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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 28 1998

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

Re: CC Docket No. 96-45, Federal-State Joint Board on Universal Service

Dear Ms. Salas:

On September 25, 1998, BellSouth submitted the attached information to Commission David Baker, member of the Federal-State Joint Board. This information describes a USTA consensus plan for federal universal service support for non-rural companies was described.

In accordance with Commission rules, the original of this response and one copy are being filed with your office. Acknowledgment and date of receipt are requested. Please call the undersigned with any questions.

Cynthia K. Cox

cc: Commissioner David Baker (w/o attachment)

BELLSOUTH

BellSouth Telecommunications, Inc.
38L64 BellSouth Center
675 West Peachtree Street
Atlanta, Georgia 30375

Federal Regulatory

September 25, 1998

Commissioner David Baker
Georgia Public Service Commission
47 Trinity Avenue
Atlanta, GA 30334

Dear Commissioner Baker:

Enclosed for your use is a copy of the presentation that explains USTA's Plan for Federal Universal Service Support for Non-Rural Companies. Also attached is a copy of USTA's Whitepaper detailing the Plan. We have shared this plan during our recent ex parte contacts with other Joint Board Members and staff and regret that we were unable to meet with you in person.

If you would like further information on the plan or have questions concerning it, please call me at 404-927-1435.

Sincerely,

Peter F. Martin

Peter F. Martin
Director, Regulatory

PRESERVING UNIVERSAL SERVICE IN COMPETITIVE MARKETS FOR NON-RURAL CARRIERS

A Plan Proposed by USTA

September 14, 1998

I. Introduction

The Telecommunications Act of 1996 ("1996 Act") charges the Federal Communications Commission ("FCC") working with a special federal-state joint board ("Special Joint Board"), with establishing a new universal service support program based on the principles and requirements set out in the Act. These principles and requirements include the following:

* Quality services should be available at just, reasonable and affordable rates;
* Access to service and rates in rural and high costs areas should be reasonably comparable to that in urban areas;
* The mechanisms used should be specific, predictable and sufficient;
* Every telecommunications carrier shall contribute on an equitable and nondiscriminatory (i.e., competitively neutral) basis;
* Only eligible telecommunications carriers (ETCs) may receive support; and
* Any support must be explicit.

The Commission determined that it would defer any further changes in existing universal service support for rural companies pending further review and at least until January 1, 2001. The Commission has focused its efforts to date on changes affecting non-rural companies. These changes were originally to have been in place by January 1, 1999. In July, following a request by the state members of the Special Joint Board and criticism by key Congressional leaders, the FCC decided to refer a series of issues back to the Special Joint Board and has now committed to implement the revised mechanism for non-rural carriers by July 1, 1999.

USTA has been working to develop a consensus plan for a new program of universal service support for non-rural carriers. That consensus plan is described below. While some of the member companies have individually proposed similar plans, the consensus plan is the product of extensive discussions and negotiations among the companies and represents their united position on these important issues.

II. Description of the Problem for Non-Rural Carriers

Universal service is currently maintained with support from a number of sources. All of these sources relate to the recovery of the fixed costs of the public switched telephone network. Explicit support derives from high cost funds at the federal and state level. In addition to the explicit high cost support, universal service today is maintained by a variety of intra-company support flows. Incumbent local exchange carriers ("ILECs") have developed their rate structures as part of a regulatory process such that a number of services are priced substantially above cost (e.g., access) in order that basic local exchange service remain priced below cost. In other words, affordable service for business and residential customers in high cost areas is made possible by support from other revenue sources. These anomalies in rate structures amount to implicit support and this implicit support acts as a disincentive for residential competition. This is an often overlooked, but vital, aspect of universal service support.

Intra-company support for universal service comes from a variety of sources, such as:

- Interstate access charges;
- Intrastate access charges;
- IntraLATA toll service charges;
- Geographic rate averaging (urban-to-rural subsidies);
- Business-to-residential subsidies; and
- Charges for discretionary services.

The table below briefly describes the various support mechanisms that existed prior to the FCC's universal service order.

Table 1
Support Mechanisms

Support Mechanism	Support Source	Implicit/Explicit
Federal High-Cost Fund*	IXCs	Explicit
State High-Cost Fund	Varies: ILECs, IXCs	Explicit
Long-Term Support*	Non-Pooling ILECs	Explicit
DEM Weighting*	Access Customers	Implicit
Carrier Common Line	Access Customers	Implicit
Federal and State Access	Access Customers	Implicit
IntraLATA Toll	IntraLATA Toll Users	Implicit
Business Services	Business Customers	Implicit
Geographic Rate Averaging	Urban Customers	Implicit
Vertical Services	Vertical Service Customers	Implicit

*The FCC has moved these mechanisms to an explicit, competitively neutral fund in CC Docket 96-45, *Federal State Joint Board on Universal Service*, May 8, 1997 at ¶¶ 300-306.

A necessary step (which has been avoided up to now) is for regulators to "size" the implicit support embodied in current rates. This, in turn, will enable regulators to determine the size of the universal service fund that is needed. There have been a number of efforts to measure the amount of this support,[1] but regulators need to reach an agreement quickly if real progress is to be made.

It must be emphasized that this implicit support is derived from revenues earned by telephone companies from both the interstate and intrastate services. Thus, both federal and state regulators share the responsibility for converting this implicit support into the "sufficient" explicit support mechanisms required by the 1996 Act.

The Congressional mandate in the 1996 Act and the introduction of competition require that the various support mechanisms be restructured, that subsidies be made explicit, and that support be assessed and distributed in a competitively neutral manner. Coordinated action on the

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[1] Strategic Policy Research estimated in 1993 for USTA that the amount of support contributed from access and toll services was approximately $20 billion annually. That estimate was recently updated to show that the support contributed from these services now amounts to nearly $24 billion annually.

part of the FCC and state regulators is needed to carry out this mandate. A properly designed federal plan that emerges from the current FCC rulemaking can serve as a model for states in addressing these same issues.

III. Goal of A New Universal Service Policy for Non-Rural LECs

As USTA sees it, the goals of the new universal service policy should be to:

1. Preserve and advance universal service during the transition to competition as mandated by the 1996 Act.
2. Identify and establish universal support mechanisms consistent with terms of the 1996 Act.
3. Creates a competitively neutral fund that removes disincentives for competition.

Two equally important changes are required to achieve these goals. First, a new federal high cost fund must be created for support of high-cost areas of the country with priority given in the distribution of those funds to those geographic areas with highest costs. Second, the implicit intra-company universal service support must be replaced with a more sustainable recovery mechanism.

IV. Support for High-Cost Areas of the Country Served by Non-Rural Carriers

USTA supports the following principles:

1. A federal program to support high-cost areas/states is necessary and mandated by Congress;
2. States, however, must also take steps to address their high-cost problem internally such as through rate rebalancing[2];

[2] Elimination of implicit support, according to the conventions of rate rebalancing, includes increases in below-cost rates in addition to decreases in above-cost rates. Rate rebalancing and establishing explicit intrastate high cost support mechanisms are among the tools available to state commissions to meet the 1996 Act's mandate.

3. While it is appropriate to direct some federal support to any state with high-cost areas, states with a large number of high-cost areas (rural) and relatively few low-cost areas (urban) should receive proportionately more support[3]; and
4. Support should be sufficient to assure affordable service to high-cost customers of non-rural LECs. The fund for non-rural LECs should be sized so that it provides at least the current level of support.
5. Any increase in high cost funding received by a regulated ETC shall be offset with intrastate rate reductions.

V. Collection Mechanism for High Cost Support for Non-Rural Carriers

High cost support should be funded by a surcharge on the total retail bills (combined interstate and intrastate) assessed by every telecommunications carrier. This approach ensures fairness among carriers and competitive neutrality. Basing the surcharge on combined revenue also eliminates opportunity for strategic behavior (*e.g.*, misreporting traffic as intrastate to minimize a surcharge on interstate retail). USTA strongly believes that in order to maintain equity the same basis (*i.e.*, total retail revenue) should be used for both federal and state universal funds. In other words, states which decide to establish their own end-user charges to support universal service should be required to apply the charges to total retail revenue — interstate (originating in the state) and intrastate.

VI. Distribution Mechanism for High Cost Support for Non-Rural Carriers

An equitable mechanism based on a cost benchmark should be developed to identify those states which will need additional support due to significant numbers of high cost customers and relatively few low cost customers over whom to spread these costs. The level of the benchmark, together with the cost estimate, determine the amount of support needed in an area. For example, if a relatively low (*i.e.*, HAI) cost estimate is used, a lower benchmark should also

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[3] USTA policy is that federal support should go to carriers.

be used to provide sufficient funding levels. Cost models can properly be used for non-rural carriers to implement the distribution of high cost funds, but should not be used to size the fund itself. Rather, the fund should be sized based on the need to support universal service and on the need to replace other sources of support.

VII. Replacing Intra-Company Universal Service Support for Non-Rural Carriers

USTA's consensus plan for replacing intra-company support for universal service is based on two premises. First, intra-company support (in the federal jurisdiction, the support derived from interstate access rates) is an important source of support for universal service for non-rural companies. Second, the current recovery mechanisms (e.g., CCL and PICC, upon completion of the transition ordered by the FCC) are not sustainable in a competitive environment. Moreover, because these cost recovery mechanisms are built into ILEC access charges and can be avoided by long distance companies which provide their own access or buy it from an ILEC competitor, they are not consistent with the 1996 Act's requirement that universal service support be provided on an equitable and nondiscriminatory basis.

A new collection mechanism for interstate intra-company universal service support should be established along the following lines:

1. Current revenues from the CCL and PICC, plus those revenues that are to be ultimately transferred to the PICC, would be used to determine the amount of support to be collected.
2. Nationwide, reductions in access (implicit subsidy) should match the size of the amounts collected from end users (explicit subsidy).[4]
3. The explicit support that will replace the reductions in implicit support will be collected by all telecommunications carriers through an end-user surcharge on total retail revenues.
4. Each ILEC study area would receive explicit per-line support equal to the amount of access reduction made by the ILEC in that study area divided by the number of residential access lines in that study area. The amount of per-line support in a

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[4] The reductions would be treated as an exogenous cost factor (a "Z" adjustment) for price cap ILECs.

study area would remain constant until such time as the FCC acts to adopt an alternative mechanism for distributing explicit support among ETCs.

5. Explicit support to replace intra-company implicit support would be portable among ETCs that provide universal service within a study area. An ETC will receive support on a per-line basis for each residential line it serves.

6. Distribution of the explicit support throughout an ILEC study area may be de-averaged, so that higher cost regions of a study area would receive greater support per-line than would the lower-cost regions of that study area. This feature is important since it eliminates a potential downside to portable support; that is, if the support is distributed on an averaged basis, it makes it even more attractive for new entrants to target lower cost, higher volume customers within a particular study area.

7. The replacement of implicit support is, in effect, a restructuring of interstate access and should not be seen as reducing interstate revenues. Therefore, states which generally mirror interstate access charges should also mirror this restructuring including the development of an end-user surcharge or another compensating action, such as rate rebalancing or another universal service approach. Section 254(f) of the 1996 Act requires that states that develop universal service mechanisms ensure that all telecommunication carriers doing business in that state contribute to preserving and advancing universal service. Additionally, section 254(b)(5) requires that states universal service mechanisms be specific, predictable and sufficient. For example, the replacement of intrastate access implicit support with explicit support recovered through an end-user surcharge on total revenue (interstate and intrastate) assessed by all carriers in the state meets the requirements in the 1996 Act and can be said to mirror the interstate mechanism which the FCC would establish under this proposal. Full mirroring of this restructuring of interstate access, however, requires an action (*e.g.*, rebalancing) by the state to compensate for the reduction in access revenues resulting from the mirroring. States may also use a combination of several means to meet this mirroring requirement. Thus, states that have rules that require mirroring should review their mirroring rules to ensure that they do not provide

results inconsistent with the FCC's universal service policies and that the resulting mechanisms are specific, predictable, and sufficient to meet the requirements of the 1996 Act.

VIII. Conclusion

USTA urges the Special Joint Board, the FCC and state regulators generally to move ahead to fulfill the Congressional mandate and establish new explicit universal service support mechanisms. Perserving universal service as competition expands is a critical part of our new national telecommunications policy.