EX PARTE

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UNITED STATES
TELEPHONE
ASSOCIATION

November 4, 1998

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW - Room 222
Washington, DC 20554

RE: *Ex Parte* Notice
CC Docket No. 96-45

Dear Ms. Salas:

On November 4, 1998, Bob Blau and Whit Jordan of BellSouth, Alan Ciamporcero, Dennis Weller and Scott Randolph of GTE, Jay Bennett of SBC, and John Hunter of the United States Telephone Association (USTA), together representing USTA, met with Emily Hoffnar, Brian Clopton, Andy Firth, Charles Keller and Bob Loube of the Commission.

The purpose of the meeting was to discuss USTA's universal service plan for non-rural carriers. The attached items were part of the discussion and were distributed at the meeting.

An original and one copy of this *ex parte* notice are being filed in the Office of the Secretary. Please include it in the public record of the above-referenced proceedings.

Respectfully submitted,

John W. Hunter
Senior Counsel

Attachments (6)

cc w/o att:

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USTA'S UNIVERSAL SERVICE PLAN

MAKING SUBSIDIES EXPLICIT, PURSUANT TO THE 1996 ACT, AND "HOLD HARMLESS"

- Most universal service funding today is implicit
  - This implicit mechanism is inefficient and unfair. It can't be sustained in a competitive market. It preempts entry into local markets, because implicit support can't be made portable

- Section 254 of the Act requires reform of the system
  - Implicit support to be made explicit
  - All carriers to contribute on an equitable and nondiscriminatory basis

- A large portion of implicit support comes from interstate switched access today
  - $4.3 Billion from CCL and PICC charges
    - Another $2 Billion in switching and transport rates
    - Implicit support from interstate access can <u>only</u> be addressed through the Federal USF mechanism

- This implicit support should be replaced by explicit Federal USF support
  - Important benefits:
    - Support for universal service is sustainable
    - ILECs can compete fairly – their rates are not burdened by implicit support contributions
    - Support becomes portable to CLECs, who now have incentive to serve residence local customers

- New Federal plan should "do no harm"
  - But that <u>alone</u> is not enough
  - Leaving fund at current size does nothing to deal with implicit support from interstate access

- Implementing USTA proposal will not harm residence customers – even those who don't make long distance calls

Review seven steps of USTA plan (i.e., removal of access subsidy, see USTA plan at No. 7).

COMPARABILITY, AFFORDABILITY AND SUFFICIENCY, PURSUANT TO THE 1996 ACT

- Sufficiency requires:
  - That the Federal fund replace the implicit support in interstate access
  - That the Federal fund provide high cost support to areas where affordability and comparability could not reasonably be maintained with state resources alone

- Support for high-cost areas of the country served by non-rural carriers should be governed by following principles:

  - A federal program to support high-cost areas/states is necessary and mandated by Congress;

  - States, however, must also take steps to address their high-cost problem internally such as through rate rebalancing;

  - 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; and

  - 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.

  - Any increase in high cost funding received by a regulated ETC shall be offset with intrastate rate reductions.

DISTRIBUTION OF SUPPORT (E.G., TO CARRIER, TO STATE COMMISSION)

- Federal support should go to carriers, and should be portable

  - Funding that replaces interstate switched access should be used to provide a per-line support amount:

    - Amount would vary by small area, and would sum to current implicit support by study area
    - 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.

  - For high-cost support to states:

    - 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.

COLLECTION OF UNIVERSAL SERVICE CONTRIBUTIONS/CONSUMER ISSUES & BILLING

- Federal support should be funded by a surcharge on the total retail bills (combined interstate and intrastate) assessed by every telecommunications carrier.
  - Assures fairness and neutrality
  - Provides largest possible base, smallest possible surcharge
  - Eliminates opportunity for strategic behavior, such as misreporting of traffic

- A 2.15% surcharge would fund the replacement of interstate CCL and PICC
  - Residence customers at all income levels would benefit
  - Residence customers at all usage levels would benefit
    - Even those with no interstate toll usage

- Would eliminate recovery of ILEC contributions through access (about $800 million today)

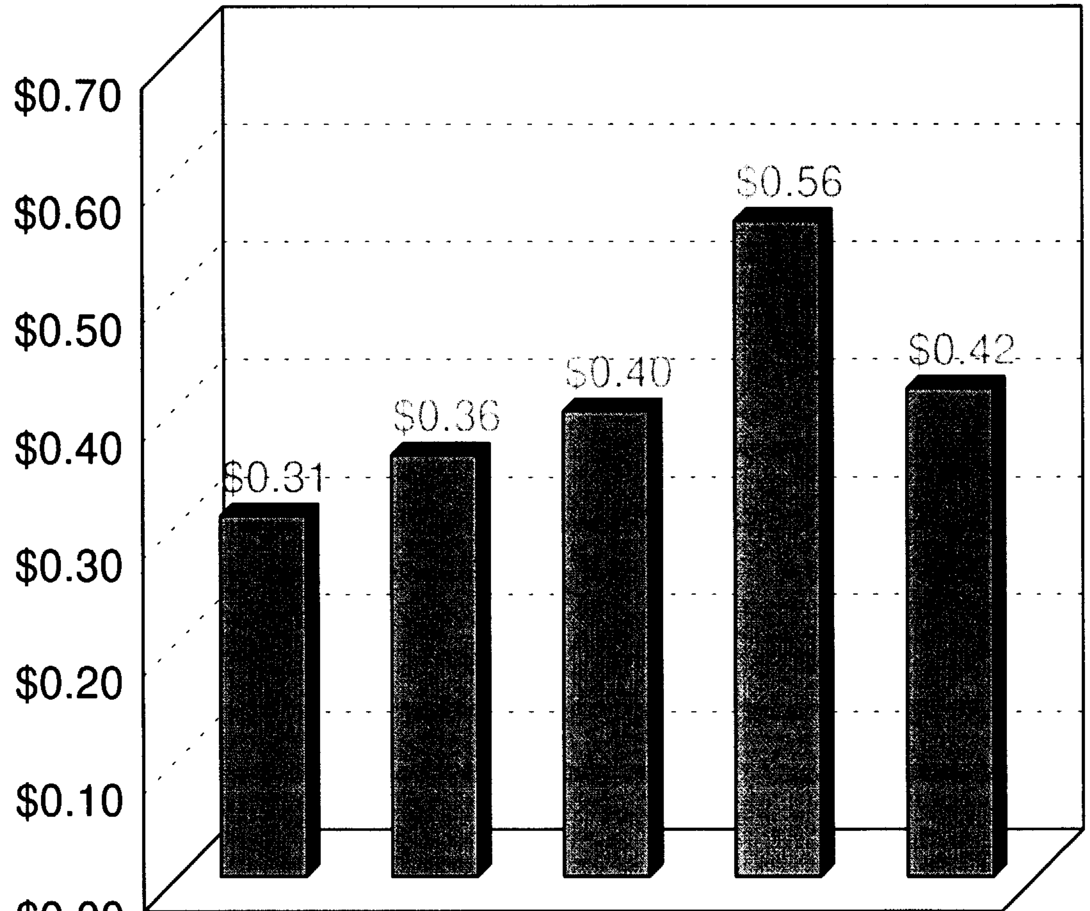
  Review customer impact data (GTE).

- In order to maintain equity the same basis (*i.e.*, total retail revenue) should be used for both federal and state universal funds.

  Review policy (SBC) and legal (BellSouth) analysis of using combined interstate and state revenues.

Net Customer Bill Savings By Household Income

On Average, Customers In All Income Segments Would Benefit From The USTA Proposal Which Would Eliminate Interstate CCL and PICC (A $4.3B Reduction In Access Charges)

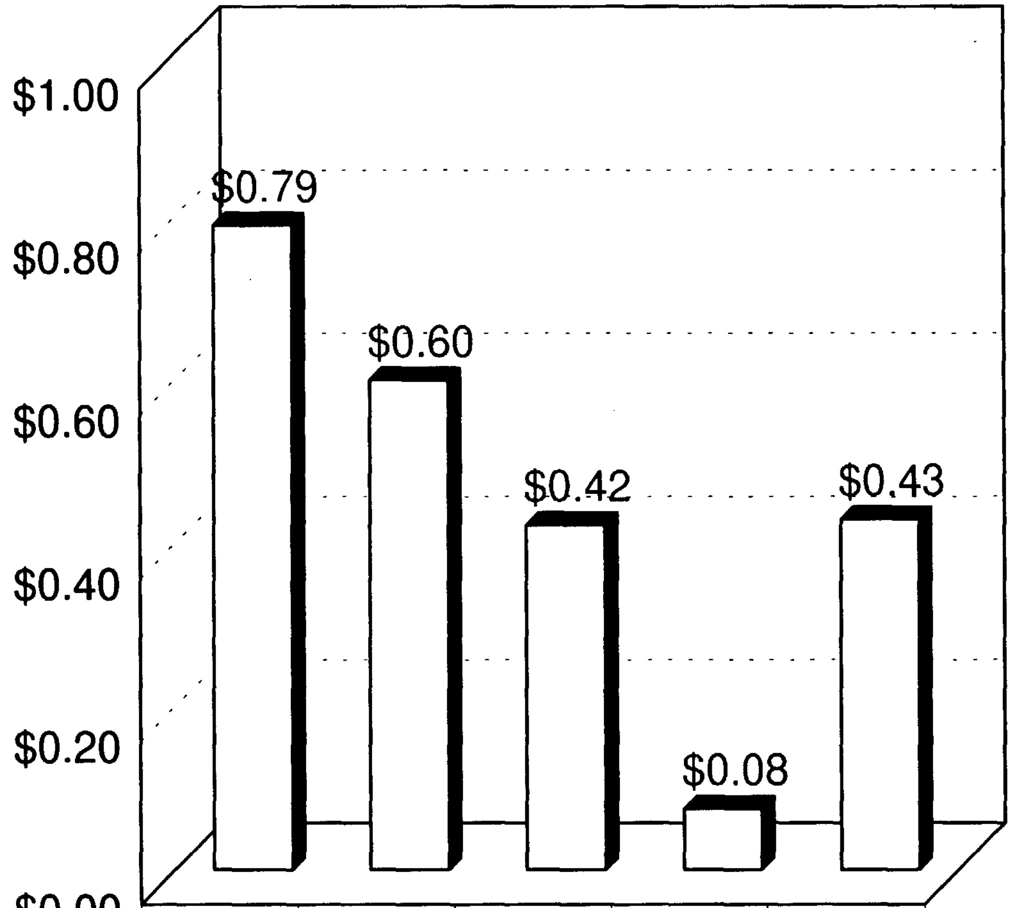


	Less than $10,000	$10,000 - $29,999	$30,000 - $59,999	$60,000 +	Average Customer
Average Local & Long Distance Bill Before Access Reduction And Surcharge	$43.86	$50.24	$57.01	$65.86	$55.78
Average Local & Long Distance Bill After Access Reduction And Surcharge	$43.56	$49.88	$56.61	$65.30	$55.37
Net Savings	$0.31	$0.36	$0.40	$0.56	$0.42

* Analysis based on 1998 PNR Bill Harvest data. Customer benefits reflect elimination of the PICC and a CCL reduction of 1.1 cents per interstate toll minute. This portion of USTA's plan would be funded by a 2.15% surcharge on total retail revenue. Any increase in high-cost funding to states would produce additional reductions in state rates.

Net Customer Bill Impact By Household Income

A Flat Fee Of $2.00 Per Line Would Generate Funding For The USTA Proposal To Eliminate The Interstate CCL and PICC: A $4.3B Reduction In Access Charges. An Average Consumer Would Pay $0.43 More Than They Do Today.

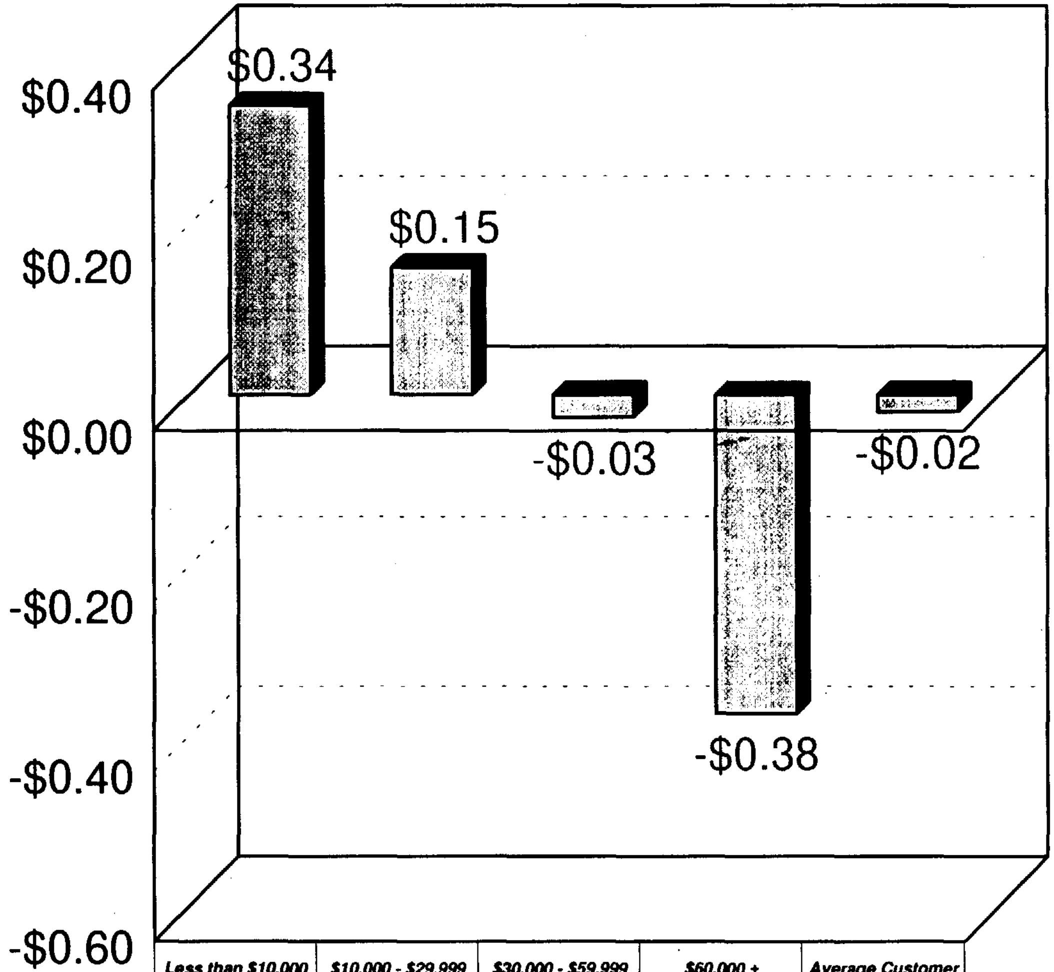


	Less than $10,000	$10,000 - $29,999	$30,000 - $59,999	$60,000 +	Average Customer
Average Local & Long Distance Bill Before Access Reduction And Surcharge	$43.86	$50.24	$57.01	$65.86	$55.78
Average Local & Long Distance Bill After Access Reduction And Surcharge	$44.65	$50.84	$57.43	$65.93	$56.21
Net Impact	$0.79	$0.60	$0.42	$0.08	$0.43

* Analysis based on 1998 PNR Bill Harvest data. Customer benefits reflect elimination of the PICC and a CCL reduction of 1.1 cents per interstate toll minute. This portion of USTA's plan would be funded by a $2.00 surcharge per local loop. Any increase in high-cost funding to states would produce additional reductions in state rates that are not reflected here.

Net Customer Bill Impact By Household Income

A Flat Fee Of $1.55 Per Telephone Number Would Generate Funding For The USTA Proposal To Eliminate The Interstate CCL and PICC: A $4.3B Reduction In Access Charges. An Average Consumer Would Be About As Well Off Or Save A Few Pennies.



	Less than $10,000	$10,000 - $29,999	$30,000 - $59,999	$60,000 +	Average Customer
Average Local & Long Distance Bill Before Access Reduction And Surcharge	$43.86	$50.24	$57.01	$65.86	$55.78
Average Local & Long Distance Bill After Access Reduction And Surcharge	$44.20	$50.39	$56.98	$65.48	$55.76
Net Impact	$0.34	$0.15	-$0.03	-$0.38	-$0.02

* Analysis based on 1998 PNR Bill Harvest data. Customer benefits reflect elimination of the PICC and a CCL reduction of 1.1 cents per interstate toll minute. This portion of USTA's plan would be funded by a $1.55 surcharge per telephone number. Any increase in high-cost funding to states would produce additional reductions in state rates that are not reflected here.

The Joint Board and the Commission have the authority to use combined interstate and intrastate revenues of interstate carriers as the revenue base for determining the interstate carriers' contributions to the federal Universal Service Fund ("USF"). The starting point of the analysis is the express language of the statute. The first instance in which the contributions to the USF are mentioned in the Communications Act is in Section 254(b). Section 254(b) enumerates universal service principles that the Joint Board and the Commission "shall base policies for the preservation and advancement of universal service..."[1] Among the enumerated principles is that "all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."[2] Congress embodied this principle in the specific statutory directive relating to contributions of telecommunications carriers. Thus, the statute mandates that "every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis" to the federal USF.[3]

The Commission has considerable discretion in selecting the revenue base to be used to determine the contributions of interstate carriers to the federal USF. As the Commission has recognized, Section 254(d) enables the Commission to use interstate and intrastate revenues as the revenue base for determining USF contributions to ensure that the universal service fund is sufficient.[4] As long as the contribution mechanism encompasses all interstate carriers and is nondiscriminatory and equitable, the mechanism passes statutory muster.

Use of interstate and intrastate revenues meets the nondiscrimination requirement of Section 254(d). All interstate carriers would be treated identically. That is all that the nondiscrimination condition requires. Even if, however, the use of combined interstate and intrastate revenues were viewed as not a completely nondiscriminatory approach, which is not the case, the other condition of Section 254(d) is that contributions be made on an equitable basis. An equitable contribution mechanism is not necessarily a nondiscriminatory mechanism. Nondiscrimination implies that all similarly situated carriers are treated the same. An equitable contribution mechanism implies a mechanism that is considered fair. Thus, a fair mechanism may not treat all contributors identically or may not have the same impact on all contributors. To the extent there is a tension between the nondiscrimination and equity requirements of Section 254(d), the Joint Board and the Commission have the authority to weigh one factor against another to determine the balance that promotes the public interest.[5]

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1 47 U.S.C. § 254(b).

2 47 U.S.C. § 254(b)(4).

3 47 U.S.C. § 254(d)

4 *In the Matter of Federal-State Joint Board on Universal Service,* 12 FCC Rcd 8776, 9192-9194 (1997).

5 *See generally Southwestern Bell Telephone Company et. al. v. FCC*, 1998 WL 485387, *4 (8th Cir.).

Equitable considerations favor combined interstate and intrastate revenues as the revenue base for the contribution mechanism. There are interstate uses that are reflected in intrastate end user revenues such as private line uses, leaky PBX traffic and connections to internet providers. As these segments of intrastate revenues increase, a mechanism based on interstate end user revenues alone could considerably understate interstate revenues in general, but more importantly, the mechanism could result in more favorable treatment to a limited class of interstate carriers such as those providing local services. Not only would such a result be inequitable but also, in practice, it would be discriminatory. In these circumstances, the Commission can exercise its discretionary authority as the administrator of the statute to select a contribution mechanism that it deems in its expert judgment promotes the public interest and statutory objectives. Where the Commission explains its determination, Courts will substitute its judgment for the predictive judgment of the Commission.[6]

A contribution mechanism that is based on combined interstate and intrastate revenues does not mean that intrastate revenues will be used to pay for the federal USF. Any contributions for the federal USF assessed on interstate carriers constitute an additional interstate cost. Each carrier is entitled to recover its interstate cost. The rates and charges that a carrier establishes to recover its federal USF contributions are jurisdictionally interstate and generate jurisdictionally interstate revenues. Accordingly, a combined interstate and intrastate revenue base does not impact a state commission's authority to regulate the rates and charges for intrastate charges that is reserved to it under Section 152(b) of the Communications Act.

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6 *Cellnet Communications Inc. v. FCC*, 149 F. 3d 429, 441 (6th Cir. 1998).

The Benefits of Funding Federal Universal Service Programs Through a Surcharge on Interstate and Intrastate Revenues

USTA proposes to fund Federal Universal Service through a uniform surcharge on all end user total (interstate and intrastate) telecommunications revenues. The benefits of using total revenues rather than only interstate revenues include simplicity, improved customer understanding, avoidance of jurisdictional arbitrage and a reduced overall surcharge level. These benefits are described in further detail below.[1]

The recent experiences related to the establishment and pass-through of PICC charges by carriers demonstrates the advantage of implementation simplicity. Customers were confused both by charges that varied by provider (and the associated explanations), as well as by different rate levels for residence and business customers and primary vs. additional lines. A uniform surcharge on all telecommunications services will avoid such confusion. Additionally, the FCC's recent Universal Service decision[2] on the jurisdictional classification of wireless carriers' traffic demonstrates the complexity imposed when only interstate revenues are utilized.

Using total telecommunications revenues will facilitate consumer understanding of the application of charges. Consumers view calls functionally rather than jurisdictionally, not caring if they are local, intrastate or interstate. At minimum, another entry on customer bills that applies to some services and not others will certainly generate numerous calls to customer service representatives seeking explanation or clarification.

Imposing surcharges on only interstate telecommunications services will create distorted economic incentives to purchase services from intrastate tariffs or to misreport

[1] The legal basis for applying the surcharge is described in a separate USTA whitepaper.

the jursidictional classification of traffic to avoid the interstate-only surcharge. Recent analogous events suggest that arbitrage and misreporting are not merely speculative concerns. For example, in 1997 Southwestern Bell's FGD measured terminating minutes were approximately 60% interstate, while unmeasured, customer-reported FGA and FGB minutes exceeded 90% interstate. Likewise, not all FGD minutes can be measured and similar anomalies exist. For example, in 1997 more than 40% of one large IXC's terminating FGD minutes were unmeasured and the customer-reported interstate usage was 25% higher than its measured interstate usage.[3] USTA proposes that any intrastate universal service fund likewise be funded through a surcharge on total telecommunications revenues.

Finally, by expanding the base of revenues, the necessary surcharge level is reduced. USTA estimates that the necessary surcharge level would be approximately 2.15% on total telecommunications revenues, compared to an approximate 5.63% surcharge level if it were only imposed on interstate revenues. The approximately $4.3B generated by this plan would permit elimination of the implicit subsidy that is today recovered through interstate CCL and PICC charges.

For the reasons described above, a uniform surcharge on all end user total (interstate and intrastate) telecommunications revenues should be included in the Joint Board recommendation.

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[2] CC Docket 96-45, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, adopted October 22, 1998

[3] For Southwestern Bell Telephone Company, interstate minutes are lower-priced than intrastate minutes.