

3) The Inclusion of "Conduit" Functions Will Create Complexity in the Determination of Who Contributes.

Section 254(d) requires that all telecommunications carriers shall contribute to universal service mechanisms on an equitable and nondiscriminatory basis. As a threshold matter, this requires that support be sufficient to substitute for implicit support in the interstate access rates of the ILECs. Continuing to recover universal service implicitly through ILEC access rates would require those carriers to contribute in a manner which is neither equitable nor nondiscriminatory.

As explained above, given the limitation of support to telecommunications service, the Commission can only include "conduit" functions which provide "access to" information services if it chooses to designate those functions as telecommunications services. This, in turn, would add greatly to the complexity of determining contributions to the fund. Those information providers who furnish "conduit" functions today would become telecommunications carriers, and would owe contributions to the universal service mechanisms based on that portion of their revenues which is associated with these telecommunications services. GTE urges the Commission not to enter into the thicket this effort would create purely for the sake of supporting Internet services.³⁵

³⁵ Further, even if the Commission were to adopt this approach, it would still not have any basis for supporting inside wire, which is not a telecommunications service in any event. As with Internet access, support for inside wire creates a class of entities who do not provide telecommunications services, and hence do not contribute, but who are nonetheless eligible to receive support from the fund.

The development of some more comprehensive approach to the treatment of different services and entities, as discussed above, might offer a more elegant way to define the funding base for universal service. However, given the proliferation of hybrid services, it is likely that distinguishing between transmission and content will remain a thorny problem within any framework that could be devised.

4) The Supported Basic Local Service Should Be Defined to Allow for Hybrid Offerings.

Who is eligible to receive universal service support will be determined by the definition of the service to be supported. The effect of hybrid services, and of different approaches to defining them, will be different for the programs to support schools, libraries, and health care providers than for the high cost fund.

4a) Eligibility to Receive Funds from the School and Library Mechanism Should Be Limited to Telecommunications Carriers.

In the case of the school and library fund, the Commission has attempted to extend the range of products and services to be supported beyond telecommunications services. The outcome of this effort will, in turn, determine which entities are eligible to receive payments from the fund. As discussed above, the Commission's decision to include Internet access and inside wire in the school and library program is not permitted by the 1996 Act. Further, if implemented, it would create an inconsistency between the set of entities who must contribute to the fund and those who may draw from it.

Support for Internet "conduit" services could be included in a manner consistent with the Act if these were determined to be telecommunications services. However, this would come at the cost of the complexity of distinguishing "conduit" functions from

“content” functions performed by the same provider. Since inside wire is clearly not a telecommunications service, it does not appear that there is any way in which it could be included, or providers inside wire made eligible to draw support from the fund, in a manner consistent with the 1996 Act.

4b) The Commission Should Not Limit the Amount of Service That Can Be Supported.

GTE has explained above how, by attempting to limit the amount of service that is included in a given package, or the inclusion of different functions in hybrid service packages, the Commission could inadvertently distort relative prices, thereby inhibiting the adoption of new services and technologies. Similar concerns apply to a feature of the plan adopted by the Commission in its May Order: the Commission has attempted to limit the amount of local service a customer can purchase at affordable rates, by excluding support for second lines and lines to vacation homes.

In a normal market, a customer decides how much to buy by comparing the price of the next unit to his or her willingness to pay. No one tries to decide for the customer how much he or she “needs”; the customer makes the appropriate decision in response to relative prices in the market. The decision to limit support to the first line may appear to minimize the distortion caused by universal service support, since it reduces the range of services to be supported. In fact, the opposite is true: by creating an artificial difference between the price of the first line and the price of the second line, the plan

would greatly distort customers' decisions as to how much service to buy, and from whom.³⁶

Many commenters have emphasized to the Commission the difficulty of defining and implementing the distinction between the first line and other lines. This has become apparent in the record developed in the Commission's Further Notice on this subject. At the root of this difficulty is the fact that the policy rests on an untenable premise: namely that the "need" for basic telecommunications services is somehow a fixed amount per household (or some other social unit). This flies in the face of common experience, which shows that different people buy different amounts of any product or service in the marketplace. Add to this the difficulty in defining the social unit to which this notion applies, and the difficulty of defining a "line" in a world of new technology and hybrid services, and the result of this conceptual vacuum is an administrative quagmire.

All of these objections have been well established in the record. What GTE wishes to emphasize here is that, if the Commission wishes to support basic service, while minimizing artificial distortions, it must support all of it. Any arbitrary distinction drawn through the middle of the local service market will create a severe price distortion between services on either side of this arbitrary line, which in turn will do violence to the efficient development of competition and of new services.

³⁶ The price difference between the first line and a second line in each carrier's offerings will create an artificial incentive for a customer to open an account with a second carrier in order to obtain another "first" line from that carrier.

The principal difficulty in the process the Commission has followed to implement the distinction between first lines and other lines is that it has been driven primarily by the Commission's decision, in its Access Reform Order, to apply different Subscriber Line Charges ("SLCs") and Presubscribed Interexchange Carrier Charges ("PICCs") based upon this distinction. The discussion has thus focused on the relatively limited price difference a customer may face for a first or second line based on these charges alone. However, the price distortion that could result if this same distinction is implemented for universal service is many times greater. Differences in SLCs or PICCs could cause a second line to cost a few cents, or a few dollars, more than a first line. In a high cost area, a customer might pay \$20 for a supported line, and \$80 for an unsupported one. This extreme and, from the customer's standpoint, irrational price difference will lead to customer confusion, threaten acceptance of the program, and unreasonably distort customers' choices.

GTE urges the Commission, as part of its broader review of its universal service policy, to adopt a plan which does not create such wide - and artificial - differences in rates. An explicit universal service plan should eliminate existing irrational elements from the pricing of local service, rather than create new ones. Even if the Commission could lawfully maintain the distinction between first and second lines for the purpose of SLC and PICC application, where the resulting rate distortion is limited, then there is certainly no need to extend the same concept to universal service, where the resulting rate distortion would be many times greater.

- 5) **The FCC Should Work With State Commissions to Develop a Better Compromise for the Division of Universal Service Funding Responsibility.**

The Notice seeks comment of the percentage of support to be provided by the Federal plan, as opposed to state plans, and on the revenue base from which such support should be derived.

With respect to the amount of funding, the 1996 Act is clear that the amount of support should be sufficient, but it does not specify what proportion of the necessary support should be supplied by the Federal plan.³⁷ Thus, different combinations of state and Federal funding could satisfy the Act's requirements. How should the appropriate balance between state and Federal responsibility be arrived at? GTE recommends that three criteria should be used to determine the answer.

First, the Federal plan must be large enough at least to replace the implicit support which is provided today by interstate access charges. As described above, implicit support is provided today by rates in both jurisdictions; when it is replaced by explicit support, the new funding would be applied toward offsetting reductions in the rates which are providing implicit support today. It is not reasonable to expect that a state commission would raise universal service funds within its own jurisdiction, and then use them to reduce interstate access rates. Thus, the interstate sources of implicit support can only be eliminated by the FCC, through the Federal plan. This simple fact places a floor under the size of the Federal plan that will be consistent with the

³⁷ This begs the question of who has responsibility for ensuring that the combined state and Federal support is sufficient, and what happens if the actions taken separately by state and Federal commissions do not produce the combined result Congress intended. GTE has argued that the FCC bears a plenary responsibility to ensure the overall achievement of the goals of the 1996 Act.

requirements of the Act. The Federal plan adopted in May is simply not adequate to do this job.

Second, the plan must strike a reasonable balance among the needs of the different states. If the FCC were to defer the funding of all universal service needs to the states, then each state would have to find funding sources within its own borders to meet that challenge. However, some states which are relatively rural, and have relatively high costs, would have to address high funding needs, but would have relatively small revenue bases from which to generate the necessary support. In its earlier comments, GTE presented data illustrating the dramatic differences across states in their funding needs, and their funding bases.³⁸ The Federal fund can serve as a device for gathering the necessary support for these areas on a broader, national base. On the other hand, if the Federal fund were to undertake all funding needs, states with relatively low costs and high revenue bases would be concerned that too much money would be collected from their customers, and transferred to customers in other states. The size and design of the Federal plan must be chosen to strike a reasonable balance among these concerns. GTE submits that the Federal plan, as adopted in May, is inadequate to meet the concerns of high cost states, and that a new balance must be struck. A group effort among state Commissions, under the aegis of NARUC, has been working to evaluate alternative approaches. GTE suggests that, in order to strike an appropriate balance, two changes must occur: First, the Federal plan must become somewhat larger. This will be necessary in any event to satisfy the first

³⁸ Comments of GTE, April 12, 1996, Appendix B, Schedule 1.

criterion, that the plan be adequate to replace the current implicit support flow from interstate access. Second, the design of the support calculation should be modified to allow greater flexibility to direct support to those states where it is most needed.

Third, there may be efficiency gains from collecting and distributing support on a national basis, as opposed to a state basis. While this is a worthy criterion to consider, GTE believes that much of the potential for efficiency gains, compared to the plan adopted in May, can be realized by using the same base of revenue for the Federal plan and for state plans.

5a) The Federal Plan Should Be Based on Both State and Interstate Revenue.

With respect to the funding base, GTE recommends that any new compromise between the responsibilities of the Federal plan and those of state plans should include a change in the funding base. All of these plans should use as their funding base the combined state and federal retail revenues. When the Joint Board made its recommendation to the Commission in November, 1996, it proposed that the Federal plan should be based on both state and federal revenues. This approach is appropriate for a number of reasons.

First, interstate rates today supply a disproportionate share of the implicit support in the system today. The interstate jurisdiction as a whole thus suffers from the same problem as one of the high-need, low revenue states discussed above: it does not have a funding base sufficient to generate explicit funding sufficient to eliminate the implicit support that is being generated today. Put another way, a Federal plan which met the first criterion listed above, and which had only interstate revenue as a base, would

require a very high percentage rate of contribution to fund it. Such a fund would certainly not be able to raise enough additional funding to meet the needs of high-cost, low-revenue states, in order to meet the second criterion.

Second, it will become increasingly difficult to distinguish between state and interstate revenue. The development of new, hybrid services will only add to this difficulty. For new entrants and wireless carriers, which do not report the jurisdictional nature of their business today, the implementation of methods for doing so will be burdensome. For ILECs, who do have reporting systems in place, this is also an issue of competitive neutrality, since it is unlikely that any new reporting procedures for their competitors will be as rigorous as those currently applied to the ILECs. If the same base of total revenue could be used for the Federal plan, as well as for state plans, the need to distinguish revenue by jurisdiction will be eliminated.³⁹

5b) The Current Split in Responsibility Does Not Correspond Either to the Need for Funding, or to the Jurisdictional Assignment of Cost.

In response to state concerns with respect to the use of total revenue for funding, the Commission, in its Order, decided to limit support to 25% of the difference between the estimated cost of service and a Federal benchmark. The Commission represented this amount as somehow corresponding to its share of responsibility for the cost. However, the result of the proposed calculation will not in fact correspond either to the need for funding, or to the share of cost allocated to interstate. Consider, for example, an area where the cost per line is \$40, and the "affordable" rate a universal

³⁹ Of course, a state would have to identify traffic originating or terminating within its borders.

service provider is allowed to charge is \$15. The need for funding in this case is \$25. Suppose the Federal benchmark is set at \$31. The Federal plan would then provide the 25% of the difference between \$31 and \$40, or \$2.25. The support provided by the Federal plan in this example is not 25% of the need, but less than 10%. Further, there is no relationship between the \$2.25 of funding provided by the Federal plan and the amount of cost that would be allocated, under current separations procedures, to the interstate jurisdiction.

5c) A New Compromise Should Be Developed Which Strikes a Reasonable Balance.

GTE proposes that the Commission, after consulting with the states, should adopt a revised Federal plan which strikes a new and more reasonable balance among policy objectives, and which is adequate to meet the requirements of the Act. This plan should be based on the sum of state and interstate retail revenue. It should be adequate to replace the current flow of implicit support from interstate rates. It should also more effectively balance the needs of high and low cost states. GTE suggests that a support calculation with the following features could meet these requirements:

First, the limitation of Federal support to 25% of the difference between cost and the Federal benchmark should be eliminated.

Second, a second benchmark should be introduced. The Federal plan should provide 100% of the difference between the higher benchmark and the estimated cost. The difference between the "affordable rate" set by the state commission and the lower benchmark should be provided as support by the state plan. The difference between the two benchmarks should be shared between the state plan and the Federal plan in

some agreed-upon percentage. As long as a single benchmark is used, once that has been chosen, and the costs estimated, the distribution of the support among the states will be fixed. By using a second benchmark, as GTE proposes, the FCC, in consultation with the states, would be able to adjust both the overall size of the fund, and its distribution across states, to satisfy the criteria set forth above.

Third, the FCC should make it clear that the benchmarks in the Federal plan are only devices for dividing the responsibility for funding between the Federal plan and state plans. They do not, and should not, represent a policy judgement by the Commission as to the amount of revenue the states should assume in their own calculations. Just as it is important that the Federal plan should eliminate the implicit support that is generated today by interstate rates, it is equally important that state plans should not rely on implicit support as a future mechanism for maintaining universal service. To the extent that a state commission assumes some revenue benchmark that is higher than the price that same commission allows carriers to charge, the state is assuming that a given level of implicit support can be maintained indefinitely. This reliance on implicit support will not meet the requirements the Act places on state commissions, in section 254(f), to ensure that all carriers contribute to universal service on an equitable basis. It will not be sustainable, since it will lead to the revenues from customers who have high levels of usage being cherry-picked by competing carriers. Finally, as discussed above in the context of interstate access prices, maintaining implicit support, by assuming revenues from services other than the basic local service, will create false price signals which will inhibit the development of local competition. The support that flows implicitly, through one carrier's rates, to a

customer with low usage and low revenue, cannot be made portable to another carrier that might otherwise compete for that customer's business.

Fourth, the funds received by ILECs from the Federal plan should be used to replace the implicit support built in to interstate access rates. However, the plan should recognize that there is explicit support being provided today by the current USF fund. Through an adjustment to the separations process in Part 36, subpart F of the Commission's rules, these funds are essentially made available to the states to help keep intrastate rates low. The Federal plan, as adopted in May, ignores this current flow of funds. The application of Part 36, subpart F to larger ILECs will be eliminated on January 1, 1999, when the new high cost fund is scheduled to take effect for those companies. This will remove the flow of funds to the states that is provided today by the current USF. At the same time, those same ILECs will be required to reduce their interstate access charges by the full amount of the support they receive from the new fund. Thus, the implementation of the new fund will not ease the problems of the states in supporting their own intrastate rates; on the contrary, it will remove more than \$200 million of support that is provided to the states today, leaving state commissions to recover this amount through rate increases, or through their own universal service mechanisms.

The new Federal plan should recognize, and build upon, the existing flow of universal service funding to the states. The existing support amounts, which have already been incorporated into local rates, should continue to be provided to the states. Further, depending on the balance struck between the needs of low and high cost states, as discussed above, it may be appropriate to pass some of the support

generated by the new Federal plan through the same Part 36 mechanism to provide new, additional funding for states with relatively high support needs and small funding bases. At the very least, however, the new Federal plan should leave states as well off as they are today.

Fifth, if a new funding base of state and interstate revenues can be agreed upon as part of this new compromise, then a clear mechanism should be established which allows each carrier to recover its contribution to the fund from its customers. If a carrier contributes on the basis of its state and interstate retail revenues, then it should be able to recover its contributions from that same revenue base. GTE believes that an across-the-board surcharge is the simplest, most equitable, and most competitively neutral mechanism for this recovery. At the very least, however, all carriers should be given the same flexibility to choose how they will pass through their contributions. The Federal plan, as adopted in May, does not do this. It specifies that ILECs may recover their contributions only through their interstate common line and special access rates. No other contributors the fund are subject to any comparable limitation. Further, while carriers contribute to the school and library fund on the basis of their state and interstate revenues, they may recover these contributions only through their interstate rates. Depending of the mix of state and interstate services a carrier provides, this requirement could lead to a significant distortion of the carrier's interstate rates.

The Commission should provide a clear mechanism through which carriers may recover from their own customers their contributions to Federal universal service mechanisms. The opportunity to establish a surcharge or to adjust rates for this

purpose should be the same for all carriers, and any rates which produce revenue that is counted in the funding base should also be subject to the recovery mechanism.

III. CONCLUSION.

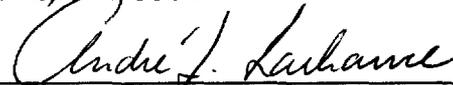
For the reasons stated hereinabove, the Federal plan, as currently defined, will not meet the requirements of the Act. As part of the Commission's effort to review and improve its approach to universal service, the Commission should proceed to develop a competitive bidding mechanism for universal service support.

Respectfully submitted,

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Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "Comments of GTE" have been mailed by first class United States mail, postage prepaid, on January 26, 1998 to all parties of record.



Ann D. Berkowitz