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

In the Matter of	)	
	)	CC Docket Nos. 96-45, 97-160
Federal State Board on	)	DA 98-715
Universal Service	)	

REPLY COMMENTS OF GTE

Dated: May 29, 1998

GTE Service Corporation and its affiliated domestic telephone operating, wireless, and long distance companies

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INTRODUCTION AND SUMMARY

The combined effect of the Federal plan, taken together with state mechanisms, should be to satisfy the requirements of the Telecommunications Act of 1996 ("1996 Act"). GTE's Proposal dated April 27 is designed to accomplish this by achieving the following three policy objectives:

First, the Federal plan must be sufficient to replace the implicit support currently provided by interstate access rates.

Second, the Federal plan should provide to the states a reasonable amount of support that will be used to replace implicit support generated today by intrastate rates. The amount of this support should be chosen to strike a balance between the interests of low and high cost states. The Federal fund should not attempt to provide all of the funding that states would need to replace the support implicit in current state rates.[1]

Third, the Federal plan should maintain the amount of support provided by the current high cost fund ("HCF").

Several parties have identified one or more of these objectives. However, most parties have ignored at least one of them, and, in so doing, have failed to identify correctly the amount of support the Federal plan must provide. In general, these parties have assumed either (i) that the current implicit support mechanisms can, and should,

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1 Sprint (at 6) suggests that GTE has proposed a Federal plan that would "be large enough to replace the implicit support generated by intrastate access, toll, and vertical features." In fact, GTE has not proposed such a plan, and GTE agrees with Sprint that the Federal plan should not fund all state needs. Instead, GTE proposes only that the Federal plan should provide funding that cannot reasonably be provided by a state, because of its high costs and/or limited funding base.

be maintained indefinitely, or (ii) that the Commission should arbitrarily declare a new price level for the industry. Neither assumption is reasonable.

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GTE Service Corporation and its affiliated domestic telephone operating,[1] wireless,[2] and long distance[3] companies (collectively "GTE") respectfully submit their Reply Comments on proposals to revise the methodology for determining universal service support.[4] Proposals were submitted by several parties in response to the Common Carrier Bureau's Public Notice DA 98-715 (released April 15, 1998) (the "Notice").

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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 Wireless Incorporated.

3 GTE Communications Corporation, Long Distance division.

4 GTE's proposal described in these reply comments, and its comments on proposals proffered by other parties, in no manner prejudices its positions set forth in its appeals of the Commission's universal service or access charge reform orders. *See Texas Office of Public Utility Counsel v. F.C.C.*, No. 97-60421 (5th Cir.) ("*Texas Ofc. Of Pub. Util. Counsel*"); *Southwestern Bell Tel. Co. v. F.C.C.*, No. 97-2618 (8th Cir.) ("*Southwestern Bell*").

I. THE FEDERAL PLAN MUST BE SUFFICIENT TO MEET THE COMMISSION'S POLICY GOALS.

A. The Current Support Mechanism Includes Both Implicit And Explicit Support.

Universal service today is maintained by a combination of explicit funding and implicit support from rates for other services, such as access, toll, some local business services, and vertical services. This flow of support is illustrated in Exhibit I (Figure 1). Figure 1 displays the contribution toward GTE's common costs made by each of the major groups of services GTE provides. For each service group, the direct, or TSLRIC cost of that service group is subtracted from its revenue at current prices. The difference is the contribution, in dollars per year, made by that group of services. [5] Figure 1 shows this amount for (from left to right) interstate switched access, intrastate switched access, state toll provided by GTE, vertical services, local business service, and local residence service. [6] This display provides a convenient way to observe where the money comes from, and where it goes, within the pricing structure of incumbent telephone companies today. All of the major service categories other than residence

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5 The amounts shown are totals for GTE's domestic local serving areas, in dollars per year. They do not include amounts for any other ILEC. They are based on GTE's own Total Service Long Run Incremental Cost ("TSLRIC") estimates. However, the same basic pattern shown in Figure 1 would result if estimates from one of the proxy cost models were used, or if the same analysis were performed for another nonrural ILEC.

6 Some services are not included in Figure 1. For example, special access is not included. The revenue from the interstate subscriber line charge ("SLC") is not included in calculating the contribution from switched access.

local have large positive contributions, while residence local service has a large negative contribution – that is, it does not cover its direct cost.[7]

Exhibit I (Figure 2) provides for comparison the contribution levels that would result if GTE's rates were rebalanced so that each major service group made an equal percentage contribution to common costs, and so that the overall revenue level remained the same. The result would be dramatic reductions in interstate switched access rates, and also in rates for state access, toll, and vertical services. Rates for residence local service, in contrast, would rise substantially. The difference in contribution, by service category, between current rates and these rebalanced rates provides a measure of the support flow generated by, or received by, each category.[8]

The "excess" contribution provided by GTE's interstate switched access (that is, contribution above a constant-margin rate level) is approximately $1.18 billion per year[9]. As GTE has stated in its Proposal, the corresponding amount for the non-rural

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7 While Figure 1 is a useful way to depict the major support flows within the system, because it presents an average across all of GTE's serving areas, it also fails to show some important rate relationships. For residence customers pay different rates, and cause different costs, depending on where they are located and which service package they buy; these are averaged together within the bar for residence local.

8 The rebalanced rates are "cost-based" in the sense that they would reflect the TSLRIC of each service, plus a contribution toward common costs.

9 The calculation used revenues, based on Tariff Review Plans ("TRPs") filed with the Commission, for CCL, PICC, local switching, and switched transport, but excluding the SLC. The "rebalanced" rate for these access services used in the calculation was $.08 per minute. Bell Atlantic incorrectly suggests (at 13) that GTE's estimate of the implicit support in interstate access is based on the difference between the revenue and the incremental cost. In fact, the rate GTE uses for comparison includes a markup for contribution toward common costs, which, if applied uniformly to all GTE's direct costs, would yield GTE's current revenue.

Incumbent Local Exchange Carriers ("ILECs") as a group is $6.3 billion per year.[10] Figure 2 also displays the amount of explicit support GTE expects to receive from the current HCF in 1998. This is about $90 million.[11]

Taken together, Figures 1 and 2 demonstrate some simple facts about universal service:

First, universal service is supported today by a combination of implicit and explicit funding mechanisms.

Second, of these, the implicit mechanisms are by far the most significant. Even for GTE, which is the largest single recipient of support from the current HCF, the current explicit support is less than one tenth of the amount of implicit support that GTE generates annually from its interstate switched access charges alone.

Third, the total amount of support provided today is the sum of the implicit and explicit amounts.[12] Taken together, these represent a large flow of support from interstate sources today. Those parties who argue in favor of a "small fund" ignore the simple fact that we have a large fund today.

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10 The access rates on which the TRP reports are based include the ILEC's recovery of their contributions to the school and libraries fund. This amounts to about $1.1 billion annually. If the Commission were to adopt an alternative method for recovering these ILEC contributions, this amount could be removed from the ILECs' carrier access rates. This would reduce the implicit support in switched access to about $5.1 billion for the nonrural ILECs as a group.

11 This amount has already been reflected in the state rates whose contributions are shown in Figure 1. For nonrural ILECs as a group, the amount of current HCF is approximately $217 million.

12 See for example, AT&T at 10: "Under the prevailing scheme, the support for universal service is comprised of a combination of explicit programs and implicit subsidies embedded in the rates for other services."

Fourth, implicit support is generated by combination of state and interstate rates. Thus, even if the Federal fund were to replace all of the implicit support provided by interstate access today, as GTE has proposed, this would not -- as some parties have suggested -- require the Commission to shoulder the entire burden of universal service support. Further, although GTE has proposed that some reasonable amount of Federal support should be provided to the states, this amount would be a relatively small proportion of the total amount of implicit support generated by state rates today. Thus, if the Commission were to provide such support to the states, the bulk of the responsibility for addressing state funding needs would remain with the states.

Fifth, the current implicit funding mechanism is very inefficient. Certain customers who purchase large quantities of toll, or vertical services, are "taxed" at very high rates – several hundred percent – to pay for universal service, while others contribute nothing.

Sixth, the revenue needed to support universal service is already in the system today.[13] Sufficient support for universal service will not, as some parties claim, place large new burdens on customers, or repress demand for telecommunications services. In fact, on average, the net effect will be zero. Universal service should not involve inventing a new price level, but rather rearranging the existing one. In fact, the new, explicit method of raising the same amount of universal service support will be more efficient, and less distorting, than the current, implicit system, for the same reason that a

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[13] The exception, of course, is the funding for schools, libraries, and health care, which really is a new call on resources.

broadly-based tax with a low rate is more efficient than a narrowly-based tax with a high rate.

Finally, there are some services (access, toll, vertical services) that generate implicit support, and others (chiefly residence local) that receive it. It should be possible to look through either end of the telescope to observe this process. That is, it should be possible to calculate the current amount of support either by comparing the cost of basic local service with the rate for that service, or by calculating the implicit support provided by other service rates. If the costs estimated by the universal service model are consistent with the costs that underlie the other rates in the system, then either approach should yield about the same answer. Parties have been able to avoid this simple truth either by ignoring some portion of the picture presented in Figures 1 and 2, or by inventing a new cost level that is not consistent with the way in which other service rates are regulated today.

B. Support that is currently implicit must be made explicit.

In order to meet the requirements of the 1996 Act, and in order to allow competition to develop in local telecommunications markets, it is imperative that the Commission replace the universal service support that is now implicit in rates with new funding that is explicit and competitively neutral. Because this goal is to be achieved through a combination of state and Federal action, the Federal plan need not replace all intrastate sources of implicit support. However, at a minimum, the plan must be sufficient to replace implicit support that is generated today by interstate access rates, since it is not reasonable to expect that this funding source will be replaced by any state action.

Many parties acknowledge the need to replace implicit support with explicit funding. Sprint, for example, agrees (at 5) with GTE on the "desperate need to eliminate the implicit support generated by interstate access." The Ohio commission says (at 3) that "our interpretation of the intent of the federal universal service fund, is exactly as described in the1996 Act: 'to replace existing implicit subsidies with explicit and predictable subsidies.'"[14] AT&T also appears to agree (at 8) that "the Federal plan should remove high cost support from implicit interstate mechanisms and recover that support from explicit interstate mechanisms." Yet, at the same time, AT&T suggests (at 5) that no funding should be provided to nonrural ILECs for this purpose. AT&T further proposes (at 6) that ILECs should continue to provide implicit support from a variety of sources, such as toll services, yellow pages, and wireless services. Continued reliance on implicit support in the manner suggested by AT&T is not permissible under the 1996 Act; nor can it lead to a competitive market outcome.

47 U.S.C. section 254 [15]establishes the principle that support that is currently implicit should be made explicit. More specifically, section 254 requires that all carriers contribute to universal service on an equitable and nondiscriminatory basis. Clearly, if one carrier (the ILEC) is required to contribute support implicitly through its rates for other services, but other carriers have no such obligation, then the contributions are not

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14 See also BellSouth at 1, SBC at 2.

15 All statutory references in these reply comments are to 47 U.S.C. unless otherwise specified.

equitable and nondiscriminatory. Thus, the specific requirements of section 254 cannot be satisfied unless the current implicit support is made explicit.[16]

Removal of implicit support is also necessary if competition is ever to develop in local markets. It is clear from Figure 1 that, at today's prices, basic local telephone service is not an attractive market for a new firm to enter. Instead, entrants will vie to serve those customers who purchase large amounts of the access, toll or vertical services that provide the high levels of contribution shown on the left side of Figure 1, and will provide local service only to the extent that it allows them to capture such customers. Sprint observes (at 1):

> "there will be no meaningful, facilities-based competition until such time as the revenue stream from end users and subsidy sources is predictable, sufficient, and sustainable. The current system of implicit, inefficient, untargeted subsidies is not only unsustainable, it is unlawful, and will not attract competition to the local market. No quantity of corporate mergers will bring true competition to a market where there is no profitability."

The current level of implicit support cannot provide the correct incentives for firms to enter local markets, and to serve low-volume customers, because implicit support cannot be made portable to another carrier. AT&T (at 10) suggests that there is no need to provide explicit, competitively neutral support until competition, as measured by AT&T's standards, develops in local markets. For the reasons explained by Sprint, the provision of sufficient, explicit support is a necessary condition for the development of

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16 Bell Atlantic argues, incorrectly, (at 13) that the 1996 Act does not require implicit support to be made explicit. At the same time, Bell Atlantic recognizes (at 6) that "Competitive neutrality ... means that no subgroup of carriers – or their customers – is disproportionately burdened by universal service assessments." Yet Bell Atlantic is willing to have ILEC customers for access and toll services disproportionately burdened by contribution levels of several hundred percent in order to provide implicit support for universal service.

competition. Thus, AT&T's proposal, if adopted, would ensure that serving local customers remains an unattractive business proposition.[17] Further, the requirements of section 254 are not conditioned on the achievement of any particular level of competition, or any other trigger; neither AT&T, nor the Commission, may create any such conditions.

Several parties warn that a fund large enough to eliminate implicit support will distort customers' choices and inhibit competition. In fact, the opposite is true; as Figure 1 makes clear, it is the current system of implicit support which is inefficient, unreasonably distorting, and not competitively neutral. This system "taxes" some carriers, and not others; it "taxes" some customers at very high rates, and others not at all. As GTE pointed out in its comments, a uniform percentage surcharge of less than 3% on total retail revenue (state plus interstate) would be sufficient to replace the implicit support in interstate access. Surely a 3% "tax" on all services, all carriers, and all customers, is more efficient and less distorting that the current crazy quilt of implicit support, which "taxes" some customers at rates of several hundred percent.

C. The Commission Cannot Selectively Ignore Current Sources Of Funding.

Some commenters avoid acknowledging the level of support that must be provided by simply ignoring one of the major components of that support. Bell Atlantic, for example, says: "(T)he current amount of interstate high-cost universal service support is $1.7 billion, and the [1996] Act requires only this amount to be made

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[17] Note that if AT&T wishes only to serve high-volume customers, then it does not care whether its conditions are ever met; in the meantime, the continuation of implicit support would mean high prices, and high margins, for those high-volume customers AT&T might wish to target.

explicit."[18] Apparently, according to Bell Atlantic, the 1996 Act requires only that what is now explicit should be made explicit. If the *status quo* were all that Congress intended, why was section 254 included in the 1996 Act at all?

Bell Atlantic argues (at 5) that the current explicit fund must be sufficient, because satisfactory penetration levels for basic local service have already been achieved in most areas of the country.[19] This selectively ignores the fact that the bulk of the support that has made those results possible has come from implicit sources, and not from the current explicit Federal mechanisms.

Ad Hoc (at 10) similarly chooses to ignore the support that comes from interstate access today, claiming that this flow of funds has nothing to do with universal service. A brief glance at Figure 1 suggests otherwise; in many of GTE's study areas, interstate access is the largest single source of funding for universal service. In a similar vein, Bell Atlantic (at 13) argues that all of the costs recovered through interstate access are "legitimate costs that the exchange carriers incur to provide service." GTE agrees that they are legitimate costs, but most of them are incurred to provide local service, and are not caused by the provision of access. Certainly, Bell Atlantic has never before suggested that loop costs -- the recovery of which represents the largest single component of access charges -- are "shared costs." The fact that the recovery of certain costs have been assigned to the interstate jurisdiction does not imply that these are economic costs of access; rather, this allocation through the separations process is simply the mechanism through which the implicit support flow from interstate was

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[18] Bell Atlantic at 12. *See also* Maryland at 7.

[19] *See also* Maryland at 4.

originally implemented under rate of return regulation. By ignoring the fact that this implicit support flow exists, these parties are asking the Commission to leave these flows in place, in violation of the requirements of the 1996 Act.

Some parties, on the other hand, choose to ignore the need to address the implicit support that is generated today by intrastate rates.[20] GTE believes that states such as South Dakota, Wyoming and Vermont have made a reasonable case that some additional support should be provided to states that have unusually high costs and/or limited funding bases. It does not appear reasonable that a customer in a low cost area in Wyoming should have to contribute many times more toward the national goal of affordable, reasonably comparable rates than a customer in a similarly low cost area in Delaware would pay. This does not mean that GTE proposes to supply all of the funding states would need through the Federal mechanism. Rather, the issue is what amount the Federal fund must supply in order for the outcome in a given state to be reasonable.

D. The Commission Cannot Ignore The Existing Revenue Level.

Some parties seek to ignore components of the current implicit support flow by simply assuming a new, and lower, overall level of prices. As Figures 1 and 2 make clear, universal service is, in part, an exercise in rebalancing rates so as to associate the proper level of revenue with the provision of basic local service, through a combination of the "affordable" local service price the subscriber pays and the universal service support. If this sum is set correctly, then, as Sprint points out, new firms will have the correct incentives to enter the local market. At the same time, offsetting

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[20] *See, for example*, Ameritech at Attachment B, page 5.

reductions can be made in the rates for services, such as interstate switched access. that provide implicit support today, thus replacing implicit support with explicit support.

Rebalancing rates along these lines will align rates with costs, improve efficiency, provide a secure basis for universal service, and ensure that carriers face the correct price signals for entry and investment decisions. However, there is nothing about this process that should provide a basis for establishing a new and different average price level, across all of the major service categories in Figure 1, as a result of the implementation of the Commission's universal service plan.

The current revenue level of nonrural ILECs has been established by the Commission and by the various state commissions. The basis for regulation at the Federal level for the last eight years has been the Commission's price cap plan. A majority of states have also adopted some form of incentive regulation, while the remaining states continue to employ rate of return regulation. Each commission, using its chosen mode of regulation, has established a price level which it has found to be reasonable. It is unlikely that one of these commissions would open a rate case, and find that the new revenue level for the ILEC should be half, or one-third, of the current level. Similarly, it is not likely that this Commission would find a price cap productivity factor of 50% or 70% in a given year to be reasonable. Yet parties such as AT&T and MCI are asking the Commission to take an equivalent action.

AT&T provides estimates (in AT&T's Attachment 1) that purport to show that the rates for local service generally cover their costs. Instead, this exercise only serves to demonstrate that the results of the cost models are open to manipulation. If the cost levels assumed by AT&T were to be implemented throughout the price system in Figure

1 in a consistent manner, the result would be a dramatic reduction in the overall price and revenue level of the ILECs.[21] MCI, in a similar fashion, suggests (at 7) that only a small part of the contribution generated by interstate access today is implicit support for universal service. This assertion, like AT&T's, can only be correct if one is willing to assume a completely different price level for the ILECs.

If the Commission wishes to make a dramatic change in the way it determines the interstate price levels of nonrural ILECs, then it should have a separate proceeding for that purpose, assemble a record, and make a specific finding that the rate level should be changed. Such a significant change in the basis of regulation should be made explicitly, and not as an indirect outcome of a universal service proceeding.

What basis does AT&T have for proposing a dramatic change in the basis the Commission uses for establishing the overall interstate rate levels of the nonrural ILECs? AT&T offers nothing more than the cost levels estimated by the HAI model, which it has co-sponsored. Yet, as many parties in this proceeding have noted, the results of the proxy cost models, and particularly of the HAI model, are not reliable. Even when used with the common inputs specified by the Commission staff, which tend to narrow the differences between the HAI and BCPM models, the models produce estimates for cost and support levels which vary widely across different areas. The

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[21] In a recent proceeding in Hawaii, AT&T proposed a set of UNE rates based on the results of the Hatfield model. Using these rates, GTE estimated what its total revenue in Hawaii would be if its entire current output were sold as UNEs. GTE's current revenue in Hawaii is about $270 million. If the same volume of output were sold as UNEs at the Hatfield-derived rate levels, the total revenue would be just over $90 million. In order to accept the Hatfield estimates, one would have to assume that GTE could somehow continue to operate with only one third of its current revenues.

models produce aggregate support estimates, at the nationwide level, which differ by more than 40% for some of the alternative benchmark combinations GTE evaluated in its Proposal. Within those aggregates, the variation is even wider: BCPM, which is generally said to provide higher support in rural, western states, nonetheless would estimate 51% less support than HAI in one such state, Arkansas. Yet in Puerto Rico, BCPM would provide 271% more support than HAI.[22] If one looks at smaller geographic units, such as wire centers, the variations are even more dramatic, so much so that the two models do not even support the same wire centers within a state. Between benchmarks of $31 and $51, BCPM provides about 14% of the total support to business lines; HAI provides only 4% of its support estimate to business lines. No wonder, then that South Dakota complains that "the results don't make sense."

It is precisely for this reason that GTE has sought to define externally measurable objectives for the Federal plan – objectives that do not depend on the vagaries of the cost model chosen. GTE recognizes that geographically disaggregated cost estimates are necessary in order to target support to small geographic areas. However, in selecting the model, the inputs, the benchmarks, and the percentages, the Commission should always hold up the result to an external standard, since there is no reason to expect that the results of any particular cost estimate will be reasonable, or consistent with the prices in the rest of the system depicted in Figure 1.

The objectives proposed by GTE are readily quantified, and are not subject to the same errors as are the cost model estimates. The only numbers necessary to calculate the first objective, replacing the implicit support in interstate access, are the access

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22 These results are for a plan with benchmarks at $20, $25, and $40.

revenues, which are based on TRP reports, and the assumed cost-based rate.[23] The amount of new funding to be sent to the states is a policy choice to be made by the Commission, with input from the states. Finally, the amount of support provided to nonrural ILECs by the current HCF is a readily determined number.

In any economic problem, there is generally some sort of adding-up constraint which the optimal solution must satisfy. In a consumer welfare problem, it is the budget constraint. In regulatory economics, it is the revenue sufficiency constraint. It is relatively easy to produce any desired outcome if one is willing to violate this constraint. In this case, AT&T and MCI are willing to assume a completely new cost level, with no factual basis for doing so. If sufficiently low costs are assumed, no service will ever be shown to receive support.

The Commission should only accept this arbitrary cost level is it willing to apply the same cost level consistently to all of the ILEC services it regulates. This would be a very new approach to regulation for the Commission. In the past, it has sought to establish a productivity offset for its price cap plan which reasonably represented the change in the companies' unit costs over time. Certainly this logic cannot apply to the cost level proposed by AT&T and MCI, which differs from the current price cap level by far more than year-over-year productivity gains would account for.

In some times and places in the history of regulation in the United States, some commissions relied on various forms of fair value regulation. In some cases, the fair

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[23] GTE has used a rate of $.08 for this purpose. While others may arrive at a slightly higher or lower estimate, the implicit support calculation will not be very sensitive to this assumption. Further, if the estimate of the cost-based rate were lower, the resulting support estimate would be higher.

value would be determined by means of a replacement cost study. For various reasons, this form of regulation was generally abandoned sixty years ago. Yet this is the form of regulation to which AT&T and MCI are proposing the Commission should return.[24] Note that, under this approach, the regulated firm could suffer a capital loss if the replacement cost of its assets were to fall, and a capital gain if the replacement cost were to rise. The Commission has before it some forward-looking cost estimates which are much higher than the current revenue level, as determined by the Commission's current price cap mode of regulation, and some which are much lower.

GTE submits that before the Commission makes such a sweeping change in its mode of regulation, it should consider the implications of such a change very carefully. It has no reasonable basis, on the evidence of the cost models, to impose a new level of prices and revenues on the nonrural ILECs. It would appear heroic to assume that the ILECs could operate effectively on a fraction of their current revenue, yet the actions proposed by AT&T and MCI would only make sense if that were a valid assumption. Rather than begin with the assumption that the revenue streams in Figure 1 are wildly incorrect in aggregate, the Commission should focus its efforts on rebalancing the price system in Figure 1 to align the relative rates for the major service categories with the best estimates of relative costs, both by service and by geographic area.[25] At the same time, it is reasonable to assume that the cost estimates used for this purpose are consistent with the overall revenue level produced by the current form of regulation.

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[24] Except that fair value looks at actually existing plant while AT&T/MCI looks at entirely hypothetical plant, thus adding another level of approximation.

[25] Of course, the Commission has control of only a portion of this process: the Federal plan, and interstate access rates.

The current revenue level would then serve as an adding-up constraint for the rates in Figure 1, so that the support estimated by comparing the cost of local service with the benchmark should produce a support amount that is consistent with the implicit support within the current rates for access, toll, and vertical services.

II. GTE'S PROPOSAL WILL NOT "SHELTER" ANY OF THE ILEC'S REVENUES.

MCI suggests (at 7) that "once dollars have been moved from implicit funds to explicit funds, they will be insulated from market forces." [26] In fact, this is not the case. In general, the Commission has not given adequate consideration to the manner in which its Federal support would be adjusted over time. For the implicit support that is generated by interstate access today, there are two potential sources of revenue erosion: the constraint imposed by the Commission's price cap plan, and the loss of access minutes to competition. Making this support explicit, as GTE proposes, and as the Act requires, will not eliminate either source of pressure on the ILECs' revenues.

Once the support implicit in current access has been replaced by an explicit per-line support amount, if the Commission wishes to capture the effects of productivity gains from that time forward, it may consider the use of a productivity offset mechanism for that portion of the per-line support amount. This would not be the same as the offset currently used for access, since the demand units would now be different, and hence the growth in those units over time.

Making the support amount explicit will not shelter it from competitive erosion, because the support will be portable. The explicit support will correctly align the

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[26] In a similar vein, Texas (at 3) expresses concern that the current implicit support could become "institutionalized."

revenue associated with the purchase of local service with the costs caused by that transaction. For the same reason that this will provide the correct incentives for a new firm to enter and compete for local customers, it will also place the correct amount of the ILEC's revenue at risk when the ILEC loses a local service customer to competition. What this arrangement will not do is to place at risk the revenue that supports low-volume local service customers when an ILEC loses high-volume access minutes to a competitor. The current implicit support system incorrectly associates costs caused by the provision of local service with the purchase of access by high-volume customers, thus creating artificial incentives for entrants, and artificial market risks for incumbents.

GTE has already proposed a more effective method for adjusting the support amount over time than any price cap productivity offset, or any recalculation of the cost estimates. Subjecting the support amount to the market discipline of competitive bidding is the best way to correct any possible errors in the initial support amount , and periodic rebidding would also provide the most accurate means of adjusting the support amount over time to reflect changes in technology, input prices, or the definition of universal service.

III. GTE'S PROPOSAL PROVIDES A REASONABLE MECHANISM FOR RECONCILING THE CONCERNS OF THE STATES.

Several commenters offer examples in which states with different distributions of cost are treated inconsistently. Ad Hoc, for example, compares (at Table 2) two hypothetical states under its proposal and under the US WEST proposal. Ad Hoc finds that the US West plan provides insufficient support for State A, which has a concentration of lines at $45, just below the $50 "super-benchmark." South Dakota (at

4) uses a similar analysis to show that the Ad Hoc plan favors states with moderately high statewide costs, relative to those with extremely high cost loops.

In its comments, GTE described the Ad Hoc plan as a mechanism for shifting the mean of the distribution of cost in each state. Unfortunately, the Ad Hoc plan does not consider any of the other characteristics of the distribution. The sliding scale approach proposed by GTE could be described as a more precise mechanism for shifting the distribution of cost. Because it is more precise, it provides the Commission with the tools to deal with the situations raised by Ad Hoc and by South Dakota. In effect, the sliding scale is a transform which slices the distribution of costs in each state into sections (determined by the benchmarks) and the shifts them laterally (in amounts determined by the percentages) to collapse the distribution. Because the sliding scale offers the Commission additional policy variables to deal with the complex distributions of cost s in the states, it will allow the Commission to devise a plan which more closely achieves the policy goals for each state.

Texas (at 6) agrees with "GTE's proposed concept of sliding scales of benchmarks and percentages, and their recommendation that the choice of benchmarks and percentages should be made only after the cost model platform and input decisions are made."

Dated: May 29, 1998

Respectfully submitted,

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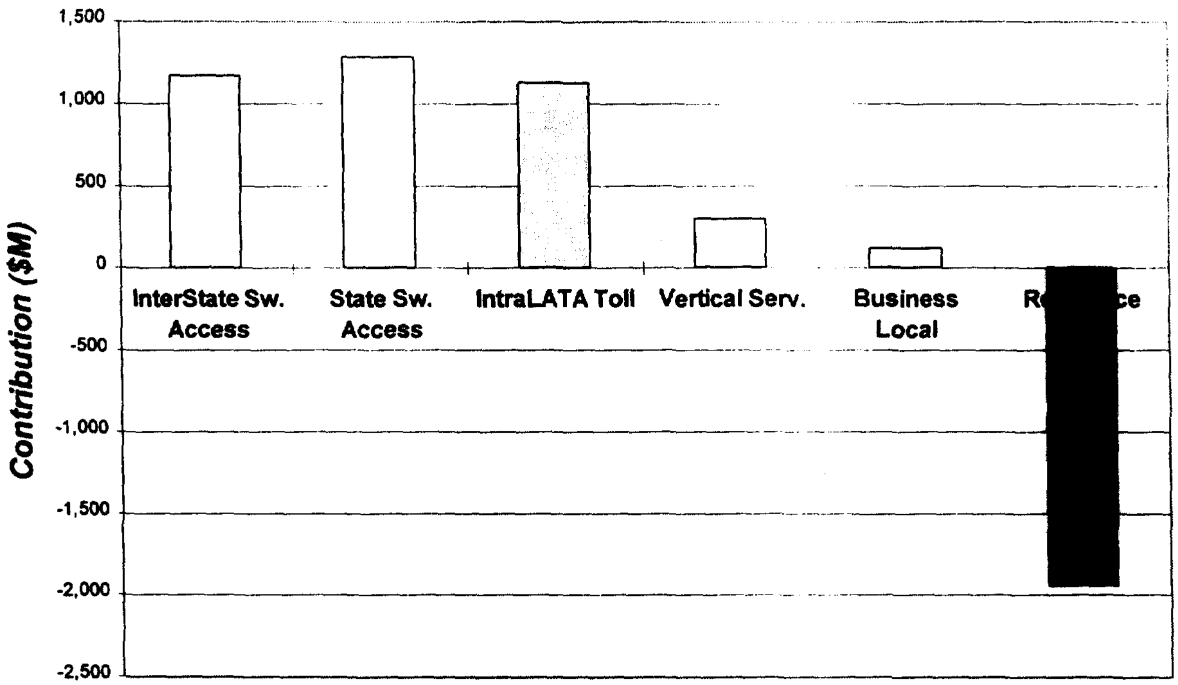
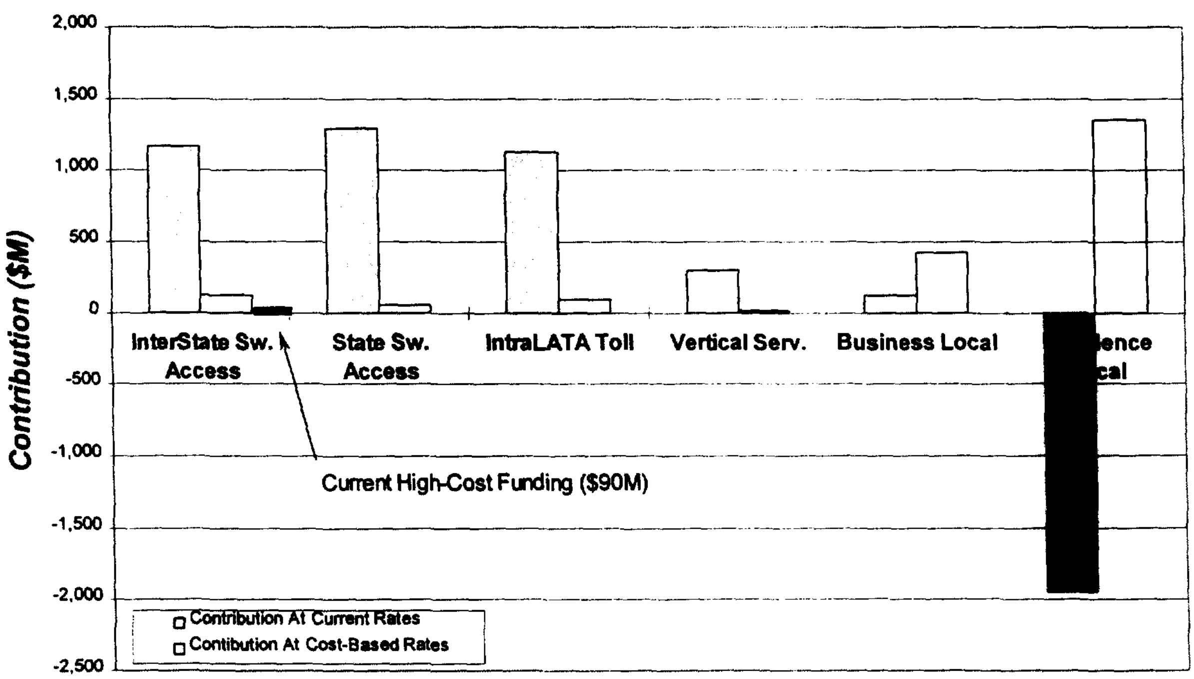
GTE EXHIBIT 1

Figure 1. GTE Contribution ($M) By Service At Current Rates



* Interstate contribution excludes EUCL charges

Figure 2. GTE Contribution ($M) By Service At Cost-Based Rates



* Interstate contribution excludes EUCL charges