. We expect that the Joint Board and the states will do the same and we hope to work with the states in further developing a unified approach to the high cost mechanisms.”), 834 (“As states [establish their own high-cost programs], we will be able to assess whether additional federal universal service support is necessary to ensure that quality services remain ‘available at just, reasonable, and affordable rates,’” *quoting* Section 254(b)(1), ¶ 202 (same)).

economic costs is “arbitrary and capricious” and is “not rational.”⁴⁴ In making this argument, however, these petitioners do not even attempt to defend the alternative: distributing universal service funds using embedded costs.

The Commission has determined that forward-looking economic cost “best approximates the costs that would be incurred by an efficient carrier in the market” and “will send the correct signals for entry, investment, and innovation.”⁴⁵ Unlike embedded costs, forward-looking economic costs do not encourage recipient carriers to inflate their costs or to refrain from efficient cost-cutting measures.⁴⁶ The Commission has correctly noted that “setting support levels in excess of forward-looking economic cost would enable [recipient] carriers . . . to use the excess to offset inefficient operations or for purposes other than ‘the provision, maintenance, and upgrading of facilities and services for which support is intended’”:

This excess, by increasing the burden on all contributors to the support mechanisms, would also unnecessarily reduce the demand for other telecommunications services.⁴⁷

The petitioners do not (and, indeed, cannot) contest any of these findings. Consequently, there is no basis for their argument that the Commission’s decision to base universal service support using forward-looking economic costs is “arbitrary” or “not rational.” Instead, it would be irrational for the Commission to have adopted embed-

⁴⁴ Western Petition at 14-18; RTC Petition at 9-12.

⁴⁵ *Universal Service Order* ¶¶ 199, 224; *see also* Recommended Decision, 12 FCC Rcd at 230-32.

⁴⁶ *See Universal Service Order* ¶ 226.

⁴⁷ *Id.* ¶ 225, quoting 47 U.S.C. § 254(e).

ded costs for the new, competitively neutral, universal service program. Carriers like AirTouch which operate in competitive markets should not (and indeed, cannot) be required to subsidize the inefficiencies of other carriers, including their competitors.

The petitioners alternatively contend that the *Universal Service Order* violates the sufficiency and predictable principles because the Commission has not yet adopted a forward-looking economic cost model for use with rural carriers.⁴⁸ This is unjustified. The time to assess whether a given universal service program is “specific, predictable and sufficient” — as Section 254(b)(5) directs — is *after* the Commission adopts the program.⁴⁹ The Commission will not even begin considering adoption of a forward-looking economic cost model for rural carriers for over a year. The petitioners can participate fully in this upcoming proceeding. If the Commission ultimately adopts a cost model which the petitioners believe does not meet the requirements of Section 254, they can challenge the decision at that time.

⁴⁸ The Rural Telephone Coalition also argues that the *Order* “fails to resolve the concerns . . . regarding the LECs’ ability to recover embedded costs,” stating that “[t]he record is replete with comments pointing out that LECs will suffer a loss due to legacy costs.” RTC Petition at 10. AirTouch agrees that the record is replete with LEC “comments” asserting that LECs will suffer a loss due to legacy costs. However, the Commission did not ignore these “comments.” What the Commission determined was that:

No carrier, however, has presented any specific evidence that the use of forward-looking economic cost to determine support amounts will deprive it of property without just compensation. Indeed, the mechanisms we are creating today provide support to carriers in addition to other revenues associated with the provision of service.

Universal Service Order ¶ 230.

⁴⁹ Indeed, the Commission may never even adopt a cost model approach for rural carriers because it may decide instead to pursue the more market-driven approach of competitive bidding. *See Universal Service Order* ¶¶ 319-25.

C. The Commission Should Reject the Arguments to Increase the Subsidies Available to Rural Carriers Before It Adopts a New High-Cost Program

The current high-cost fund program is broken, as Congress has determined.⁵⁰ Because it is based on the actual reported costs of incumbent LECs, the program “does not provide a direct incentive for carriers to reduce or minimize their costs.”⁵¹ Indeed, the Commission has noted that by that using reported costs, “the higher the cost, the more support,” with the result that the program constitutes “a ‘blank check’ for high-cost LECs.”⁵²

However, the current high-cost program is even more bizarre. For example, the DEM weighting program “in reality often subsidizes small companies with average or even below average costs.”⁵³ This is because small incumbents receive DEM

⁵⁰ See note 40 *supra*.

⁵¹ *Amendment of Part 36*, CC Docket No. 80-286, *Notice of Inquiry*, 9 FCC Rcd 7404, 7414 (1994); see also *id.* at 7422 (“We are concerned that LECs allocating a high percentage of their incremental loop investment to the interstate operations may have little incentive to avoid costs that are not justified by sufficient customer demand or other economic need.”).

⁵² *Amendment of Part 36*, CC Docket No. 80-286, *Notice of Proposed Rulemaking*, 10 FCC Rcd 12309, 12324, 12329 (1995).

⁵³ *Amendment of Part 36*, 10 FCC Rcd at 12316. The DEM weighting program “is based on the theory that smaller telephone companies have higher local switching costs than larger LECs have.” *Federal-State Joint Bd. on Universal Service, Notice of Proposed Rulemaking*, 11 FCC Rcd 18092, 18109 (1996); see also *Recommended Decision*, 12 FCC Rcd at 187 ¶ 189. Commission staff recently determined that the per-line cost for a 4,000-line switch is less than 14% more than the per-line cost of an 80,000-line switch (\$157.75 vs. \$139.00, respectively). See *Cost Model Further NPRM*, CC Docket Nos. 96-45 and 97-160, FCC 97-256, ¶ 129 (released July 18, 1997). Nevertheless, the DEM weighting program gives all small incumbents — *regardless* of their costs — up to 300% additional federal assistance.

weighting subsidy assistance “*regardless* of the level of their costs.”⁵⁴ The Commission has noted repeatedly that the DEM weighting program gives incumbent LECs “an incentive to manipulate their categorization of . . . [costs] to maximize the amount of assistance received.”⁵⁵ Given the current rules and the perverse built-in incentives they generate, it should not be surprising that during the first seven years of the universal service program, the number of subsidized lines almost doubled (from 19.5 to 36.5 million loops).⁵⁶

The Commission has determined correctly that a radically new approach is needed for the new environment. The new approach will take effect for non-rural carriers in 16 months; for rural carriers, it will not begin to be implemented before January 2001 (and even then, rural incumbents will likely enjoy a multi-year transition). During the intervening three (or more) years, rural carriers will essentially receive assistance under the current program with all its perverse incentives.

The Commission in its *Universal Service Order* has determined to make modest adjustments to the current plan. Rural incumbents attack these adjustments. This challenge is not surprising: anyone with a “blank check” capable of receiving additional subsidy dollars has an incentive to argue its continued entitlement to having a “blank check.”

⁵⁴ *Amendment of Part 36 NOI*, 9 FCC Rcd at 7415 (emphasis added).

⁵⁵ *Amendment of Part 36 NPRM*, 10 FCC Rcd at 12332; *see also Amendment of Part 36 NOI*, 9 FCC Rcd at 7409 (“DEM weighting has appeared to give an incentive to some LECs to manipulate our separations rules as they categorize their costs.”).

⁵⁶ *Amendment of Part 36 NOI*, 9 FCC Rcd at 7423.

As discussed herein, the rural incumbent LEC challenge to the Commission's modest adjustments to the current program should be rejected. If anything, the Commission on reconsideration should eliminate the DEM weighting program or at least adopt the fixed-per-line support which the Joint Board had recommended.⁵⁷

1. *Limit on Corporate Operations Expenses.* In its *Order*, the Commission concluded that corporate operations expenses are not costs "inherent in providing telecommunications services, but rather may result from managerial priorities and discretionary spending."⁵⁸ The Commission therefore ruled for the first time that some limit should be placed on the amount of corporate operations expenses that may be recovered through the federal subsidy program.⁵⁹ Several rural incumbents challenge this decision, complaining that the action will limit what they can spend on "executive compensation, legal and consultant fees, and other administrative costs."⁶⁰

The Commission should reject these arguments. If anything, it should preclude incumbents from including any corporate operations expenses in their reported

⁵⁷ The Joint Board made this recommendation because it "will encourage rural carriers to operate efficiently because no additional support will be provided for increased costs." The Joint Board further noted that 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." *Recommended Decision*, 12 FCC Rcd at 237. The Commission choose not to adopt this recommendation because of its belief, not substantiated in the record, that a frozen level of support "may not" provide sufficient support for rural incumbents. *Universal Service Order* ¶ 303.

⁵⁸ *Universal Service Order* ¶ 283.

⁵⁹ *Id.* ¶¶ 253, 273, 307; *see also Reconsideration Order* ¶¶ 17-22.

⁶⁰ Western Petition at 8-9; *see also* Alaska Ass'n Petition at 2-3; Fidelity at 1-5; GVNW Petition at 9-12; and USTA at 10-11.

costs. As the Commission has previously noted, such “administrative expenses do not appear to be costs inherent in providing service in high-cost areas of the country.”⁶¹

Incumbent carriers, like competitive carriers, are free to spend what they want for their executives and consultants. However, this right does not translate to a right to have these costs subsidized by competing carriers. Incumbent LECs should be faced with the same choices made by their competitors: keep corporate operations expenses to reasonable limits.

2. *Subsidy Caps on Newly Acquired Exchanges.* In recent years, large incumbents have sold a considerable number of rural exchanges to rural incumbents. Because of the design of the current high-cost program, the purchasing incumbent is often eligible to receive after the sale much greater federal subsidy dollars than the selling incumbent had received. The Commission in its *Universal Service Order* determined that, until the buying and selling incumbents both operate under a forward-looking cost model, the purchasing incumbent should be limited to the per-line support that the selling incumbent had received.⁶²

Rural incumbents oppose this limitation, arguing that it is “unreasonable and unlawful” and imposes “an unnecessary chill on the legitimate, voluntary sale of exchanges.”⁶³ The Commission’s new rule does neither. It merely ensures that the price

⁶¹ *Amendment of Part 36 NPRM*, 10 FCC Rcd at 12325 (“propos[ing] to remove [such] costs . . . from the loop costs used to determine eligibility for a level of USF assistance.”).

⁶² *Universal Service Order* ¶ 308.

⁶³ GVNW Petition at 20-21; RTC Petition at 7-8; TelHawaii at 2-4; USTA at 7-9; Western Petition at 12-13.