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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Federal State Board on)
Universal Service:)
Report to Congress)

CC Docket No. 96-45

DA 98-2

REPLY COMMENTS OF GTE

GTE Service Corporation, on behalf of its
affiliated domestic telephone operating,
wireless, long distance and Internet access
companies

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February 6, 1998

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SUMMARY

In reviewing the comments filed by the various parties, it is clear that the Commission should correct its policy towards Universal Service in order to comply with Subsection 254(e) and adopt a universal service plan that is sufficient and results in affordable and "reasonably" comparable rates across all states.

The Commission's Federal plan must place the burden of supporting Universal Service on a larger revenue base of interstate and intrastate revenues in order to avoid extreme rate distortions in those states with relatively small customer populations, high costs and small bases of intrastate revenue over which universal service funding could not adequately be distributed or recovered. In order to avoid artificially distorting any carrier's rates, the contribution base should match the base on which recovery is allowed by all contributing carriers.

The Federal plan should be sufficient to satisfy several specific needs. First, the fund should be large enough to replace the implicit support provided by interstate access rates today. Second, while GTE believes the current universal service plan is inadequate and should not serve as a model of the future, any new plan should provide at least as much support to the states, through the Part 36 process, as the existing plan does. Third, the plan should also provide enough additional support to the states, through Part 36, to ensure that no state is faced with a universal service burden it cannot address with its own state resources, and that no group of customers is called upon to contribute disproportionately to universal service.

The calculation of the Federal fund as currently proposed, which would cover only 25% of the cost above a Federal benchmark, is inadequate to meet these

requirements. The Commission must establish a new compromise, which ensures that Federal funding is adequate, while striking a reasonable balance among the interests of high and low cost states. At the same time, it should be clear that the difference between the local rate a state commission may set and the Federal benchmark should be funded by state universal service mechanisms.

The 1996 Act does not permit the Commission to support information services through Federal universal service mechanisms, or to require entities who provide only information services to contribute to the fund. However, the Commission can, and should, establish a new, more consistent approach to the treatment of different providers. This should include the manner in which these entities compensate local carriers for the use of their networks, as well as their status as contributors to, or recipients from, universal service mechanisms.

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GTE Service Corporation, on behalf of its affiliated domestic telephone operating,¹ wireless,² long distance³ and Internet access companies⁴ (collectively "GTE") hereby reply to comments submitted January 26, 1998, in response to the Commission's Public Notice, DA 98-2, released January 5, 1998 ("*Notice*"). The Notice sought comment to assist the Commission in preparing its Report to Congress on Universal Service as required by H.R. 2267, the 1998 appropriations legislation for the Departments of Commerce, Justice, and State.

I. THERE IS WIDESPREAD AGREEMENT THAT THE FEDERAL PLAN IS INSUFFICIENT.

Many parties, spanning a wide range of interests, agree with GTE that the

¹ GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., and Contel of the South, Inc.

² GTE Mobilnet Incorporated, Contel Cellular Inc. and GTE Airfone Incorporated.

³ GTE Communications Corporation, Long Distance division.

⁴ GTE Internetworking, GTE Intelligent Network Services.

Federal plan, as adopted in May, 1997 and modified in subsequent orders,⁵ is insufficient, and fails to meet the requirements of the 1996 Act.⁶ State commissions argue forcefully that the fund will not be sufficient to maintain universal service, especially in states with higher costs. Mississippi, for example, says (at 1) that "the FCC's current proposal does not meet the requirements of the Telecommunications Act of 1996 and places an unreasonable burden on those states with high cost rural

⁵ *Federal-State Joint Board on Universal Service, Report and Order*, CC Docket No. 96-45, FCC 97-157, 12 FCC Rcd 8776 (rel. May 8, 1997) ("*USF Order*"). The Commission released an erratum correcting this Order on June 4, 1997, FCC 97-157, 1997 FCC LEXIS 2995. Order on Reconsideration, FCC 97-246, 12 FCC Rcd 10095 (rel. July 10, 1997). The Commission issued an errata correcting this Order on July 24, 1997. Report and Order and Second Order on Reconsideration, FCC 97-253 (rel. July 18, 1997). Third Report and Order, FCC 97-380, 1997 FCC LEXIS 5608 (rel. October 10, 1997). Third Order on Reconsideration, FCC 97-411 (rel. December 16, 1997). Fourth Order on Reconsideration, FCC 97-420, 1997 FCC LEXIS 7229 (rel. December 30, 1997). Petitions for review are pending *sub nom. Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir.). While GTE generally responds herein to the issues raised by the Commission in the Public Notice and replies to the comments submitted by other participants, GTE in no way limits its right to either raise other issues on appeal or to otherwise address issues raised by the parties on appeal. These Reply Comments and GTE's previously filed Comments are not, and are not intended to be, an exhaustive critique of the *USF Order* with respect to matters which may be addressed on appeal. Indeed, both these Reply Comments and GTE's previously filed Comments assume, for the purpose of discussion, the validity of rules that GTE may challenge.

⁶ Pub. L. No. 104-104, 110 Stat. 56 (1996), codified at 47 U.S.C. ' 151 *et seq.* (the "1996 Act"). All references to "the Act" refer to the Communications Act of 1934, as amended by the 1996 Act.

areas."⁷ Incumbent local exchange carriers ("ILECs") that serve rural areas also express similar concerns.⁸ These parties join GTE in urging the Commission to adopt a plan that is sufficient: "The Commission should correct its policy in order to comply with Subsection 254(e) as written, and should announce its intention in the Report to Congress."⁹

A. The Plan Does Not Meet the Funding Needs of High Cost States

In its Comments, GTE noted that many states with relatively high costs, and relatively small bases of intrastate revenues, would be unable to fund universal service adequately on their own, given the modest level of support provided by the Federal plan.¹⁰ There was broad agreement on this point among the commenters, many of whom provided supporting evidence. US West, for example, calculated the surcharge on intrastate revenue that would be required to fund state plans if the current deficiency in the Federal plan is not corrected. According to US West's analysis, the majority of states would need surcharges greater than 10%, eight states would have surcharges

⁷ Alaska at 13; Alabama, Alaska, Arkansas, Georgia, Idaho, Kentucky, Maine, Montana, New Hampshire, New Mexico, North Carolina, South Carolina, Vermont, and West Virginia (the "States' Joint Comments") at 3; Colorado at 2; Iowa at 4; Kansas at 1; Mississippi at 2; Nebraska Legislature at 1; Nebraska Public Service Commission at 2; New Mexico Attorney General at 2; Pennsylvania at 4; Texas at 3-4; State of Utah, Office of the Governor at 1; Utah State Legislature at 1; Washington at 7, 13; Western Governors' Association at 1; Wisconsin at 5; Wyoming at 3, 5.

⁸ BellSouth at 10; Federal Communications Commission Local and State Government Advisory Committee at 2(5); SBC at 6; US West at 5; Aliant at 2-4; John Staurulakis, Inc. ("JSI") at 4; Puerto Rico Telephone Company at 8; United States Telephone Association ("USTA") at 8.

⁹ States' Joint Comments at 3.

¹⁰ GTE at 28.

above 30%, and Montana would need to assess a 50% surcharge.¹¹ Alternatively, US West estimates that 39 states would have to raise their rates for basic local service, in many cases to levels that could not plausibly be called affordable. Similarly, the States' Joint Comments estimate that individual state plans would need surcharges as high as 40% if the Federal plan is not modified.¹² Wyoming estimates that if the current 75/25% split of responsibility is maintained, its state universal service mechanism will have to generate \$51.75 in support per access line per month.

Commenters noted that the surcharges estimated for each state depend not only on the presence of high cost areas in the state, but also on whether the state has a base of high-density, low cost areas which can serve as a funding source.¹³ The ability of a state to fund universal service, or the surcharge that customers would have to pay if it attempts to do so, will thus depend on the way in which accidents of history and geography have combined high and low cost areas within each state. If the lion's share of funding responsibility is left to the states, as the current Federal plan would do, then rates (inclusive of the surcharge to fund universal service) would not be "reasonably comparable" across states.¹⁴ Further, while it might be reasonable for a customer who chooses to live in a high cost area to pay rates which reflect some portion of the higher

¹¹ US West at Attachment 1. In order to develop these estimates, US West made a series of assumptions regarding universal service costs and the relevant Federal benchmark. Without endorsing US West's specific assumptions, GTE believes that the analysis does capture the essence of the problem created for the states by the inadequacy of the Federal plan.

¹² States' Joint Comments at 3.

¹³ JSI at 4; Wyoming at 2; Aliant at 4; Washington at 7.

¹⁴ JSI at 4; Wyoming at 3.

cost, it does not appear reasonable that a customer who chooses to live in a low cost area in Wyoming should have to contribute many times more toward the support of high cost areas than a customer in a similarly low cost section of Pennsylvania or New Jersey.

Set against these concerns are those of ILECs that serve states with lower costs and/or higher revenue bases. These companies fear that their customers will be unreasonably taxed to support customers in more rural states. Bell Atlantic, for example, warns of "sharp local rate increases in low-cost states".¹⁵ GTE, in its comments, recognized (at 28) that a balance must be struck between the concerns of high and low cost states. What is clear from the comments, however, is that the Federal plan, as proposed, does not represent a reasonable balance. It is not reasonable to expect Wyoming to raise \$51.75 for each supported line, when the base on which any plan must be supported includes only 300,000 lines. Even if the Wyoming Commission adopts the best possible state universal service plan — one which fully recognizes the necessary support and makes it explicit — the result may be rates which are not affordable.

The very essence of universal service policy is a degree of averaging between low and high cost customers. As the Washington Commission points out, while it makes sense to deaverage the calculation of the support customers receive, to reflect differences in cost across areas, it does not follow that contributions to the universal

¹⁵ Bell Atlantic at 3; Ameritech at 4.

service mechanism should also be deaveraged.¹⁶ If Bell Atlantic's argument that no state should support another were carried to its logical conclusion, we would calculate a separate surcharge for each census block group ("CBG") in the country. The result would be that each CBG would pay its own costs, either directly through rates or indirectly through a USF surcharge. No customer would have to subsidize anyone in another area, but the rates customers would pay (including any surcharge) would vary wildly from one CBG to another, and many would be at a level that would not be affordable. Bell Atlantic is thus wrong to suggest that a sufficient Federal fund would create new rate distortions. The point of the exercise is to spread the burden of funding across as large a base as possible, so as to avoid the extreme distortions that would result if a state like Wyoming had to fund its universal service burden entirely within its own borders. This cannot be accomplished without a Federal plan that takes the entire nation as its funding base, so that the burden of supporting universal service, which Congress has adopted as a national goal, is spread across all customers, and so that no one group of customers must contribute disproportionately.

B. The New Federal Plan Should Not Remove Existing Support to the States.

As GTE explained in its comments (at 33), the rules adopted by the Commission in May would effectively remove from the states the flow of support that is provided to large ILECs by the current USF. This would occur because the Commission's Access

¹⁶ Washington at 7.

*Reform Order*¹⁷ requires the entire amount of funding from the new plan, rather than any net increase in funding, to be applied toward reductions in interstate access rates. At the same time, the mechanism in Part 36, subpart F of the Commission's rules which uses USF funds to offset state costs would be eliminated. Many states share GTE's concerns over this unnecessary change in the support made available to them. The State Joint Comments, for example, note that

"Under the existing high cost support mechanism, the Commission authorized carriers to shift costs to the interstate jurisdiction through Part 36 to reduce their intrastate revenue requirement, and the federal High Cost Fund paid for those shifted intrastate costs. Therefore, the existing mechanism provided support to keep local rates low. Applying Federal USF support exclusively to interstate access service would remove this support. It would overturn the old system, without any finding that the new system would meet the continuing goal of keeping rates affordable, as well as new goals, such as keeping rates reasonably comparable."¹⁸

GTE does not believe that the current USF plan is adequate, or that it should serve as a model for the future. However, the new plan that replaces it should at least do no harm — it should leave each state with at least as much support as it gets today. As Alaska observes (at 12), "(T)he legislative history of the Act indicates that Congress did not intend to eliminate the support provided under existing universal service support mechanisms." Therefore, the Commission's rules should be changed to flow at least as

¹⁷ Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges, CC Docket No. 96-262, First Report and Order, FCC 97-158 (rel. May 16, 1997 (*"Access Reform Order"*)), petitions for review pending *sub. nom. Southwestern Bell Tel. Co. V. FCC*, No. 97-2618 (8th Cir.)

¹⁸ States' Joint Comments at 6-7. Texas agrees (at 4): "That loss in revenue would result in a higher intrastate revenue requirement to be recovered by higher intrastate rates or from the Texas USF." See also South Dakota at 2; JSI at 5; Iowa at 5; Bell Atlantic at 6.

much support through Part 36 as does the current plan. Net increases in funding from the new plan may then be applied toward interstate access reductions.¹⁹

However, simply providing states with the same support they receive today will not be sufficient. Bell Atlantic suggests (at 7) that if "all states were guaranteed that the amount of high-cost support to any state would not fall below the current amount, adjusted for inflation, no recipient state could suffer a significant rate increase..." This ignores the fact that the current USF provides only a small proportion of the total support for universal service. Most support today is generated implicitly by ILEC rates, both for interstate access and for a variety of state services. The 1996 Act recognized that this implicit support flow will have to be replaced by explicit universal service mechanisms. Because the implicit flow is vulnerable to competitive erosion, it cannot be "sufficient" or "predictable." Because it is generated by the rates of one provider in each market — the ILEC — it does not satisfy the Act's requirement that all telecommunications carriers must contribute on an equitable basis. By all means, the Commission should "do no harm," but it must do much more than that if it wishes to save the patient.

C. Funds From the Federal Plan Should Be Used to Offset Interstate Access Rates, Among Other Purposes.

GTE shares the concern expressed by many state commissions that the Federal fund, as presently formulated, will not be adequate to support affordable local rates. However, several of the states, in expressing this concern, have focused their attention

¹⁹ As will be discussed below, a new Federal fund may also provide an increased flow of funds, compared to the current plan, to some states.

on the requirement that ILECs must use any Federal funds to make offsetting reductions in their interstate access rates. Some states argue that the Federal fund is intended to support local service, not interstate access service.²⁰ The Attorney General of New Mexico says, for example (at 5), that carriers "should be required to use the federal USF contributions to lower rates for basic local telephone service in high-cost areas, rather than using those contributions to lower rates for other telephone services." Bell Atlantic points out that toll service is not included in the Commission's definition of supported services.²¹

These arguments confuse the services which are supported with those for which offsetting rate reductions should be made. Rates for basic local service do not need to be reduced to make them affordable; as the Commission found in its *USF Order*, they are generally affordable today.²² These affordable local rates are made possible by implicit support which is provided by rates for other services which are too high. The task of reforming universal service, therefore, lies not in reducing local rates still further, but in replacing the current implicit support with an explicit mechanism that is more sustainable, and competitively neutral.

Interstate access prices provide implicit support for local rates today. When explicit funding sufficient to replace this support becomes available from the Federal plan, then access rates can, and should, be reduced to eliminate the artificial margin

²⁰ See, e.g., Wyoming at 5; South Dakota at 2; Bell Atlantic at 6.

²¹ Bell Atlantic at 6.

²² *USF Order* at ¶ 2. If anything, it should be possible in many states to make some increases in local rates without endangering affordability.

which generates implicit support. Under this new plan, local service will be the service that is supported; but offsetting reductions will be made, at the outset of the plan, to the rates for access.

As GTE explained in its comments (at 4-5), if implicit support continues to be raised through interstate access rates, the requirements of the 1996 Act will not be met. It is therefore necessary that the Federal plan be sufficient at least to replace the support generated implicitly by interstate access today.²³ However, this does not imply, as MCI suggests (at 3) that all Federal support an ILEC receives must be applied toward reductions in interstate access charges. There are other needs the Federal plan must satisfy. First, as discussed above, the new Federal plan must provide at least as much support to the states, through the pass-through mechanism in Part 36, as the states receive today from the USF. Further, much of the implicit support for local service is also provided today by rates for intrastate services. This support should also be replaced by explicit mechanisms. For the reasons set forth by many state commissions in their comments, a state with high cost and a limited revenue base may not have the internal revenue sources necessary to address this funding requirement through a state plan alone.²⁴ A reasonable balance between state and Federal funding should thus include enough additional Federal funding, passed to the states through the existing Part 36 mechanism, to ensure that no state faces an unmanageable

²³ The Federal plan is the only means for addressing implicit support in interstate access rates.

²⁴ States' Joint Comments at 4; Mississippi at 2; Washington at 7; Wyoming at 6.

intrastate universal service burden.²⁵

D. The Division of Responsibility Between State and Federal Plans Should Be Chosen to Ensure Overall Sufficiency, and to Balance the Needs of the States.

Many parties agree with GTE that the Commission's decision to fund only 25% of the amount over a Federal benchmark is unreasonable, and should be corrected.²⁶

However, what is most important is not the specifics of how the Federal support is calculated, but whether the resulting support amount is sufficient, when combined with the efforts the states should reasonably be expected to make. Several parties, when discussing this issue, mistakenly assume that the amount over the Federal benchmark represents the entire need for universal service funding.²⁷ In fact, the Federal benchmark is simply an arbitrary number, chosen to serve as a dividing line between the Federal plan and state plans. Since no state has local rates as high as \$31, even if the Commission were to fund 100% of the support above that level, a significant

²⁵ If the Federal fund is sufficient to replace the implicit support currently provided by interstate access, this would represent a significant step toward addressing the funding needs of high cost, low revenue states, since interstate access generally represents a higher proportion of the total local exchange carrier revenue in those states.

²⁶ Alaska at 12; the States' Joint Comments at 2; Colorado at 2; Kansas at 1; Mississippi at 2; Nebraska Legislature at 1; Nebraska at 3; New Mexico Attorney General at 2; South Dakota at 2; Texas at 3; State of Utah, Office of the Governor at 1; Utah State Legislature at 1; Washington at 7; Wisconsin at 3; Wyoming at 2.

²⁷ For example, US West (at 3) refers to 25% as the "small portion" of the cost of universal service that will be provided by the Federal fund, and 75% as "the balance of the costs of providing universal service in high-cost areas."

amount of funding from state plans would still be necessary.²⁸

It is not reasonable for the Federal plan to provide all necessary universal service funding (*i.e.*, the full difference between the local rate and the cost of local service) because to do so would make the FCC responsible for the decision of a particular state to set a low rate for local service.²⁹ Similarly, as discussed above, the balance struck in the *USF Order* is not reasonable, because it would ask individual states to absorb differences in cost over which they have no control, and which they lack the resources to address through their own state mechanisms. GTE believes that the Federal benchmark and percentage should be set so that unusually high costs are largely absorbed by the Federal plan. At the same time, the benchmark mechanism would ensure that if a state chooses to set an unusually low rate for local service, the funding requirement caused by that decision would be borne by the state.³⁰

GTE suggests that the parameters of the Federal plan should be chosen to ensure that the Federal support is sufficient to meet the needs discussed above: (1) To

²⁸ If an auction mechanism is adopted on a cooperative basis between the FCC and state commissions, as GTE has proposed, then the auction would settle the question of what the total funding need is for a given area. It would still be necessary to agree on the division of responsibility for this funding between Federal and state mechanisms.

²⁹ This concern is raised by Bell Atlantic (at 5).

³⁰ As GTE explained in its comments (at 32), the Commission should make it clear that the choice of a benchmark does not imply that the state has no responsibility to fund local rates set below the benchmark level.

replace implicit support from interstate access; (2) to continue the support provided to states by the current USF; and (3) to assist states with limited resources in replacing the current implicit support from their intrastate rates. The benchmark and the percentage of Federal responsibility should be chosen to meet these objectives, while maintaining a reasonable balance between the interests of low and high cost states. The combination of a \$31 benchmark and a 25% Federal percentage will not allow the Federal plan to satisfy these needs.³¹ As GTE explained in its comments (at 31-32), the Commission will find it difficult to achieve a reasonable balance among its objectives using a single benchmark. If a second benchmark is introduced, the Commission would be able to adjust the size of the fund, and the distribution of the fund among the states, to meet its policy goals.³²

E. The Federal Plan Should Use Both State and Interstate Revenue as a Base.

GTE agrees with the many parties who propose that contributions to the Federal plan should be based on both state and interstate revenues.³³ GTE supports this approach, even though it would certainly increase GTE's share of contributions,

³¹ Senators Burns and Stevens, for example, in their letter to the Commission dated January 27, 1998 ("Burns/Stevens"), state (at 12) that the current formula "is not consistent with the level of support provided by Federal sources today for many of the smaller local exchange carriers, and also has the potential to adversely impact larger local exchange carriers." The Senators urge the Commission to "carefully review" its decision to fund only 25% above the benchmark.

³² GTE suggests that the Federal fund should cover 100% of the amount above an upper benchmark. The state would be responsible for 100% of the funding needed below a lower benchmark. The amount between the two benchmarks would be split between the Federal and state plans.

³³ Alaska at 14; BellSouth at 11; Colorado at 3; JSI at 9; Sprint at 4; USTA at 8; Wyoming at 5.

because it is the only practical means to fund a sufficient Federal plan.³⁴ The base of interstate revenues is too small to support a sufficient Federal plan. Further, as many parties have pointed out, attempting to classify all revenue as either state or interstate will be an administrative nightmare, especially for carriers such as wireless carriers who do not, traditionally separate costs according to jurisdiction, and will introduce competitive distortions. The simple fact is that interstate rates provide a disproportionate share of implicit support today. If the burden of universal service support is spread equitably across all telecommunications services in the form of a uniform surcharge on all retail rates, both state and interstate, this will inevitably redistribute some of the funding responsibility from interstate services to state services, just as it redistributes the burden from high cost to low cost areas. In effect, universal service becomes a kind of separations reform. As long as contributions are assessed equitably, and there is a clear recovery mechanism, such as a uniform surcharge, then no carrier will be competitively disadvantaged by this mechanism.

A clear mechanism for carriers to pass through their contributions is necessary for the plan to be securely funded, to be competitively neutral, and to avoid unreasonable rate distortions. While the Commission has recognized carriers' need for recovery, it has been reluctant to permit a clear recovery mechanism. AT&T complains (at 4) that ILECs are allowed to pass through their fund contributions in the form of increased charges for wholesale access services. The Commission has made this

³⁴ When implicit support is removed from interstate access rates, and this reduction is reflected in long distance rates, the base of interstate retail revenue will become even smaller.

approach necessary because it is unwilling to apply a surcharge to the subscriber line charge ("SLC"), which is the principal source of interstate end user revenue for ILECs. AT&T has long recognized that each carrier must be able to pass through its contribution; hence if recovery from end-users is blocked by the caps on SLCs, and by the lack of a surcharge, then ILECs must be allowed to pass through their contributions to their access customers. GTE agrees with Sprint and others that the base of contributions should be state and interstate revenue, and that recovery should be through an explicit surcharge to end-user customers. If this approach is implemented, then the concern raised by AT&T, of the recovery of contributions through wholesale rates, will not arise.

To avoid artificially distorting carriers' rates, it is important that the base on which contributions are calculated should match the base on which recovery is allowed, and that the all carriers are required to contribute to the fund on an equitable basis. For example, the Commission based contributions to the school and library fund on total end-user revenue, but it permitted most carriers to recover this contribution through interstate rates only.³⁵ The Commission more appropriately permitted wireless carriers to pass through their contributions through rates charged for all CMRS services, recognizing that limiting the pass-through to interstate services would afford carriers that provide more interstate services a competitive advantage over carriers that offered more intrastate services.³⁶ As the Commission rightly recognized, depending on the

³⁵ *USF Order* at ¶ 851.

³⁶ *Fourth Order on Reconsideration* at ¶ 309.

mix of state and interstate services a carrier offers, a pass-through limited to interstate services can lead to a severe distortion of a carrier's rates for interstate services. This is the case for ILECs, whose end-user revenue is predominantly intrastate. The use of total end-user revenue - state and interstate - for both funding and recovery would ensure that the recovery mechanism affects all rates in a consistent manner.³⁷

The Commission has the authority to base contributions for the Federal plan on both state and interstate revenues — as it has already done in the case of the school and library fund.³⁸ GTE believes that the Commission also has the authority necessary to base recovery on both state and interstate rates. While the Commission cannot regulate the rates for state services, it can establish a surcharge, for the purpose of funding the Federal plan, and arrived at through a Joint Board process, which is based on a percentage of both state and interstate rates.³⁹

A few parties have suggested that the Commission should depart from retail revenues as a basis for calculating contributions to the fund, or for recovering those contributions. Airtouch, for example, suggests (at 6) that a flat surcharge should be applied per line. Similarly, AMSC (at 7) proposes that its service should be assessed

³⁷ GTE disagrees strongly with BellSouth's suggestion (at 11) that the funding base should be total revenue, but that recovery should be limited to interstate rates. This would expand the problem described here with the current school and library fund to the high cost fund as well.

³⁸ See US West at 2; Sprint at 3-4. Indeed, at least one state — Vermont — has for several years had a state plan which includes interstate revenue in its funding base. Several other states are considering this approach.

³⁹ The SLC, after all, is an interstate charge which is assessed when a customer purchases a state-tariffed local service. The SLC is thus in effect a surcharge on the local rate.

on a per minute basis for voice services, and on a per-kilobyte basis for data services, because the rates for its satellite-based services are higher than those of terrestrial competitors. GTE urges the Commission not to entertain these suggestions. The Joint Board has previously examined the question of whether some method can be found to base contributions on any units of demand, such as lines or minutes. The Joint Board correctly concluded that this would require establishing an equivalence among all of the different units in which service could be provided, and that no such method could be devised that would be competitively or technologically neutral. The price of a service is the best method — indeed the only market-based method — for relating that service to competing services in the marketplace. The amount a customer is willing to pay is the best measure of the amount of service that is being provided to that customer, and it is entirely reasonable that customers who buy more should contribute more. As for the deadweight losses Airtouch seeks to minimize, the most effective way the Commission can minimize those losses is to replace the current system of implicit support, which maximizes those losses, with a sufficient, explicit mechanism, based on retail revenues, which will be much more efficient. The potential harms to competition, and to the efficient development of technology, that could be inflicted by a unit-based contribution methodology would far outweigh any possible efficiency gains from a flat-rated scheme.

Just as distortions may result if funding and recovery are not based on total end-user revenue, as PCIA notes (at 9), the Commission's recent action to increase the de minimis exception to \$10,000 for contributions to the universal service fund may create an anomaly between facilities-based and resale carriers. While resale revenues

are generally excluded from the revenue base upon which carriers will contribute to the universal service fund, the Commission has instructed facilities-based carriers to treat resellers below its \$10,000 cap as end users, thus including revenues from these resellers in their contribution base.⁴⁰ Even though the Commission places the burden on resellers to notify facilities-based carriers if they qualify for the de minimus exception, in practical effect this places the administrative burden on the facilities-based carrier to ensure that the reseller is in compliance with its universal service obligations and could result in an undue advantage for resellers. For example, in the CMRS industry, facilities-based carriers do not normally pursue the details of a reseller's business plan because resellers are reluctant to disclose competitive information. If a facilities-based carrier assumes that all resellers will contribute to the fund unless it is notified otherwise, then small resellers that are not aware of their obligations or that refuse to notify a facilities-based carrier of their exempt status because to do so would trigger a payment obligation on the reseller's part could escape payment into the universal service fund. In addition to the billing difficulties this will create for carriers, this would confer an artificial competitive advantage on resellers. This difficulty is caused, in part, by the Commission's failure to establish a clear mechanism for recovery of carriers' contributions. If the base of contribution is total end-user revenue, and if each carrier applies a surcharge to end-users' bills to recover its contributions, then a reseller would pay this surcharge unless it notified the wholesaler that it was not an end-user, and that its revenue was not *de minimus*. This would create an incentive for

⁴⁰ Fourth Order on Reconsideration at ¶¶ 295-298

resellers to notify wholesalers correctly.

II. THE COMMISSION SHOULD DEVELOP A FRAMEWORK WHICH TREATS ALL PROVIDERS OF TELECOMMUNICATIONS SERVICES IN A CONSISTENT MANNER.

Several commenters argued that the Commissioners should expand the base of contributors to the Federal universal service mechanisms to include information service providers.⁴¹ Other parties argued that, as a matter of principle, information service providers should not contribute.⁴² Both sets of arguments are moot, since the 1996 Act does not empower the Commission to require a carrier that provides only information services to contribute to the fund. Similarly, the Act does not permit information services to be supported by the Federal plan.⁴³ Senators Burns and Stevens (at 12) make this abundantly clear: "We debated and decided in section 254 whether or not information services would be directly supported by universal service, and the answer was clearly not. The Commission cannot use its generic authority to trump the

⁴¹ See, e.g., Ameritech at 2-3, Airtouch at 27-30, Business Networks at 3.

⁴² See, for example, America Online at 15-16, Information Technology Industry Council and Information Technology Association ("ITA") at 8-11.

⁴³ GTE at 10; BellSouth at 2-5, AT&T at 9. As BellSouth points out (at 5), in order to arrive at its conclusion that information services could be supported by the school and library fund, but could not be supported by the high cost fund, it had to interpret identical phrases within the statute inconsistently. Senators Burns and Stevens (at 10) call this a flawed interpretation which has led to a "bizarre and legally untenable result."

unambiguously expressed intent of Congress."⁴⁴

What the Commission can do is to develop a more consistent approach for treating different services and providers generally. GTE (at 14-16) urged the Commission to develop such an approach, which would apply to the treatment of interconnection and access pricing, as well as universal service. Senators Burns and Stevens make a similar recommendation: "Clearly the Commission needs a more consistent and comprehensible formulation of the definitions if the changes made by the Telecommunications Act are going to have any relevance to modern communications in the 21st century."

Senators Burns and Stevens describe (at 7-9) the harms that would result to competitive telecommunications markets, as well as to universal service, if a more consistent means is not found to charge entities whose services depend upon the local service infrastructure. They recognize, however, that this does not imply that traditional access charges, at their current levels, should apply to ISPs. They also recognize, as did GTE, that any classification the Commission may create can include only telecommunications services among the service to be supported by the Federal universal service mechanisms. However, they point out that the term "telecommunications service" as defined by the 1996 Act need not be interpreted as narrowly as the Commission has done in its previous Computer decisions. Finally, the

⁴⁴ As GTE explained in its comments (at 20), the Commission's attempt to divide information services between "conduit" and "content" does not avoid this constraint, because, as long as both are considered information services, neither can be eligible for support. Senators Burns and Stevens observe that "(I)f Internet conduit service is not a telecommunications service, then that service can never be supported as part of universal service under the terms of section 254."

senators also make it clear that whatever interpretation the Commission applies to the question of services to be supported must also be carried through in a consistent manner to the question of who must contribute to the fund:

In section 254 Congress did directly address the issues of what services could be supported by universal service, who should contribute, and who may receive such support. The Commission cannot have it both ways. To the extent that it insists on treating all hybrid services as information services and not telecommunications services, then that decision must be followed consistently — with all its uncomfortable consequences — throughout the Communications Act.⁴⁵

Of course, some commenters have suggested that they should have it both ways — that information services should be eligible for support, but that ISPs should not be required to contribute.⁴⁶ The senators make it clear that this was not the intent of Congress.

Unless a more consistent approach to the treatment of carriers is found, the neutrality of the universal service mechanism will also be compromised. ISPs argue that they will in fact contribute to universal service, since the telecommunications services they buy from other carriers will include, either in the prices of the services or as a separate surcharge, recovery of the wholesaler's contribution to the fund.⁴⁷ If ISPs become contributing carriers, instead of end users, then this transaction will be considered "wholesale," and the assessment of the surcharge will simply be moved to the ISP's end user. This is true, as long as the ISP buys all of its telecommunications

⁴⁵ Burns and Stevens at 12.

⁴⁶ See, e.g., Comcast at 8; AOL at 19, 21; Commercial Internet Exchange Association at 10, 12; United States Internet Providers Association at 2-3.

⁴⁷ See, e.g., AOL at 17; WorldCom at 8; ITA at 8-9.