PUBLIC NOTICE

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COMMON CARRIER BUREAU SEEKS COMMENT ON PROPOSALS TO REVISE THE METHODOLOGY FOR DETERMINING UNIVERSAL SERVICE SUPPORT

CC Docket Nos. 96-45 and 97-160

Comment Date for filing additional proposals: April 27, 1998
Comment Date: May 15, 1998
Reply Comment Date: May 29, 1998

In the *Universal Service Order*,[1] the Commission adopted a four-step methodology for determining the appropriate level of federal universal service support that non-rural carriers will receive beginning January 1, 1999. As part of that methodology, the Commission determined that the federal fund will provide at least 25 percent of the total support necessary for non-rural carriers (25/75 decision). The Commission also concluded that rural carriers will receive support based on forward-looking costs no sooner than January 1, 2001. Several parties have set forth proposals to modify the Commission's approach to determining support for non-rural and rural carriers. Some of these proposals were presented in the Commission's proceeding to prepare a Report to Congress on Universal Service, required by statute,[2] and, in particular, in the *en banc* hearing on universal service issues held on March 6, 1998. In this Public Notice, we seek to augment the record by encouraging interested parties to submit additional proposals for modifying the Commission's methodology, or updates to those on the record, by **April 27, 1998**. Comments from interested parties on these proposals are due on **May 15, 1998**, and reply comments are due on **May 29, 1998**. In the *Report to Congress*, the Commission states that, prior to implementing the Commission's methodology for determining high cost support for non-rural carriers, the Commission will complete a

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[1] Federal State Joint Board on Universal Service, *Report & Order*, CC Docket No. 96-45, 12 FCC Rcd 8776 (1997), as corrected by Federal State Joint Board on Universal Service, CC Docket 96-45, *Errata*, FCC 97-157 (rel. June 4, 1997), *appeal pending, Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir. filed June 25, 1997).

[2] Departments of Congress, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1988, Pub. L. No. 105-119, 111 Stat. 2440, 2521-2522, § 623. Federal-State Joint Board on Universal Service, Report to Congress, CC Docket No. 96-45, FCC 98-67, (rel. Apr. 10, 1998) (*Report to Congress*).

25/75 decision and of the method of distributing high cost support.[3] The Commission also states that it will continue to work closely on these issues with the state members of the Federal-State Joint Board on Universal Service (Joint Board), including holding an *en banc* hearing with participation by the Joint Board Commissioners.[4]

Background

In the *Universal Service Order* and the accompanying *Access Charge Reform Order*,[5] the Commission set in place rules that will identify and convert existing mechanisms for providing federal universal service support to explicit, competitively-neutral federal universal service support mechanisms.[6] The Commission determined that non-rural carriers serving rural, insular, and high cost areas (collectively referred to as "high cost areas") would begin to receive support based on forward-looking economic cost beginning January 1, 1999, while rural carriers serving high cost areas would move to a forward-looking methodology no sooner than January 1, 2001.[7] The Commission also determined that it would assess and permit recovery of contributions to high cost support mechanisms based only on interstate revenues because such an approach would continue the historical method for recovering universal service support contributions and promote comity between the federal and state governments.[8] Thus, the Commission concluded that carriers may recover their contributions through interstate access and interexchange revenues.[9] Finally, the Commission directed that incumbent LECs use high cost support to reduce or satisfy the interstate revenue requirement

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[3] *Report to Congress* at para. 224.

[4] *See Report to Congress* at paras. 224, 228, 231.

[5] Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing and End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, and 95-72, *First Report and Order,* 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*); *Order on Reconsideration,* 12 FCC Rcd 10119 (1997); *Second Order on Reconsideration,* 12 FCC Rcd 16606 (1997); *Third Order on Reconsideration,* 12 FCC Rcd 22430 (1997); *See also Fourth Report and Order and Second Report and Order*, CC Docket Nos. 94-1, 96-262, 12 FCC Rcd 16642 (1997).

[6] In particular, the Commission adopted a methodology for universal service support for rural and non-rural carriers that will replace the following existing programs: the interstate high cost fund, Long Term Support, and Dial-Equipment-Minute (DEM) weighting programs. *Universal Service Order*, 12 FCC Rcd at 8889, para. 204.

[7] In the meantime, rural carriers will continue to receive support based on their embedded cost. As encouraged by the Commission in the *Universal Service Order*, the Joint Board has sought nominations for a Rural Task Force that will study the establishment of a forward-looking economic cost mechanism for rural carriers. Federal-State Joint Board on Universal Service, *Public Notice*, FCC 97J-1 (rel. Sept. 17, 1997).

[8] *Universal Service Order*, 12 FCC Rcd at 9198-9203, paras. 824-836.

[9] *Universal Service Order*, 12 FCC Rcd at 9199-9200, paras. 829-830. Price cap LECs may treat their contributions as exogenous changes to their price cap indices. *Access Charge Reform Order*, FCC Rcd at 16147, para. 379.

otherwise collected through interstate access charges.[10] That decision was based on the decision in the *Universal Service Order* to fund only the federal share, or 25 percent, of high cost support from the federal mechanism, discussed below.

In the first step of the Commission's four-step methodology for determining support for non-rural carriers, a forward-looking economic cost mechanism selected by the Commission, in consultation with the Joint Board, will be used to calculate the forward-looking economic cost to non-rural carriers for providing the supported services in high cost areas.[11] Second, the Commission will establish nationwide revenue benchmarks calculated on the basis of average revenue per line.[12] Without adopting a precise method for calculating the benchmarks, the Commission stated in the *Universal Service Order* that it appears that the benchmarks should be approximately $31 for residential services and approximately $51 for single-line businesses.[13] The Commission intends to make a formal determination on the appropriate revenue benchmark before it implements a high cost support mechanism based on forward-looking costs. Third, the difference between the forward-looking economic cost and the benchmark will be calculated. Fourth, federal support will be 25 percent of that difference, corresponding to the percentage of loop costs allocated to the interstate jurisdiction.[14] In the *Universal Service Order*, the Commission stated that, once states have taken steps to identify the subsidies implicit in intrastate rates, the Commission may reassess the amount of federal support that is necessary to ensure affordable rates.[15] A number of parties have sought reconsideration of the Commission's decision to initially fund only 25 percent of total high cost support.[16] Since the period for filing comments on those

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[10] *Access Charge Reform Order*, 12 FCC Rcd at 16148, para. 381.

[11] Alternatively, states may submit cost studies that, if consistent with the criteria established by the Commission in the *Universal Service Order*, will be used to compute the forward-looking cost. The Commission will select a forward-looking mechanism by August 1998. *Universal Service Order*, 12 FCC Rcd at 8890, 8910, 8912-16, paras. 206, 245, 248-50.

[12] *See Universal Service Order*, 12 FCC Rcd at 8919-8924, paras. 257-267.

[13] *Universal Service Order*, 12 FCC Rcd at 8924, para. 267.

[14] *Universal Service Order*, 12 FCC Rcd at 8925, para. 269. As discussed in note 4, federal support for universal service historically has been provided by three Commission mechanisms, but other mechanisms also have contributed to maintaining affordable rates in rural areas, including subsidies implicit in intrastate rates. Because of the patchwork of implicit and explicit universal service support mechanisms that evolved prior to the 1996 Act, it has not been possible to quantify the actual historical federal share of total universal service support.

[15] *Universal Service Order*, 12 FCC Rcd at 8926, para. 272.

[16] *See, e.g.*, the petitions filed on July 17, 1997 in CC Docket No. 96-45 by the following parties: Alaska Public Utilities Commission at 5-6; Alaska Telephone Association at 1-2; Arkansas Public Service Commission at 1-3; GVNW Inc. at 2, 8; Rural Telephone Coalition at 3-4; Sprint Corporation at 1-3; United Utilities at 3-4; U S WEST at 6; Vermont Public Service Board at 2-3; Western Alliance at 18-19; and Wyoming Public Service Commission at 2. Several parties have also appealed that decision. *Texas Office of Public Utility Counsel et. al.*

reconsideration petitions closed, several parties have proposed specific alternatives to the Commission's 25/75 funding decision.[17]

Proposals to Modify the Commission's Methodology

Upon recommendation by the Joint Board, the Commission adopted a nationwide revenue benchmark based on average revenues per line.[18] Subsequent to the Joint Board's recommendation, a majority of state members of that Joint Board endorsed a nationwide benchmark based on the nationwide average cost of service, as determined by a forward-looking cost model.[19] In light of the recommendation of the Joint Board's majority state members and the proposals described in this Public Notice, we seek additional comment regarding the use of a cost-based benchmark.

U S WEST proposes to modify the second step of the Commission's forward-looking methodology for non-rural carriers by creating a second revenue benchmark (Interstate High Cost Affordability Plan or IHCAP).[20] Under the IHCAP, the federal mechanism would provide support for 25 percent of the costs between a "Primary Benchmark" and a "Super Benchmark," and 100 percent of the costs above the Super Benchmark. For demonstration purposes, the IHCAP assumes a Primary Benchmark of $30 and a Super Benchmark of $50.[21]

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v. FCC, No. 97-60421 (5th Cir. filed June 25, 1997).

[17] All of the proposals described in this Public Notice will be available on the Commission's web page at http://www.fcc.gov under the heading "Universal Service." The proposals that calculate forward-looking cost use a forward-looking economic cost model. For demonstration purposes, fund estimates are based on two industry-proposed models under consideration by the Commission, the Benchmark Cost Proxy Model (BCPM) and the HAI model (HAI), however the versions of the models and the inputs used may vary across proposals. BCPM was submitted by BellSouth Corporation, BellSouth Telecommunications, Inc., U S WEST, Inc., and Sprint Local Telephone Company. Submission to CC Docket Nos. 96-45 and 97-160 by BCPM proponents, dated Dec. 11, 1997. HAI was submitted by AT&T and MCI. Letter from Richard N. Clarke, AT&T, to Magalie Roman Salas, FCC, dated Dec. 11, 1997. Versions of HAI filed before February 3, 1998, were known as the Hatfield Model.

[18] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Recommended Decision,* 12 FCC Rcd 87, 246 (1996); *Universal Service Order*, 12 FCC Rcd at 8919, para. 259.

[19] The majority state members concluded that a revenue-based benchmark will require periodic review and more regulatory oversight than a cost-based benchmark. *Majority State Members' Second Report on the Use of Cost Proxy Models*, CC Docket 96-45 (filed April 21, 1997) at 14-15.

[20] Exhibit of James D. Smiley, U S WEST, for FCC En Banc Hearing, Universal Service (Mar. 6, 1998) (IHCAP Proposal). U S WEST does not specify different benchmark levels for different types of lines, *e.g.*, residential, single-line business, or multi-line business lines.

[21] Using BCPM with a set of "common inputs" developed by Commission staff, rather than default inputs, U S WEST estimates that a federal fund that supported all switched lines would be $2,836,903,776 for the non-rural carriers. Letter from Glenn Brown, U S WEST, to Magalie Roman Salas, FCC, dated Mar. 13, 1998

An Ad Hoc Working Group convened through the National Association of Regulatory Utility Commissioners proposes an alternative approach for determining and distributing high cost support for both rural and non-rural carriers (Ad Hoc Proposal).[22] In lieu of the forward-looking cost methodology established by the Commission, a draft of the Ad Hoc Proposal filed with the Commission on April 10, 1998 calculates federal support for each state in five steps. First, the Ad Hoc Proposal uses a forward-looking economic cost model selected by the Commission to calculate the average forward-looking cost per line for each state, as well as the average forward-looking cost per line for the nation. The difference between these amounts is calculated for each state and multiplied by a composite state separations factor which the proposal assumes to be 75 percent.[23] Second, the above process is repeated using embedded cost. Specifically, the difference between each state's average embedded cost and 105 percent of the national average embedded cost is calculated for each state and multiplied by a composite state separations factor.[24] Third, the lesser amount resulting from the first two steps is determined. Fourth, a "hold-harmless" level is calculated for each state equal to federal support received by carriers in that state under existing mechanisms. For those states with above-average embedded costs that also currently make a net contribution to federal support mechanisms, the hold-harmless level is increased to ensure that a state's net contribution does not increase. Finally, the federal support for each state is set at either the hold-harmless amount or the amount determined in step 3, whichever is greater. Federal support below the hold-harmless level is distributed by state commissions to carriers that receive support under the current system.[25] Federal support above the hold-harmless level is distributed to other eligible telecommunications carriers (ETCs) according to a state

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(IHCAP Proposal) at att. Using BCPM and HAI with default inputs, the Telecommunications Industry Analysis Project (TIAP) estimates that a federal fund with $30 and $50 benchmarks would be $8,318 million with BCPM and $2,556 million with HAI. Letter from Carol Weinhaus, TIAP, to Magalie Roman Salas, FCC, dated Mar. 11, 1998 (TIAP Proposals) at 21.

[22] Letter from Peter Bluhm, Vermont Public Service Board, to Magalie Roman Salas, FCC, dated April 10, 1998, at att. High Cost Support: An Alternative Distribution Proposal (Ad Hoc Proposal); *see also* Statement of Thomas Welch, Maine Public Utilities Commission, at March 6, 1998 en banc Commission meeting, transcript at 24-25. Using HAI 5.0a, the Ad Hoc Group estimates that total high cost support for non-rural carriers under the Commission's forward-looking methodology would be $4,900 million, 25 percent of which would be supported by a federal mechanism. The Ad Hoc Group estimates that their approach would result in a federal fund of $1,830 million. Ad Hoc Proposal at 22. TIAP estimates that the Ad Hoc Proposal would result in a federal fund of $1,699 million with BCPM and of $1,196 million with HAI. TIAP Proposals at 14.

[23] The proposal notes that it may be more appropriate to use individual state's composite separations factor. Ad Hoc Proposal at note 34.

[24] In order to reduce the overall size of the federal support fund, the target figure is set at 105% of the national average cost. Ad Hoc Proposal at 14.

[25] The Ad Hoc Working Group notes that this support would be portable to competitive LECs that are eligible telecommunications carriers. Ad Hoc Proposal at note 44.

distribution plan reviewed by the Commission. The Ad Hoc Working Group and the Telecommunications Industry Analysis Project (TIAP) also examine possible modifications to the Ad Hoc Proposal.[26]

TIAP proposes four alternatives to the federal forward-looking methodology. One proposal increases federal support to 40 percent of the difference between forward-looking cost and the revenue benchmark (40/60 Proposal).[27] In another proposal, the federal fund supports 100 percent of the difference between the forward-looking economic cost and the benchmark only in one or two of the lowest density zones served by non-rural carriers (Density Zone Proposal).[28] A third proposal applies one nationwide surcharge to each telephone number per month (Telephone Number Proposal). Based on the assumption that the federal fund will provide 100 percent of the necessary support, the surcharge is calculated by dividing the fund by the number of phone numbers in service, and by twelve months.[29] A fourth proposal applies one nationwide surcharge to each customer's bill based on a percentage of the total (interstate and intrastate) revenues on the bill (Percentage of Retail Revenues Proposal). Based on the assumption that the federal fund will provide 100 percent of the necessary support, the surcharge is calculated by dividing the fund by total annual retail revenues.[30]

We seek comment on the use of a cost-based benchmark and the proposals of U S WEST, the Ad Hoc Working Group, and TIAP. In addition, we seek comment on how to modify our rules in the event such a proposal were adopted. We also seek comment on the appropriate method and revenues to recover contributions for high cost support.

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[26] *See* Ad Hoc Proposal at 18-21; TIAP Proposals at 16-20.

[27] TIAP estimates that the federal fund using a 25/75 approach and a $30 benchmark would be $3,938 million with BCPM and $1,927 million with HAI. TIAP estimates that a federal fund using a 40/60 approach and the same benchmark would be $5,484 million with BCPM and $2,267 million with HAI. TIAP Proposals at 27, 33.

[28] Assuming a $30 benchmark, TIAP estimates that federal support for the lowest density zone calculated by the models (0 to 5 lines per square mile) would result in a fund of $3,965 million, based on BCPM, or $2,410 million, based on HAI. TIAP states that federal support for the two lowest density zones (0 to 5 lines per square mile and 5 to 1000 lines per square mile) "would increase the federal fund by 312% for BCPM and 277% for HAI." TIAP Proposals at 24.

[29] Using 1996 interstate and intrastate retail revenues, TIAP estimates that, with a $30 benchmark, and a total fund of $3,628 million with HAI or $11,670 million with BCPM, a monthly surcharge would be $1.31 or $4.20, respectively. TIAP also calculates estimated surcharges and fund sizes at $40 and $50 benchmarks. TIAP Proposals at 38.

[30] Using 1996 total retail revenues, a $30 benchmark, and a total fund of $3,628 million with HAI or $11,670 million with BCPM, TIAP estimates that this surcharge would be 1.9% or 6.2%, respectively. TIAP also calculates estimated surcharges and fund sizes at $40 and $50 benchmarks. TIAP Proposals at 41.

Implementation of High Cost Support Methodology

In the *Universal Service Order*, the Commission established a forward-looking economic cost methodology for non-rural carriers that will calculate support based on forward-looking cost beginning January 1, 1999. AT&T seeks to delay implementation of the high cost support mechanism for "the Major ILECs . . . at the very least until these companies have opened their markets to robust and widespread local competition."[31] In contrast, proponents of the Ad Hoc Proposal support the implementation of their proposal for both rural and non-rural carriers on January 1, 1999.[32] U S WEST recommends that non-rural carriers begin receiving support based on the IHCAP on January 1, 1999, and that a forward-looking methodology that will best meet the needs of rural carriers should be determined after several years of experience of calculating support based on IHCAP for the non-rural carriers.[33] We seek comment on these implementation proposals. With regard to AT&T's petition, we seek comment on the specific criteria that should trigger implementation of the forward-looking methodology for non-rural carriers.

Finally, in its *Report to Congress*, the Commission commits to completing a reconsideration of the issues raised in this Public Notice prior to implementing the new high cost mechanism for non-rural carriers.[34] The Commission specifies that, in the course of reconsidering these issues, it will work closely with the state members of the Joint Board.[35] The Commission attests that, in the past two years in particular, the ideas generated by the formal and informal dialogue among state members of the Joint Board and the FCC Commissioners have facilitated the shared objectives of preserving and advancing universal service as competition develops in local markets.

Final Regulatory Flexibility Analysis

In the *Universal Service Order* we conducted a Final Regulatory Flexibility Analysis (FRFA),[36] as required by the Regulatory Flexibility Act (RFA).[37] We received no petitions

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[31] Letter from Brian Masterson, AT&T, to Magalie Roman Salas, FCC, dated Mar. 12, 1998, at att. Presentation of Joel Lubin, AT&T, to March 6, 1998 en banc Commission meeting.

[32] Ad Hoc Proposal at 13.

[33] IHCAP Proposal at 4. *See also* letter to William E. Kennard, FCC, from Solomon D. Trujillo, U S WEST, dated April 2, 1998.

[34] *Report to Congress* at para. 224.

[35] *See Report to Congress* at paras. 224, 228, 231.

[36] *Universal Service Order*, 12 FCC Rcd at 9219-9260 paras. 870-983.

for reconsideration of that FRFA. In this present Public Notice, the Commission promulgates no additional final rules, and our action does not affect the previous analysis. If commenters believe that the proposals discussed in this Public Notice require additional RFA analysis, they should include a discussion of these issues in their comments.

Deadlines and Instructions for Filing Proposals and Comments

Interested parties may file additional proposals regarding the Commission's methodology for determining universal service support for rural and non-rural carriers on or before **April 27, 1998**. Interested parties may file comments in support of or opposition to the proposals on or before **May 15, 1998**. Reply comments are due on or before **May 29, 1998**. All filings should refer to CC Docket Nos. 96-45 and 97-160, and DA 98-715. One original and five copies of all filings must be sent to Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W., Room 222, Washington, D.C. 20554. Parties must also send copies to the individuals listed on the attached Service List (Appendix) and to the Commission's copy contractor, International Transcription Service, Inc., 1231 20th Street, N.W., Washington, D.C. 20554.

For further information, please contact Chuck Keller at (202) 418-7380 or via electronic mail at <ckeller@fcc.gov>.

Action by the Chief, Common Carrier Bureau.

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[37] *See* 5 U.S.C. § 604. The RFA, *see* 5 U.S.C. § 601 *et. seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

APPENDIX
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