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DATE: June 3, 1998

REPLY TO

ATTN OF: Jane Whang

SUBJECT: Ex Parte Submissions for the Record

TO: Magalie Roman Salas

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JUN - 4 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Please find enclosed documents that were submitted to the Commission in preparation for the en banc on June 8, 1998, in CC Docket Nos. 96-45 / 97-160, and DA 98-715. These documents should be placed on the public record. Thank you.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Dennis Weller
Biographical Information

Dennis Weller is Chief Economist at GTE. Mr. Weller is responsible for GTE's policy positions on such issues as the transition to competition, universal service, and access reform. Prior to joining GTE, Mr. Weller served as pricing strategist for AT&T. Mr. Weller did his graduate work in economics at Stanford.

En Banc Hearing
June 8, 1998
Statement of Glenn Brown

Good morning Mr. Chairman and Joint Board Members. My name is Glenn Brown, and I am Executive Director - Public Policy for U S WEST. Among my areas of responsibility are the related subjects of Universal Service and Access Reform.

On behalf of U S WEST and the many high-cost rural customers we serve, I would like to thank the FCC for deciding to reconsider the earlier 25/75 split of funding between the interstate and state jurisdictions. I am here today to describe the Interstate High Cost Affordability Plan (IHCAP) which has been presented in this proceeding by U S WEST. This plan was developed in an effort to find a workable middle-ground solution to an urgent and critical problem - preserving the availability of affordable basic service and access to advanced services in rural high-cost areas of the "non-rural" LECs.

As many commenters have stated, a stronger federal role in supporting universal service will be necessary in the more rural regions of the nation including many of the Western, Southern, New England and Appalachian states. For example, in U S WEST's 14 state service territory, we serve over half a million customers who cost in excess of \$50/month, and of that total, 200,000 cost over \$100/month. In many of these states there are no large urban centers to offset these costs.

It is also vitally important that the Commission meet its January, 1999 target for implementing new explicit funding for non-rural LECs. Currently, U S WEST faces competition for local customers, particularly in business markets. In August of 1996 the Commission took action to open local markets. In July of 1997, and again this July, the Commission will direct significant reductions in access charges. As these sources of implicit support are removed, it is absolutely essential that new explicit support be provided, particularly when it is required to serve as a "safety net" for the highest-cost of our rural customers.

In developing the IHCAP plan, we had four objectives:

1. It must be simple and understandable.
2. It must leave the states with the primary role for rate rebalancing and the assuring affordable service to all of their customers.
3. It must appropriately address the needs of states that face a disproportionate problem because of large numbers of high-cost rural customers and relatively few low-cost urban customers - and it must do so with minimum additions to the federal fund.
4. It must be capable of implementation by January 1, 1999.

The workings of the IHCAP plan are shown on Chart 1. A proxy model is run to determine the forward-looking cost of serving customers by small areas of geography. It is important that these areas be as small as possible and practical so that support may be efficiently targeted to the customers who need it the most. Areas where the cost is less than \$30/month would receive no explicit federal support. Where costs are between \$30/month and \$50/per month, explicit funding responsibilities would be split between the federal and state jurisdictions consistent with the 25/75 relationship established in the prior FCC Order. Costs over \$50/month would be funded 100% from the federal fund.

Chart 2 illustrates the impact of the IHCAP plan on five "randomly" selected states (SD, MO, GA, TX, FL). The solid bar shows the required surcharge on intrastate revenues to meet the high-cost funding obligations under the 25/75 plan. The striped bar shows the impact of the IHCAP plan.

We believe that IHCAP offers a simple, effective and fair method for the FCC to assure that the mandates of the 1996 Act for affordable service in rural high-cost areas are fulfilled. I must point out in closing, however, that, as demonstrated by BellSouth and GTE, there will still be considerable implicit support remaining in interstate access following the implementation of IHCAP. The Commission must continue to address and carefully manage this implicit support as local competition evolves.

Thank you, and I look forward to your questions.

Chart 1

Operation of IHCAP Plan

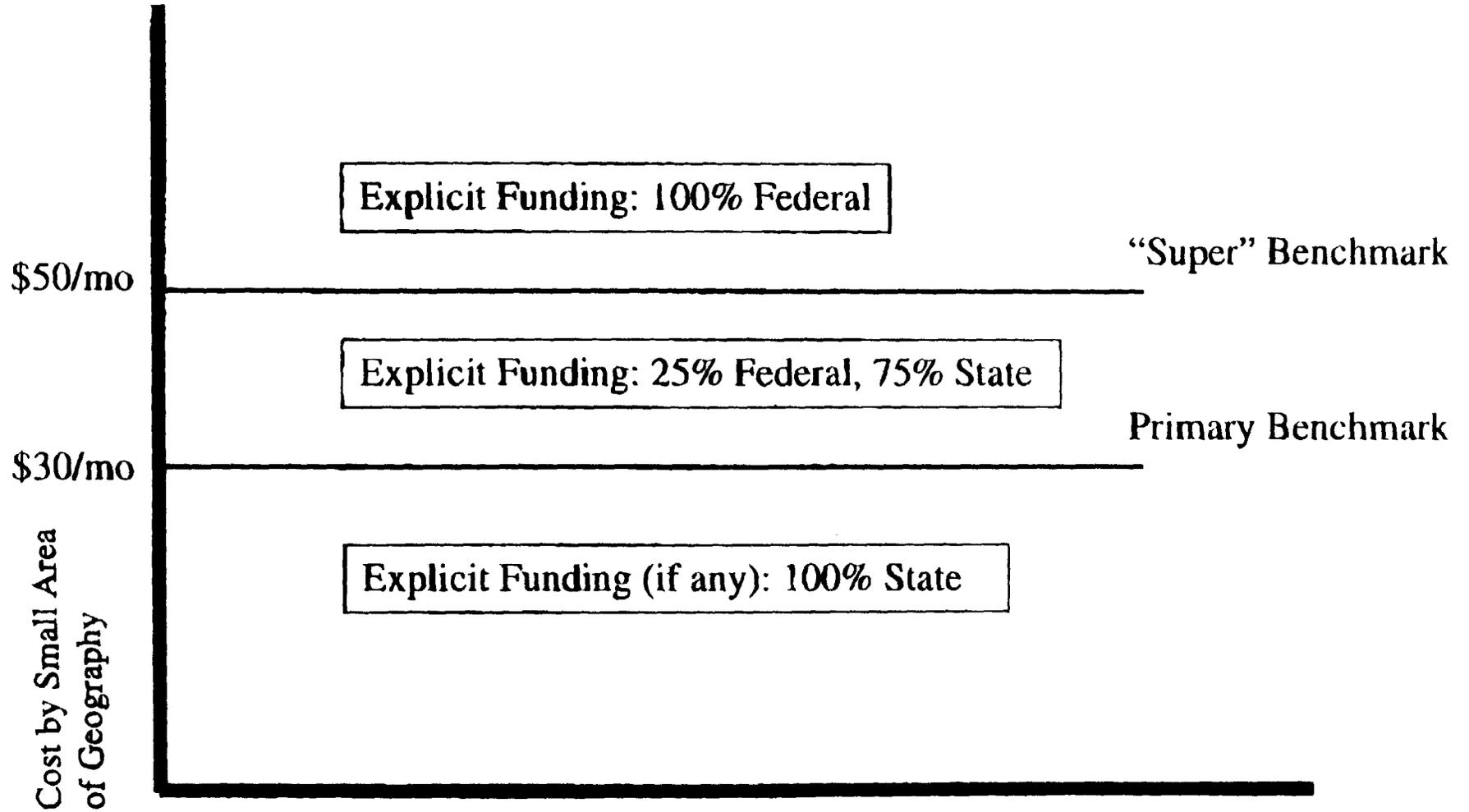
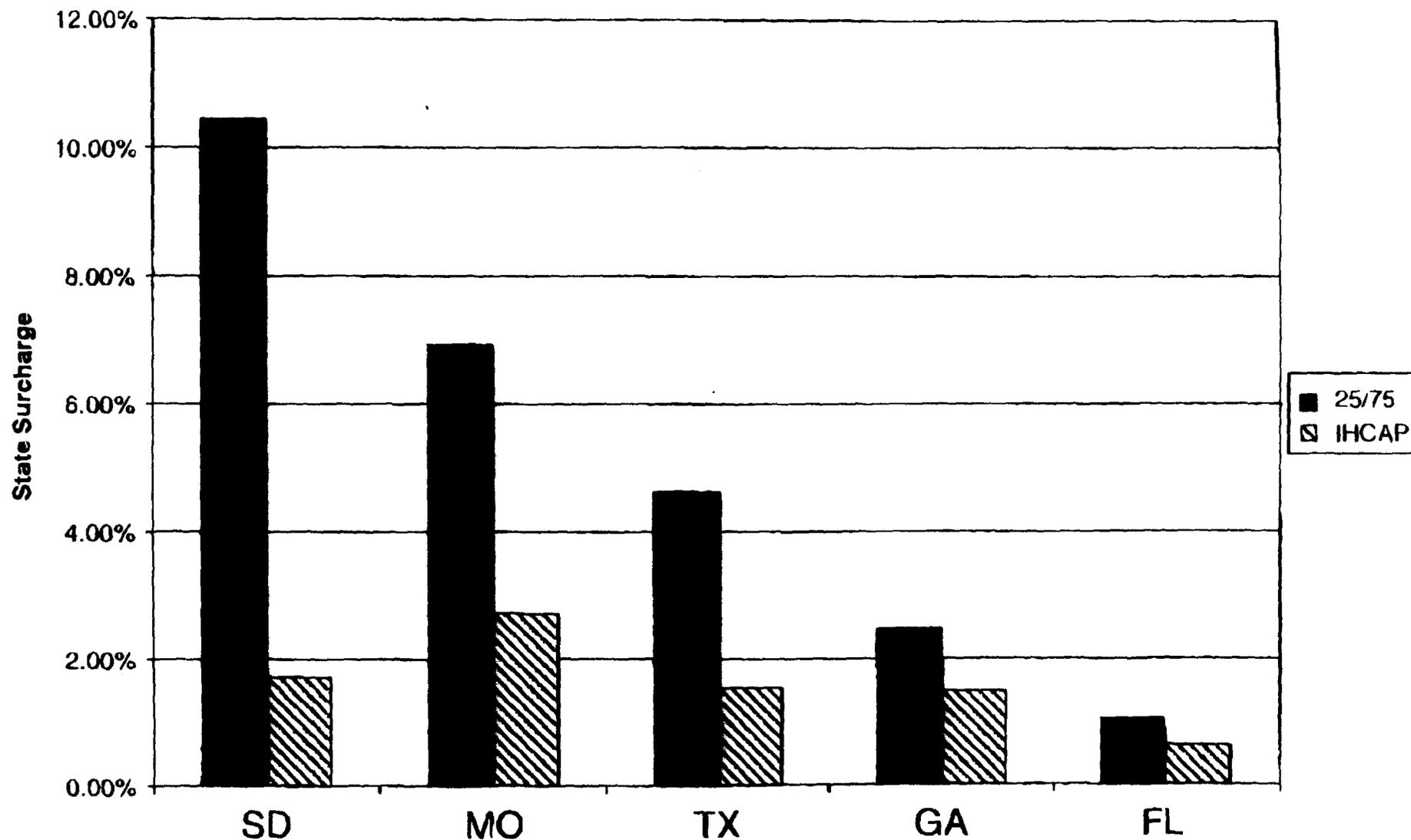


Chart 2
Impact of IHCAP



Note: This chart assumes a fund size of \$4.5B derived from using FCC "common inputs" in the BCPMJ model. The actual fund size will be determined after completion of further proceedings to finalize model inputs.

**SUMMARY OF BELLSOUTH'S UNIVERSAL SERVICE PROPOSAL
FCC EN BANC MEETING**

**Ernest L. Bush, Assistant Vice President, Federal Regulatory
June 8, 1998**

In response to the Public Notice released April 15, 1998 by the Common Carrier Bureau, BellSouth submitted its proposal for a methodology for sizing the federal universal service fund on April 27, 1998. Since the FCC's adoption of its "25/75 interstate/intrastate" plan in its May 7, 1997 Order, numerous commenting parties, including states, Congress, and industry participants, have expressed concern that the FCC's methodology will result in a federal support mechanism that is insufficient to cover all of the existing support, implicit and explicit, received today. BellSouth believes that its proposal, set forth below, resolves many of the concerns raised by the FCC's plan. BellSouth's methodology would establish the minimum size federal fund necessary to assure that current implicit and explicit levels of federal support for universal service are maintained. At the same time, nothing in BellSouth's methodology would preclude the Commission from identifying circumstances under which the Commission would provide states with additional federal support.

Similar to the FCC's proposed four-step methodology, BellSouth's methodology begins with determining the cost of universal service for areas no larger than wire centers based upon a reasonable economic cost model. In the second step, the current state-specific implicit support that is included in interstate access charges is determined. The loop-related access charges whose cost recovery has been assigned to the interexchange carriers, rather than the end users—the carrier common line charges and the presubscribed interexchange carrier charges—contain the implicit support for universal service. In step three, these amounts would be deducted from the total universal service costs derived from the model with the residual being the universal service support responsibility of the states.

The size of the federal high cost fund would be the implicit support identified in step two and the amounts associated with the existing explicit mechanisms which include the interstate high cost loop fund, dial equipment weighting, Long-Term Support, and Lifeline and Link-Up programs. BellSouth's proposal is visually depicted in the attached Exhibit 1. Support would be calculated on a per line basis in a given wire center and would be portable to any eligible carrier.

BellSouth's methodology provides an efficient means to achieve the Commission's objective that the states receive from the federal fund at least the same level of support that they are receiving from current implicit and explicit mechanisms. An integral part of building a sufficient universal service support program is the states' responsibility for creating explicit and sustainable state funds to replace any implicit support that remains after the federal fund is implemented. Each state would thus need to compare the state's view of the economic cost of providing the supported services to the maximum price that can be charged for the supported services, and provide explicit funding or rate rebalancing to deal with any implicit support not taken care of by the federal fund.

The federal USF should be supported by all providers based on an assessment against both intrastate and interstate revenues received from end users. Local exchange carriers could recover their contributions to the USF through a per line charge on the interexchange carrier similar to the PICC. The federal USF would be implemented, as planned, on January 1, 1999. BellSouth's proposal would apply to non-rural companies; rural carriers would continue to receive the amount of support currently provided.

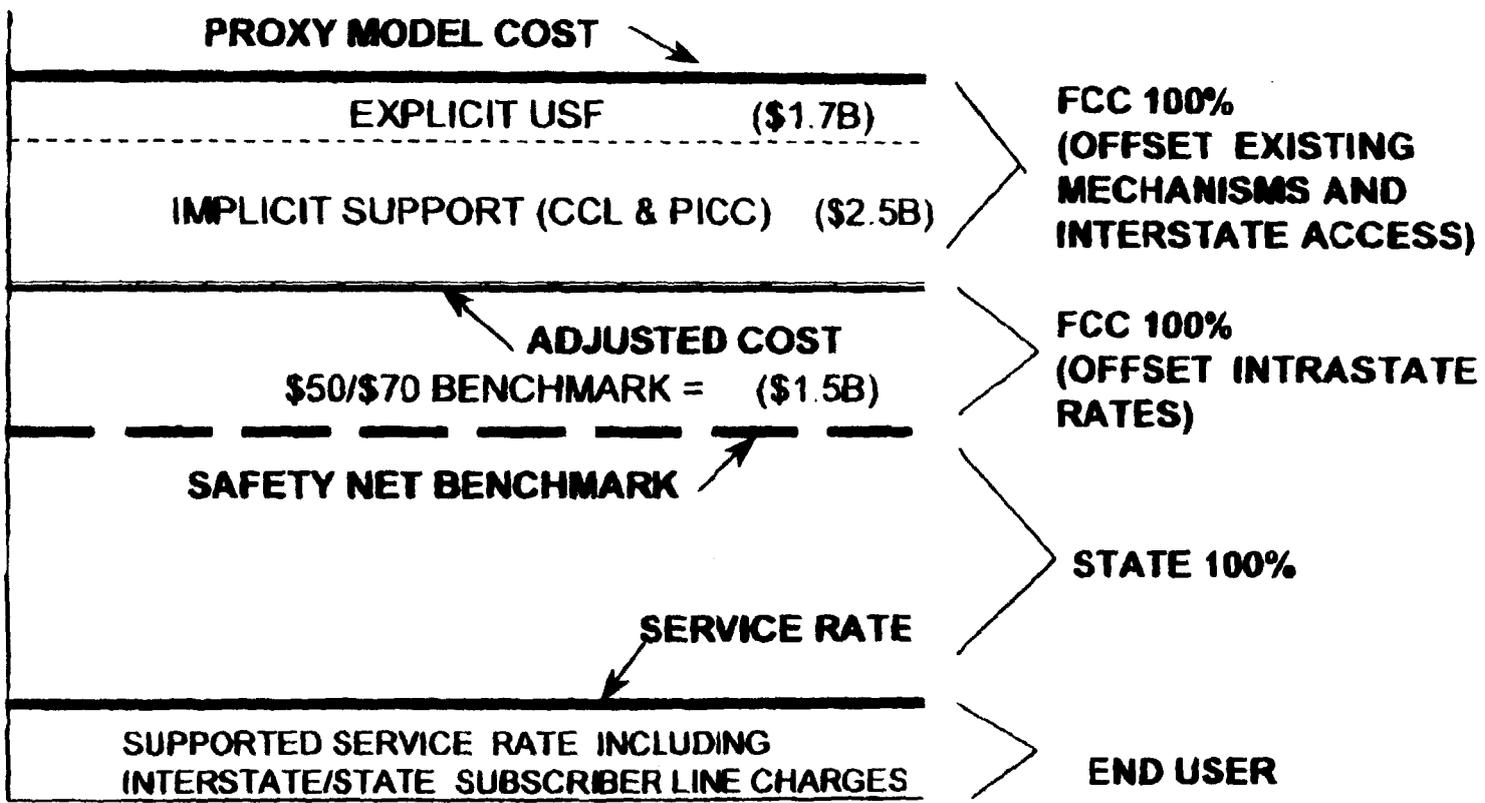
As previously discussed, BellSouth believes that this proposal is the minimum necessary to assure that the federal fund continues to provide an amount equal to the current implicit and explicit support provided today in the interstate arena. In an effort to address additional concerns of a number of parties, BellSouth proposed a compromise solution in its May 15 Comments in this proceeding. In addition to the minimum USF outlined above, BellSouth recognizes the valid concern of some states that they will be unable to support a state USF that places the majority of the funding burden on the intrastate jurisdiction. Therefore, BellSouth incorporated into its proposal a "safety net" benchmark that would shift the burden of support in those states with high costs to the interstate USF above the "safety net" benchmark.

This benchmark would be compared to an adjusted per line cost that accounts for the support already provided by the federal USF. Any amount above the safety net benchmark would be fully supported by the federal USF. This approach is similar to that proposed by US West. In the attached Exhibit 1, BellSouth's calculations are based upon a \$50 benchmark for residential lines and a \$70 benchmark for single line business lines. As shown in the Exhibit 1, the additional funding requirement would be approximately \$1.5 billion.

Thus, BellSouth's methodology provides for adequate federal universal service support. The Commission has already acknowledged that the new, explicit federal USF should assure each state the same level of support that the state receives from existing interstate implicit and explicit mechanisms. At the same time, the state commissions have made a compelling case that the federal fund should provide additional support to the states to assist them in reducing intrastate implicit support. BellSouth's compromise solution would meet all of these objectives.

EXHIBIT 1

BELLSOUTH COMPROMISE SOLUTION FOR FEDERAL USE



FEDERAL FUND WOULD APPROXIMATE \$5.7B

James (Jim) W. Sichter

Vice President, Regulatory Policy, Sprint Local Telecom Division. B.A., University of Kentucky, M.S. (economics), Wright State University; Masters, Public Administration, University of Missouri-Kansas City. Responsibilities include both state and federal regulatory policy for Sprint Local Telecom Division. Previous experience in policy analysis, access planning, cost analysis, revenue planning and corporate strategic planning. Member of the faculty, National Association of Regulatory Utility Commissioners (NARUC) Advanced and Annual Regulatory Studies Programs.

COMMISSIONER-CHAIRMAN JAMES M. IRVIN

James M. Irvin was sworn into the Office of Commissioner of the Arizona Corporation Commission on January 6, 1997. On November 6, 1997, he was voted Commission Chairman. During his first year at the Arizona Commission, Chairman Irvin established a Universal Telephone Service Task Force with one of its primary functions being to investigate ways of bringing service to unserved and underserved areas of Arizona. Prior to beginning his service at the Commission, Chairman Irvin served in the private sector as Chief Executive Officer of C.S.G. Security Services, Inc. from 1983 to 1997 and as Vice-President of a Northern California Trucking Company from 1979 to 1983. Chairman Irvin has been named twice to the Who's Who of Business Executives; 1992-1993, and 1996-1997. He was also a member of the American Management Association, the President's Association Division. Chairman Irvin is also actively involved in the Phoenix community working with local schools, serving as a volunteer Deputy Sheriff, serving on the Board of Directors for Silent Witness, and participating as a member of Rotary International. He is a graduate of the University of Southern California with a bachelor of science degree in education. He also has a masters degree in business administration from Loyola Marymount University. He is married to Carol Fehring Irvin and has three children, Lauren, Ashley and Daniel.

June 2, 1998

**EXECUTIVE SUMMARY OF THE ARIZONA CORPORATION COMMISSION
PROPOSAL FOR DISTRIBUTION OF FEDERAL USF FUNDS TO ESTABLISH
SERVICE TO LOW-INCOME CUSTOMERS IN UNSERVED AREAS**

The Arizona Corporation Commission's ("Arizona Commission") Proposal is unlike the other Proposals before the FCC in that it covers a very discrete issue which undermines universal service in several regions of the country including western states such as Arizona and upon which the federal funding mechanism has thus far been silent. This problem is the inability of low-income customers located in unserved and underserved areas to obtain telephone service because they cannot afford to pay the line extension or construction charges necessary to extend facilities to their homes.

The Arizona Commission's Proposal is to set aside a fixed proportion of federal funds to begin to address the problem of unserved and underserved areas and the inability of low-income customers to obtain telephone service because they cannot afford to pay the required line extension or construction charges. The distribution of these funds would be accordance with fixed federal and state guidelines to be established by the Joint Board and FCC.

High Cost Fund ("HCF") support has traditionally and still is, only directed towards keeping monthly rates low for customers who already have telephone service. There is no vehicle or mechanism for assistance to help the "unserved" and "underserved" low-income customer to obtain telephone service. Other existing measures are also inadequate to effectively address this issue:

1. Section 214(e)(3) of the Telecommunications Act of 1996 ("Federal Act") relating specifically to unserved areas does not apply here. Specifically, the carrier is willing to serve the customer but due to the costs involved, the customer cannot afford to pay the line extension charges required under state tariff.
2. The FCC's Lifeline Program subsidizes the monthly rates of low-income customers. Unfortunately, because some low-income customers in Arizona are unable to pay to have facilities connected to them, they are unable to take advantage of this important program and the lower monthly rates.
3. The FCC's Link Up Program is limited to providing a reduction in the carrier's customary charge for commencing telecommunications service for a single telecommunications connection at a customer's place of residence. No assistance is provided to offset line extension or construction charges, which act to prevent the establishment of service in many cases.

4. Measures contained in existing state line extension or construction charge tariffs which pass through a reduced, pro-rated cost to the customer have not solved the problem since customers cannot afford to pay even the pro-rated cost.
5. While the Rural Utilities Service ("RUS") provides low interest loans to companies for the purpose of bringing facilities into remote areas, these loans are not available in all cases and some companies have chosen not to utilize this option.
6. Cellular or wireless technologies are not a viable option at this time since the networks do not yet exist in remote areas or in some instances wireless cannot be provided due to geographical constraints.

The Arizona Commission is recommending in its Proposal that the Joint Board and FCC take the following steps:

1. Define and recognize the problem at the federal level for purposes of the federal funding mechanism.
2. Determine the extent of the problem on a nationwide basis.
3. Focus upon low-income customers who meet the federal lifeline default eligibility criteria.
4. Allocate a fixed amount of federal USF funds to be used to partially offset line extension charges and/or line construction charges associated with establishing service to low-income customers.
5. Establishment of federal and state guidelines setting criteria and standards for distribution.
6. States to examine cases on an individual basis.

Statement of the Ad Hoc Working Group

Mr. Chairman, members of the Commission, members of the Joint Board. I am Peter Bluhm, Policy Director for the Vermont Public Service Board. I appreciate being invited here to discuss with you how to satisfy the Telecommunications Act's requirement that rates for customers in rural areas be affordable and reasonably comparable to rates in urban areas. With me today is Joel Shifman of the Maine Public Utilities Commission, the other lead staff author of the Ad Hoc Plan who will be available to answer questions this afternoon.

I will focus on the two key tests of a successful universal service plan: The universal service plan must be sufficient and it must be efficient.

Sufficiency means that the system of support for high cost areas must allow affordable local telephone rates to be available to subscribers everywhere in the country. Rates do not have to be equal between downtown Los Angeles or Houston and rural Vermont, but they must be reasonably comparable. A sufficient universal service plan is essential for the benefits of competition to be realized by all Americans.

Efficiency is also necessary. Financial resources are limited, and regulators cannot federalize all high cost support objectives including all implicit subsidies existing in state rate structures. It is neither economically desirable nor politically possible to raise \$10 or \$15 billion dollars through a surcharge on interstate services. Universal service at the federal level must make do with a smaller budget, and should be limited to supporting the areas that are most closely connected with the comparability objectives of the Telecommunications Act.

The current system fails first because it is insufficient. It does not even pretend to

support all rural and high cost areas equally, in that it discriminates against rural areas served by large companies. Vermont is by one definition the most rural state in the country, yet its major carrier serve 85% of our customers. Customers who live in the area served by this carrier receive substantially less support for high-cost loops and switching than do customers in other, equally rural areas. Furthermore, the current program totally ignores the high interoffice costs in many rural states. Thus the rate comparability requirements of the Act cannot be achieved unless the current system is substantially modified.

The current system also fails to comply with the Act because, by basing support in part on the size of the incumbent, the current system is incompatible with competition. Competition requires that subsidies be explicit and portable. A support system that links the amount of support available in an area to the identity of the incumbent clearly would destroy any effort to achieve meaningful portability.

The Commission's order of May 1997 establishing a 25/75 federal/state split likewise fails the test of sufficiency. The rule itself actually moves away from sufficiency by in effect repealing current high cost support.

Even if current support levels were maintained, however, the 25-75 plan is insufficient. Indeed, even if the Commission were to apply the full 25 percent support entirely to the state jurisdiction, the results still would not be sufficient to ensure that customers everywhere in the country have reasonably comparable rates.

Simply put, some states have low-cost urban areas from which they can draw support. Other states, however, have only small urban areas, and very limited ability to finance high

costs. For these states, average costs are so high that it is impossible for them to obtain comparable rates, no matter what they do. In states with many high cost customers and few low-cost customers, the surcharges needed to achieve comparable rates would be so large that, when added to existing rates, the total cannot be comparable with low-average-cost states. These high average cost states would face the Hobson's choice of either imposing very high end user surcharges, thus destroying comparability, or imposing very high interexchange carrier access charges, thus impeding competition and economic development.

A universal service support system can be both sufficient and efficient. The Commission should set up an overall framework for support, but that framework can anticipate that the states will fill in some of the pieces. While the Act does not require any state to enact a high cost support program, the Commission can appropriately make some assumptions about state effort. The only alternative is raising \$8 to \$10 billion dollars, something that is politically unacceptable to the Congress, and frankly, something that is not necessary.

A sufficient fund of more modest size, however, requires regulators to be selective about how federal support will be distributed. If support is given to areas that can raise that support another way, such as from low-cost areas inside their own states, there will not be enough funds left over to finance affordable and comparable rates in other states.

The Ad Hoc Plan limits federal support to states to the amount by which that state's cost exceeds a national average. The plan assumes that if a state has average costs that are at or below the national average, the state can support its high cost areas from within its own

borders by surcharging its own low-cost areas to support its own high-cost areas. This decision is appropriate since much of the anticipated support is implicit today in rates that are set by state commissions. There is no immediate need to replace these instate transfers with federal support.

The Ad Hoc mechanism also uses both forward-looking and embedded costs in calculating support. This feature has been controversial, but it serves important purposes beyond constraining the size of the interstate fund. First, there is much uncertainty about the accuracy of forward-looking models. I recommend that the Commission find a way to limit their applicability until there is more confidence that they predict costs accurately. The use of embedded costs also creates incentives for network upgrades in areas that have suffered from under-investment, and encourages competition by not overcompensating incumbents in areas where they have old and highly depreciated plant.

The AD Hoc Plan provides a sound framework to meet the requirements of the Telecommunications Act. Working together, the Commission and the states can ensure that all of their resources are used, fairly and evenly, to guarantee to customers everywhere in the country rates that are affordable and reasonably comparable.

I appreciate the opportunity to speak to you today. Mr. Shifman and I will be pleased to answer your questions at the appropriate time.

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

Variable Benchmark Option

Under the variable benchmark option, the federal high cost program would supply 100% funding support to areas served by non-rural LECs whose costs to serve an area exceed a benchmark that varies from state to state. The cost would be determined by using a forward-looking economic cost proxy model. Conceptually, the benchmark would vary based on a measure that reflects a state's ability to internally support and fund universal service requirements. States that have a relatively low ability to internally support universal service would have a relatively low benchmark, while states that have a relatively high ability to internally support universal service would have a relatively high benchmark.

The variable benchmark would be based on two principal components: (1) the state's forward-looking economic cost as determined by the cost proxy model; and (2) the state's ability to internally fund its universal service requirements. This option contemplates that the first component would require the use of a forward-looking cost model for determining costs on a relatively small geographic basis. Creation of a state high cost fund is neither required nor precluded under this option. Non-rural Eligible Telecommunications Carriers would be reimbursed directly by the federal high cost fund administrator for customers served within the high cost area. This approach would ensure that all of the very highest cost areas throughout the nation are supported through the federal program.

Incorporating the second component - a state's ability to fund its universal service requirements internally - into a variable benchmark would be a two-step process. First, a factor must be selected that serves to differentiate among states that will get more versus less support. Second, that factor must be

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

used to vary the benchmark over the range of benchmarks to be considered. As an example, "State A" might have a large revenue base that would require less support, and its benchmark for the federal fund might be \$75, while "State B" might require more support, and would have a federal funding benchmark of \$40. The factor used to differentiate among the states must be based on independent, publicly available data. Such a factor might recognize the ratio of intrastate revenues to total revenues; the ratio of intrastate traffic volumes to total traffic volumes; the degree of variability of cost throughout the state; the ratio of lines located in urban and rural areas of the state; the state's ability to keep local rates within a reasonable range, a measure of local competition in the state, or some combination of these or other measures. Other parties may provide different logical and relevant choices for the factor to be used in this option, and the FCC should consider all reasonable alternatives.

Because the FCC has not yet chosen the most appropriate forward-looking cost model or its inputs, this option is presented on a conceptual basis at this time. It is meaningless to calculate a total fund size or a state-by-state distribution of support resulting from use of this option without resolving the cost model platform issues, choice of inputs, geographical support area and the factor(s) for varying the benchmark. Because of the wide range of options, however, it is clear that this option could be designed to provide a wide range of support amounts while reasonably controlling the size of the federal fund.

Variable Support Option

Under this option, the support amount for each non-rural Eligible Telecommunications Carrier would be computed as the

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

difference between the cost of serving an area and a nation-wide benchmark; however, the federal percentage of high cost funding would vary from state to state. In contrast to the plan adopted in the FCC's May 8, 1997 order in which the payment of federal support remains a constant 25% in all states, under this option the percentage of federal support provided will vary depending on the state's ability to internally support universal service. States that have a relatively low ability to internally support and fund universal service will have a relatively high percentage of support provided through the federal program, while states that have a greater ability to internally support universal service will receive a lower percentage of federal support.

Like the variable benchmark option, this option would reflect the state's ability to fund its universal service requirements internally. This option contemplates the use of a forward-looking cost model for determining the amount of support on a relatively small geographic basis. However, contrasted with the variable benchmark option, the variable support option would utilize a single benchmark for all states. Variability would occur in the percentage of the federal contribution to the support of the high cost areas for each state. This variability would be based on a factor that would yield a range of funding percentages. As with the variable benchmark option, any factor used for this purpose should be based on independent, publicly available data. The factor for varying the federal support percentage might include the ratio of intrastate revenues to total revenues; the ratio of intrastate traffic volumes to total traffic volumes; the degree of variability of cost throughout the state; the ratio of lines located in urban and rural areas of the state; the state's ability to keep local rates within a reasonable range, a measure of local competition in the state, or some combination of these or other

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

measures. Other parties may provide different logical and relevant choices for the factor to be used in this option, and the FCC should consider all reasonable alternatives.

Because the FCC has not yet chosen the most appropriate forward-looking cost model or its inputs, this option is presented on a conceptual basis at this time. It is meaningless to calculate a total fund size or a state-by-state distribution of support resulting from use of this option without resolving many issues, including the choice of the cost model platform, choice of inputs, geographical support area and the factor(s) to be used for varying the federal support amount. Because of the wide range of options, however, it is clear that this option could be designed to provide a wide range of support amounts while reasonably controlling the size of the federal fund.

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**FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

**EN BANC HEARING ON
PROPOSALS TO REVISE THE METHODOLOGY FOR
DETERMINING UNIVERSAL SERVICE SUPPORT**

CC Docket Nos. 96-45 and 97-160

STATEMENT OF SUSAN M. BALDWIN

**Senior Vice President
Economics and Technology, Inc.
Boston, Massachusetts 02108**

on behalf of

Time Warner Communications Holdings Inc.

June 8, 1998

STATEMENT OF SUSAN M. BALDWIN

I am Susan M. Baldwin, Senior Vice President of Economics and Technology, Inc. ETI is a consulting firm specializing in telecommunications economics, regulation, management and public policy. I was a principal author of the paper, *Defining the Universal Service "Affordability" Requirement*, that forms the basis for Time Warner Communications' proposal to the FCC for consideration of community income as a factor in universal service support.

ETI's analysis of the relationship between income and high-cost support was an outgrowth of our detailed analyses of various cost proxy models that were first presented to the Commission in 1996, in the early stages of CC Docket 96-45. One thing that struck us was the fact that the models that purported to "target" support on the basis of high-cost also directed support to many well-to-do communities where customers clearly could afford to pay for the entire cost of their local telephone service, without any subsidy whatsoever. Further research demonstrated that this was not an isolated condition; it was a nationwide pattern. ETI's analysis demonstrated that a decision not to fund support to high-income CBGs would result in a significant reduction in the overall size of the interstate high-cost fund.

The *Telecommunications Act of 1996* explicitly requires that "affordability" be included as a consideration in the development of a comprehensive universal service support mechanism: "Quality and rates — Quality services should be available at just, reasonable, and affordable rates." The extent to which service is "affordable" to an individual consumer is inextricably tied to that consumer's income level and ability to pay, and in fact the Joint Board, in its Recommended Decision, and the Commission, in its Report and Order, have acknowledged that income level directly affects the determination of what is an "affordable" price. The Commission has also agreed that community income, as represented by the percentage of students eligible for school lunches, is a valid basis for establishing the variable discounts necessary to make telecommunications affordable to schools and libraries.

The universal service goal is not advanced by subsidizing consumers who can afford to pay the entire cost of their telephone service — and whose decision to take service is unaffected by the presence of such a subsidy. Indeed, some of the specific attributes of exclusive high-income communities — large lots, low population density, remoteness from primary population centers — are the very same conditions that tend to raise the cost of providing local telephone service. Ironically, many low-income areas, such as densely populated inner-city communities, are because of such attributes also *low-cost* areas, and could well be forced to subsidize the “high rent” high-cost-to-serve suburbs.

Policies that would flow universal service support to such communities serve only to impose significant costs and economic burdens upon other segments of the economy while doing nothing to advance the cause of universal service or produce any other offsetting economic or social benefit. Among other things, a funding obligation that is larger than one that is minimally necessary to achieve the universal service goal will undermine other Commission and Congressional objectives, perhaps even including universal service itself! By forcing new entrants to make larger-than-necessary payments to the universal service funding mechanism, such policies will increase the costs of and barriers to competitive entry, and thereby diminish the prospects for effective competition overall. They will also work to suppress demand for price-elastic services, thereby limiting the potential benefits that all sectors of the economy can derive from increased access to and use of the nation's telecommunications resources.

The ETI study and Time Warner's proposal are not offered as providing definitive or prescriptive guidance as to how to structure an income-based funding mechanism. Rather, it is offered to demonstrate

- that many “high-cost” communities are also high-income communities;
- that public data is available from the Census Bureau to support the administration of a community income-based funding mechanism; and

- that there is an opportunity to achieve a significant decrease in the overall size of the universal service support fund, fully consistent with the statutory requirement that service be "affordable," without any consequential impact upon the overall universal service goal.

The structure of a community income-based funding mechanism should be built upon three specific policy initiatives:

- *First*, the FCC and the states should conclude that the highest income high-cost areas are to be excluded from universal service support. For example, if all CBGs with median income levels in the top 30% of their state were placed in this category, the funding requirement could be reduced by as much as 20% to 30%. The specific policy can be highly flexible, and can involve state-specific or national income standards, or some combination, as well as absolute and/or flexible affordability thresholds.
- *Second*, there should be a safety net for low-income consumers residing within high-income high-cost areas who cannot afford to pay full cost-based rates.
- *Third*, to avoid rate shock, transition plans should be established that would allow carriers to move rates in high-cost high-income areas toward their full forward-looking costs.

If done correctly — and it can be done correctly — the result will be "win-win" for all concerned: Universal service at affordable rates can be assured, while minimizing the potential adverse impact upon nascent competition, innovation, and the economy generally.

Thank you very much for the opportunity to present these comments here today.