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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

April 2, 1998

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, D.C. 20554

Re: Ex Parte Presentation - CC Docket No. 96-262

Dear Ms. Salas:

In its Petition for Reconsideration (Petition) filed July 11, 1997 in the above-referenced docket, the United States Telephone Association (USTA) sought reconsideration of a number of issues of concern to USTA's price cap local exchange carrier (LEC) members.

In the *Second Order on Reconsideration and Memorandum Opinion and Order* released October 9, 1997, the Commission noted that issues which were not addressed there would be resolved in a future order on reconsideration. I am writing on one issue in particular that should be immediately resolved because it will impact the 1998 annual Access Tariff filing.

USTA urges the Commission to clarify that the price cap productivity factor should not be applied to the universal service fund (USF) contributions. In the *First Report and Order,* released May 16, 1997, for access charge reform, the Commission determined that USF contributions would be recovered through exogenous changes in the price cap indices (PCIs) for the Common Line, Trunking and Interexchange baskets in proportion to the end-user revenues contained in each basket. In its Petition, USTA pointed out that while it would be much less burdensome to exclude USF contributions from price caps altogether, if the contributions are to be recovered through existing rate elements rather than discrete charges, the exogenous cost adjustments to the price cap indices should not be subject to the affects of the price cap productivity factor. The exogenous cost adjustments for the USF contribution are intended to increase the price cap indices to allow the LECs room under the price cap to adjust access rates up to but no more then the value of the USF contribution.

The Commission's rules, however, implement the exogenous cost adjustments into the price cap formula in a way that will result in the reduction of the adjustments by the productivity component of the price cap formula. The result will be a net adjustment to the price cap indices that is less then assessed USF contribution. This short fall will accumulate for each year that the exogenous adjustment is subject to the productivity factor.

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USF contributions are a predetermined, mandated cost to the price cap LECs and other telecommunication providers. Payment of these costs is not discretionary and the LEC's enhanced efficiency which promotes growth in productivity does not affect the amount of the contribution. The funds collected flow to qualified providers of universal service. If the rules are not corrected as USTA has suggested in its Petition, price cap LECs will not have a legitimate opportunity to fully recover these USF contributions. As noted in its recent petition for waiver, SBC states that it will lose the opportunity to recovery about $7.3 million of its USF contribution.[1] Over time, as the productivity reductions accumulate, the impact will be even greater and the under-recovery more dramatic. USTA estimates that the potential under recovery for all price cap LECs could be $38 million in the first year, accumulating to $76 million in the second year and $1.14 billion in the third year.

USTA recommended that the PCI for each basket be increased by an amount sufficient to eliminate the impact of the productivity factor on USF contributions. This can be achieved by reducing the revenues used to calculate PCI changes (the "R" value in the PCI formula) by the amount paid for USF and treating the USF contribution as a new exogenous change. USTA included an example in its petition to illustrate how this change would ensure that the recovery of the USF contribution matches the contribution. Only one party, AT&T, objected to USTA's methodology. However, AT&T could not support its allegation that growth in demand would offset the impact of the productivity offset. In fact, given the Telecom Act's requirements for equitable and nondiscriminatory universal service contributions [Section 254(B)(4) of the Act] price caps LECs must not be required to fund universal service through growth in demand.

In order to avoid this deleterious effect in the 1998 Annual Filing, USTA urges the Commission to adopt USTA's proposal now.

Very truly yours,

Mary McDermott

Mary McDermott
Vice President Legal and Regulatory Affairs

cc: Richard Metzger
Jim Schlichting
Jane Jackson
Tamara Preiss

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[1] See page 2, "Petition for Waiver of Southwestern Bell Telephone Company, Pacific Bell, and Nevada Bell" dated March 18, 1998.