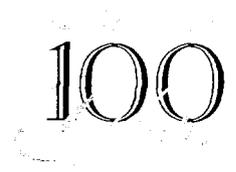




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**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

November 17, 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 16, 1998, the attached letter from Lawrence E. Sarjeant of the United States Telephone Association (USTA) was sent to Chairman Julia Johnson of the Florida Public Service Commission regarding the USTA Universal Service Plan for non-rural carriers.

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

Attachment (1)

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November 16, 1998

Chairman Julia Johnson
Florida Public Service Commission
2540 Shumard Oak Blvd.
Gerald Gunter Building
Tallahassee, FL 32399-0850

Dear Chairman Johnson:

One of the most important elements of the USTA Universal Service Plan for non-rural carriers is that it addresses implicit subsidies in both the interstate and intrastate jurisdictions. Whether or not to make implicit subsidies in interstate rates explicit has been the subject of much discussion during our recent visits with members of the Joint Board. Some state regulators might assume that interstate implicit subsidies do not affect the intrastate costs of providing universal service, and may not find it necessary to address interstate implicit subsidy mechanisms. USTA and its members believe there are compelling reasons for the Joint Board members to address implicit subsidies in both jurisdictions.

The Telecommunications Act of 1996 directs the FCC and the Joint Board to develop specific, predictable, and sufficient federal universal service support mechanisms (Section 254(b)(5)). The Act also specifies that any such support should be explicit and sufficient to achieve the universal service purposes of the Act (Section 254(e)). Further, Section 254 says that all telecom providers should contribute to universal service on an equitable and nondiscriminatory basis. This requirement will not be met so long as most of the support for universal service from the interstate jurisdiction is in the form of implicit support in rates that only incumbent local exchange carriers (ILECs) have to charge. As a matter of law, then, the Federal-State Joint Board has the authority to address interstate implicit support mechanisms in addition to those that contribute to intrastate costs.

As we have described in our Plan, the universal service problem looms large. It includes both interstate and intrastate support mechanisms that ensure affordable service across the country. Indeed, the entire rate structure of ILECs has been designed to maintain local exchange rates below cost. To address only a part of the rate structure would be short-sighted.

Congress empowered the FCC, with input from the Joint Board, to establish a Federal universal service plan. While the states may debate among themselves as to how

much funding the Federal plan should provide the states, at a minimum the Federal plan should replace the implicit support provided by interstate rates today. If the Federal plan does not deal with the current interstate support, what plan will?

Quite aside from the FCC's obligation to deal with interstate subsidies, the states have compelling reasons to support the FCC's efforts:

First, both state and interstate revenues are needed to support affordable local rates to subscribers. If high interstate access charges cause ILECs to lose large volume users, then all of the revenues from those customers – both intrastate and interstate – will be lost. If support is made explicit, and all carriers contribute to it, then competitive losses by any carrier should not be a universal service concern. But as long as support is implicit in ILECs' rates, competitive losses by ILECs – in either jurisdiction – will reduce the funds available to support affordable local service.

Second, the interstate and intrastate revenue requirements are not independent of one another. Through the separations process, the costs of an ILEC network are arbitrarily allocated between the intrastate and interstate jurisdictions. This allocation is not immutable.

- While loop costs are apportioned using a fixed 25% allocator, other costs for switching and transport are separated between the jurisdictions based on relative use. Thus, if interstate access minutes are lost to competition, there will be a shift in these traffic-sensitive costs back to the states.
- Further, when a competitor uses unbundled network elements (UNEs) to serve a high-volume customer, the costs of the ILEC facilities will be reassigned, and it is reasonable to expect that some or all of these will fall in the state jurisdiction. A UNE is not a service, but the lease of an ILEC facility. Under the current separations rules, the cost of a leased facility is booked in the same jurisdiction that has the revenue; if state authority to set UNE rates is sustained, then it is likely that responsibility for recovery of UNE costs will be assigned to the states as well. The current Joint Board on separations is now examining this issue.

Third, even if there were no shifts of cost between the jurisdictions, states have a legitimate concern about the effect of interstate cost recovery on affordability. Recall that the FCC's original access charge plan would have recovered all interstate loop costs from flat-rated subscriber line charges to end users. The carrier common line (CCL) and presubscribed interexchange carrier (PIC) charges exist today only because many parties, including state regulators, raised concern that cost-based subscriber line charges (SLCs) could threaten affordability, and the FCC responded by capping the SLC. The current cap is \$3.50 per month for residence customers. In effect, then, the FCC's preferred method of rate recovery was capped as a universal service matter, and the CCL and PICC are the funding mechanisms that make those caps possible today. Unfortunately, the CCL and PICC are implicit subsidy mechanisms; if the affordability of interstate SLC

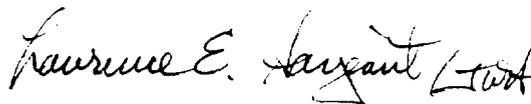
charges is to be maintained in the future, then the funding that makes this possible must be made explicit, as USTA has proposed.

If the states tell the FCC today, through their representatives on the Joint Board, that interstate access is not a universal service issue, then they are also telling the FCC that they have no interest in the possible effect on affordability of any method the FCC may choose to recover interstate costs. If the FCC were to return to its original access model, and recover all interstate loop costs through the SLC, would states have no concern? If the FCC were to deaverage this SLC to reflect differences in loop costs between urban and rural areas, would the states again have no concern? If states would be unwilling to see interstate SLCs that pass deaveraged loop costs on to end users, then states have a concern over the affordability of interstate charges. Any mechanism that holds a rate below its cost-based level in order to ensure affordability is part of universal service policy. In Section 254, Congress provided the FCC and the Joint Board with the necessary tools to ensure the affordability of rates through explicit support mechanisms. Rather than leave these tools unused, the Commission and the Joint Board should apply them, as intended, to replace the implicit support in interstate access, and to ensure that interstate rates remain affordable.

Finally, just as the ILECs rely on interstate access revenues to cover the cost of serving local customers, so too would any CLEC serving local residence customers need a corresponding source of revenue. Unfortunately, as Western Wireless explained to the Joint Board in its recent *en banc* meeting in Washington, implicit support cannot be made portable to a new carrier. The current reliance on implicit support – from both state and interstate ILEC rates – thus effectively preempts competitors from entering local markets and providing residence service. States therefore have a vital interest in ensuring that the current flow of implicit support from interstate rates is made explicit, because only then will that revenue become portable, so that competitors will have the necessary price incentives to enter markets for local residence service in each state.

I appreciate your attention to this vital matter and entrust that this letter has adequately communicated the necessity of any adequate, sustainable, and competitively neutral universal service plan to address implicit subsidies in both the federal and state jurisdictions. Not only does the ILEC rate design demand attention to both jurisdictions, but the Act also requires that the Joint Board address interstate subsidy mechanisms as it develops a national plan. Please do not hesitate to contact me if you would like to discuss this or any other element of USTA's universal service plan further.

Sincerely,



Lawrence E. Sarjeant
Vice President Regulatory Affairs
and General Counsel

cc: Members of the Federal-State Joint Board on Universal Service
Staff of the Federal-State Joint Board on Universal Service