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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
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)
Federal-State Joint Board)
on Universal Service)
)
)
Forward-Looking Mechanism)
for High Cost Support for)
Non-Rural LECs)
_____)

CC Docket No. 96-45

CC Docket No. 97-160

**AT&T REPLY COMMENTS ON PROPOSED
METHODS FOR DETERMINING HIGH COST SUPPORT**

Pursuant to the Commission's Public Notice released April 15, 1998 (DA 98-715), AT&T Corp. ("AT&T") hereby submits these Reply Comments on proposals to revise the Commission's methodology for determining high cost support for non-rural local exchange carriers ("LECs").¹

In its comments, AT&T demonstrated that the Commission should evaluate all of the proposals according to two cardinal principles: First, federal funding for universal service should under no circumstances be increased beyond present levels. AT&T at 3-4. Second, the universal service program should be competitively neutral. Id. at 4.

Moreover, AT&T outlined a three-part proposal for implementing the new methodology for calculating universal service support. First, AT&T demonstrated that, in the vast majority of cases, local sources of support fully compensate the major non-rural LECs for all their universal service

¹ In its comments, AT&T inadvertently referred to the proposal of the Ad Hoc Working Group of the National Association of Regulatory Utility Commissioners as the proposal of the Ad Hoc Telecommunications Users Group. AT&T at 13. AT&T regrets that error.

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costs. In the few study areas where that is not true, these LECs have many other sources of support, including intrastate toll, wireless, and yellow pages. Therefore, any further explicit federal support payments to these LECs should be canceled until they can show that such payments are necessary. Id. at 5-7. Second, AT&T showed that the Commission should calculate support on a study area basis, because calculating support on a wire center basis, as the Commission currently intends to do, would dramatically and inappropriately increase the size of the fund. Id. at 7-9. Finally, because there currently exists no substantial local competition, the FCC should postpone implementation of the new universal service plan until local competition materializes. Id. at 9-13.

As described below, the comments reflect broad support for the principles that AT&T set out in its comments, and a number of commenters support critical aspects of AT&T's specific proposals.

I. THERE IS BROAD SUPPORT IN THE COMMENTS FOR NOT INCREASING THE SIZE OF THE FUND AND FOR PROMOTING COMPETITIVE NEUTRALITY.

Numerous parties emphasize that the new federal fund certainly should not be increased beyond its present size. Ameritech at 7-8; Bell Atlantic at i, 2; CPUC at 3; Md. PSC at 1-2, 4-5, 7; NYDPS at 2; Sprint at iii, 1, 10; SWBT at 3. As Bell Atlantic states, the federal fund should be no larger than "the minimum necessary" to achieve the statutory purpose. Bell Atlantic at 4 (quoting remarks by Chairman William E. Kennard to the National Association of State Utility Consumer Advocates (Feb. 9, 1998)); see also id. at 14 (the Commission should minimize federal funding to "assure that carriers focus on market competition rather than subsidy collection as the key to financial success"); Del. PSC at 1, 3, 5. "[T]he 1996 Act neither requires nor contemplates that the FCC will adopt a program which requires the level of high cost universal service support to become more

expensive and burdensome to unsubsidized ratepayers than it is today." Md. PSC at 6, n.9 (citing Sen. Rep. No. 104-23, 10th Cong., 1st Sess. 25-26 (1995)). Hence, "any Universal Service Program should be kept as small as possible while still meeting the agreed-upon social objective." MCI at 3.

As Sprint notes (at 10), "[c]urrent subsidies are immense," and certainly should not be *increased* over current levels. Ameritech correctly points out that there is no reason to believe that the current level of federal support has been inadequate; indeed, telephone penetration levels have increased substantially since AT&T's divestiture. Ameritech at 4; see also Md. PSC at 4. Conversely, a number of commenters point out that the larger the universal service support mechanisms grow, the greater the burden borne by all ratepayers. Ameritech at 6-8; Bell Atlantic at 2, 10; MCI at 3, 18; see also Del. PSC 3, 5; Md. PSC at 6; NYDPS at 2. And as the California Public Service Commission recognizes, increasing the size of the federal fund risks creating a "bloated subsidy program which can never be reduced or eliminated." CPUC at 4; see also Bell Atlantic at 4; MCI at 18; Tex. PUC at 4, 6.

The commenters also agree that any universal service funding program should also be competitively neutral. See, e.g. ALTS at 6-7; Ameritech at 5; CompTel at 2-3; MCI at 1, 2, 9-10, 11-12; NYDPS at 1; Sprint at iii, 3-5. In particular, a number of commenters recognize that the Commission should recover universal service obligations through end-user surcharges. E.g., CPUC at 12-13; MCI at 12; Md. PSC at 2, 7, 8. As the CPUC notes, an end-user surcharge would "reduce consumer confusion and ensure that the correct amount is raised for the high cost program." CPUC at 13.

II. THE COMMENTERS SUPPORT IMPORTANT ASPECTS OF AT&T'S PROPOSALS.

A. There is also significant support for AT&T's specific proposals. For example, numerous commenters acknowledge that the major LECs have many sources of support (without resorting to access revenues) that adequately compensate them for universal service costs. MCI correctly notes that "prices/revenues for many interstate and intrastate services far exceed costs, but not all of these -- indeed only a small share of these -- extra revenues are needed to fund the Universal Service subsidy . . . Most of these extra revenues simply contribute to the high profits that the non-rural LECs enjoy." MCI at 7. Indeed, the Ohio Public Utilities Commission, in the context of discussing the revenue benchmark, frankly acknowledges the many local revenue sources that contribute to universal service. Ohio PUC at 4. As the Ohio Commission explains, "to protect against the overfunding of carriers, [the benchmark] should include the revenues for all additional vertical services for each single line business and residential subscriber, and not just supported services," and notes that "[t]otal intrastate residential revenues from telecommunications services include all revenues from intrastate retail residential services (including vertical services and any yellow pages revenues received from an affiliate) as well as wholesale payments by resellers for residential services in that study area." See id.

AT&T demonstrated in its comments that the revenues from these local services more than cover the major non-rural LECs' universal service costs, and therefore the Commission should cancel any further explicit federal funding until these LECs can demonstrate to their state commissions that such local revenues are no longer adequate. AT&T at 5-6 & Attachment 1.² Under these

² In the handful of study areas where local service revenues alone fail to cover the entirety of the (continued...)

circumstances, continuing explicit federal universal service funding for the RBOCs, GTE, and SNET does nothing more than provide "fat and excess profits " MCI at 18-19; ALTS at 5; see also MCI at 7 (GTE's proposal is nothing more than "an attempt by GTE to perpetuate its current monopoly revenue stream"). As the CPUC correctly notes (at 11), "the 1996 Act does not require that every alleged implicit subsidy should be replaced with a new explicit one, but allows the FCC to eliminate these subsidies if they are unnecessary to achieve the mandates of the Act." As Attachment 1 in AT&T's comments showed, the current federal payments represent a pure windfall for these LECs, which is directly contrary to the purposes of the Act and, if anything, will merely frustrate the further development of local competition. Therefore, these payments should be discontinued. ALTS at 4-5, 9 ("[T]he beneficiaries of universal service support must be consumers, not carriers"); Ameritech at 3; MCI at 7.

In all events, the Commission certainly should not adopt any methodology that would increase the size of the fund. Nonetheless, as AT&T showed in its comments, the Commission's current methodology will do just that, because support will be calculated on a wire center basis.³ Therefore, the Commission should calculate support at the study area level rather than at the wire center level.

A number of commenters agree that the wire center approach is inappropriate. For example, many commenters note that the Commission itself had found that universal service subsidies should

² (...continued)

LEC's costs, see AT&T at Attachment 1, states should look to the LEC's other sources of support, including revenues from intrastate toll, wireless, and yellow pages, before releasing any federal funding.

³ See, e.g., Bell Atlantic at 7-8, 15 (calculating support at the wire center level results in wide variances in the measure of costs that can be minimized by calculating support at the state-wide level).

not be disaggregated to a lower level than unbundled network element rates. See, e.g., GTE at 11 ("[t]o minimize arbitrage opportunities, it would be desirable for state retail, resale, and unbundled network element (UNE) rates to be consistent with one another, and with the USF support that is available"); MCI at 5 ("[s]ound public policy principles suggest that the calculations for the explicit Universal Service fund be performed over the same cost zones that each state has used for setting loop rates"); see also CompTel at 6. As the commenters note, most states have not disaggregated UNE rates below the study area level, and certainly not down to the wire center level, and therefore the Commission's approach will create opportunities for arbitrage by new entrants. See MCI at 13. However, unbundled network elements remain unavailable as a practical matter even in the few states that have established zone density pricing, because of excessive "glue" charges, nonfunctional operations support systems, and other anticompetitive conditions. Therefore, the Commission should continue to calculate support at the study area level, as it does under the current system.

In addition, because the underlying predicate for the establishment of a new universal service system -- local competition -- has thus far failed to develop, it would be prudent for the Commission to postpone implementation of the new USF program. AT&T at 10-11. Indeed, implementation would actually frustrate the further development of competition if explicit federal funding increased as a result. In its comments, AT&T laid out a test for determining when the new system should be implemented in each state. AT&T at 12-13.

A number of commenters agree that the Commission need not implement the new system on January 1, 1999. As CompTel states, "[u]ntil the ILECs actually have taken the steps necessary to open their markets to local competition, it will be impossible to measure the competitive neutrality of the Commission's high cost support approach. Thus, a threshold [test] like that suggested by

AT&T would enable the Commission to ascertain that its high cost support methodology is consistent with all the goals of Section 254." CompTel at 6-7. Similarly, noting that universal service reform "cannot be accomplished in a vacuum," MCI agrees that the new system should be implemented concurrently with unbundling, pricing and access charge reform, in order to fulfill the competitive regime envisioned by Congress. MCI at 1, 24. Given the importance of this issue, the Commission should continue to rely on the existing mechanisms until it has had time to design better system. ALTS at 4, 8-9; Evans Telephone at 7-8; SDPUC at 1; see also Celpage at 1 (proposing delay of the USF proxy model until at least Jan. 1, 2001).

B. Finally, SBC's contentions that the Commission has no statutory authority to adopt AT&T's proposals are wrong. See SBC at 6-10. First, the Commission has ample authority to cancel the existing explicit universal service payments to the major LECs. As AT&T showed in its comments, the major non-rural LECs' sources of support (*i.e.*, local service, and contribution from intrastate toll, wireless, and yellow pages) more than cover their universal service costs, and so long as that is true the Commission can cancel federal funding. See AT&T at 5-6 & Attachment 1. In other words, the Commission could validly conclude in that situation that federal payments of zero would constitute funding that is "sufficient" to preserve and advance universal service as it relates to these LECs. See Section 254(d). There is no provision of the Act that compels the Commission to provide windfall universal service payments to LECs whose local service and other sources of contribution completely cover their universal service costs.

Moreover, SBC mistakenly characterizes this as an issue of "eligibility" under Section 214(e). SBC at 7-8, 10. AT&T's proposal has nothing to do with Section 214 eligibility, nor does it seek to condition such eligibility on compliance with Sections 251 and 252. To the contrary, the SBC LECs

undoubtedly meet the eligibility requirements of Section 214(e) and are thus "eligible" to receive payments under whatever "sufficient" mechanisms the Commission establishes. Nothing in either Sections 254 or 214, however, requires the Commission to structure its universal service mechanisms to provide payments to carriers that are "eligible" under Section 214 but nonetheless do not need any such payments. As soon as SBC can show that its local service and other available revenues no longer cover its universal service costs (see AT&T at 6-7), SBC, as an "eligible" carrier, could immediately begin to receive federal funding under AT&T's proposal, if the Commission's mechanisms were so structured.

SBC is similarly confused as to the Commission's statutory authority to postpone implementation of the new system. Section 254(a)(2) of the Act expressly authorizes the Commission to establish a "timetable for implementation" of the new universal service system that is consistent with the standards and purposes of the Act. There is no dispute that the entire theory of Section 254 is that the existing sources of support will be unsustainable in a competitive environment. See AT&T at 10. As a factual matter, however, there has been no significant entry into the local and exchange access markets widespread enough to put any competitive pressure on those existing sources of universal service contribution. Therefore, the Commission can lawfully postpone implementation of the redesigned system until such competition arrives.

SBC's two statutory arguments against postponement do not withstand scrutiny. See SBC at 7-8. First, SBC argues that the fact that Section 271 expressly conditions interLATA entry on compliance with Sections 251 and 252 means that universal service subsidies cannot be similarly conditioned, since Section 254 does not contain such an express linkage. That is complete non sequitur. Section 254 independently instructs the Commission to establish a "timetable for

implementation" of the new system, and the Commission has broad discretion to establish a timetable that is consistent with the purposes and standards of Section 254. The rate at which competitive entry is eroding the pre-existing sources of support is unquestionably relevant to that determination.⁴

Second, SBC mistakenly claims that Section 214(e) prohibits the Commission from postponing implementation of the system. As with the cancellation of payments, postponing implementation has nothing to do with eligibility to receive payments under Section 214(e). Postponing implementation would not in itself strip any carrier of eligibility to receive payments, and indeed, the non-major non-rural carriers would continue to receive subsidies under the current mechanisms.

SBC also incorrectly claims that robust competition is occurring in its region. As supposed proof, SBC recites the usual litany of signed interconnection agreements and the loss of a tiny percentage of its customers. SBC at 7. The LECs' intransigence is well documented, however, in providing the critical unbundled network elements and operations support system interfaces that would facilitate competition that would actually be widespread enough to put pressure on the rates that may contain contribution for universal service.⁵ AT&T's proposed test for when the new system should be implemented is narrowly focused on the extent to which the incumbent LECs are losing margins that provide sources of universal service support. See AT&T at 12-13. If competition is

⁴ Moreover, AT&T's proposal does not involve linking implementation of the new system to compliance with Sections 251 and 252 per se. AT&T set forth in its comments its proposed test for when the universal service system would be implemented in each state. AT&T at 12-13.

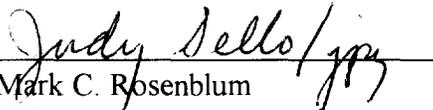
⁵ See, e.g., Request for Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers, RM No. 9210, Comments of AT&T at 8-16 (filed January 30, 1998); id., Reply Comments of AT&T at 3-7 (filed February 17, 1998).

indeed eroding away those sources of support, then SBC should be able to satisfy that test and receive federal support payments pursuant to the new system.

CONCLUSION

For the reasons stated above and in AT&T's comments, the Commission should end explicit payments for the major non-rural LECs, adopt AT&T's proposal concerning the methodology for determining high cost support for non-rural companies, and it should postpone implementation of the new system until competition develops.

Respectfully submitted,


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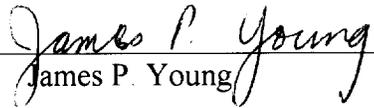
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May 29, 1998

CERTIFICATE OF SERVICE

I, James P. Young, do hereby certify that on this 29th day of May, 1998, I caused a copy of the foregoing AT&T Reply Comments on Proposed Methods of Determining High Cost Support to be served upon each of the parties listed on the attached service list by U.S. First Class mail postage prepaid.


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