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**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

**DEC 23 1998**

**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY**

**In the Matter of** )  
 )  
**Federal-State Joint Board on** ) **CC Docket 96-45**  
**Universal Service** )  
 )

**MCI WORLDCOM, INC. COMMENTS ON  
FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE  
SECOND RECOMMENDED DECISION**

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## **Executive Summary**

The Joint Board's Recommended Decision fails to provide guidance to the Commission on one essential public policy issue and on a number of implementation issues. The Commission must address and resolve all the policy and implementation issues identified in the Universal Service sections of the Act, not just the small subset of issues addressed by the Joint Board, in order to meet its statutory responsibilities.

Most significantly, the Commission must fully address and resolve the following:

1. How to size and replace existing implicit interstate Universal Service subsidies embedded in interstate access charges with explicit Universal Service support funds.
2. The nuts and bolts of actually implementing a workable explicit Universal Service support fund.

Section 254(e) of the Act requires that eligible carriers receive specific Federal Universal Service support that is "explicit and sufficient." The conference report states "To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today." The Joint Board proposal to create a new explicit Universal Service funding mechanism without simultaneously reducing implicit Universal Service subsidies does not meet the directives in the Act. If the Commission were to limit its actions to those proposed by the Joint Board, it would not meet its responsibilities under the Act.

The Commission and the Joint Board already have identified the services that comprise Universal Service and have correctly concluded that the proper costing methodology is forward looking economic cost, or more specifically the total element long run incremental cost, including

a portion of overhead costs.

MCI WorldCom agrees with the Joint Board that local competition has not yet developed to erode the implicit subsidies in above-cost rates for access and certain local services, and thus an explicit Universal Service fund is not needed to protect against any imminent shortfall in Universal Service support funds. But that does not justify calculating the Universal Service funding need based on study-area-wide cost averages that continue to bury implicit subsidies in those averages. Calculating costs at a study area rather than geographic cost zone level creates four dangers: (1) it understates the total size of the Universal Service subsidy by continuing to keep much of the subsidy hidden in the ILEC's existing rate structure, (2) in so doing, it also prevents the Commission from determining the size of implicit Universal Service subsidies; (3) it provides no guidance on how to distribute the funds when there are CLECs as well as the ILEC providing service in the study area since it does not distinguish between high-cost and low-cost areas within the study area; and (4) it could be misinterpreted to imply that the funds are intended for the ILEC or that the new entrant must offer service in the entire study area to be eligible for the fund, which would be contrary to the procompetitive spirit and letter of the Act. The method most consistent with the legal requirements of the Act is to perform cost calculations using geographic cost zones that reflect true underlying cost differences.

The only meaningful benchmark to use (to compare to the cost of providing service in high cost areas) is the projected revenue that would be generated in high-cost areas if rates were set at levels that are deemed affordable and reasonably comparable to urban rates. This is exactly what the Commission proposed in its earlier order. In contrast, a cost benchmark of the sort recommended by the Joint Board is not a meaningful benchmark because it is not related to any

agreed upon measure of affordable or reasonably comparable rates.

One approach for apportioning the total Universal Service funding needs between the interstate and intrastate jurisdictions for which a consensus seems possible is to compare the costs in different geographic cost zones to the revenue benchmark to identify the amount of Universal Service subsidy needed in each cost zone, but then to recover a larger proportion of the subsidy from the interstate jurisdiction for the higher cost zones. This has been referred to as a “superbenchmark” or “multiple benchmark” approach, but it is essential to understand that the calculation of the total Universal Service subsidy needed is based on the revenue benchmark; the superbenchmark or multiple benchmark just refers to cost cutoffs relating to the portion of the Universal Service subsidy borne by the interstate jurisdiction.

The pro-competition and non-discrimination provisions of the Act mandate that all eligible providers have non-discriminatory access to the explicit interstate Universal Service funds. States must distribute the funds to the carriers actually serving the high-cost customers for whom support is needed to make it viable to serve. The Joint Board hold harmless proposal must be transitional only and the fund size must be recalculated periodically.

It is unlawful to restrict carriers to charging customers only the direct assessment rate imposed on them. MCI WorldCom and other IXCs bear not only our direct assessments, but also bear indirect Universal Service charges that we receive from ILECs who pass through their Universal Service burden to us through higher access charges.

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

<b>In the Matter of</b>	)	
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<b>Federal-State Joint Board on Universal Service</b>	)	<b>CC Docket 96-45</b>
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**MCI WORLDCOM, INC. COMMENTS ON  
FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE  
SECOND RECOMMENDED DECISION**

**I. Introduction and Overview**

In its Public Notice released December 4, 1998, the Commission seeks comment on the Second Recommended Decision of the Federal-State Joint Board on Universal Service. Universal Service reform is a fundamental part of the new regulatory framework created by Congress in the Telecommunications Act of 1996; the Universal Service provisions of the Act are within Part II of the Act, entitled "Development of Competitive Markets," along with the provisions on interconnection, negotiation, arbitration, and approval of agreements, removal of barriers to entry, coordination for interconnection, infrastructure sharing, and explicit articulation of the nondiscrimination principle. It is essential that the Commission fully implement all the Universal Service requirements laid out in the Act if Congress' overall goal of promoting competition in all telecommunications markets is to be met.

The Joint Board's Recommended Decision correctly recognizes that competition has not yet developed to erode implicit Universal Service subsidies and that creation of an interstate fund that is larger than necessary to meet statutory requirements would harm consumers. But it

focuses primarily on the issue of reasonably comparable rates, just one of several Universal Service goals identified in the Act. Moreover, the methodology it proposes for measuring reasonably comparable rates does not even address rates; rather, it is a nebulous measure of a state's ability to provide Universal Service funding compared to a range of cost benchmarks. Without any record for support, the Joint Board suggests the states can afford to provide between 3 and 6 percent of their intrastate revenues for Universal Service support and that the interstate jurisdiction should bear the remainder of the burden.

The Joint Board's Recommended Decision fails to provide guidance to the Commission on one essential public policy issue and on a number of implementation issues (that have major policy ramifications) that the Commission had referred to the Joint Board for advice. As a result, the Joint Board recommendations provide incomplete and insufficient guidance on the implementation of the comprehensive Universal Service reform required by the Act. The Commission must address and resolve all the policy and implementation issues identified in the Universal Service sections of the Act, not just the small subset of issues addressed by the Joint Board, in order to meet its statutory responsibilities.

Most significantly, the Commission must fully address and resolve the following:

1. How to size and replace existing implicit interstate Universal Service subsidies embedded in interstate access charges with explicit Universal Service support funds.
2. The nuts and bolts of actually implementing a workable explicit Universal Service support fund, including but not limited to:
  - Defining the services that comprise Universal Service and calculating the economic cost of providing those services.
  - Constructing a meaningful benchmark that incorporates the Act's Universal Service

objectives of ensuring that rates in high-cost areas are affordable and reasonably comparable.

- After comparing the economic costs of providing Universal Service to a meaningful benchmark to identify the level of Universal Service support needed, developing a process for determining the portion of that support to be provided by the interstate jurisdiction.
- Creating policies and rules for determining which providers should receive the funds, i.e., how the money should be distributed.
- Implementing mechanisms that prevent ILEC over-recovery of costs as explicit Universal Service support mechanisms are established.
- Determining the level of state discretion, if any, in distributing the federal Universal Service support funds.
- Developing a process for reviewing the Universal Service support fund size over time.
- Giving carriers discretion in how they recover their Universal Service subsidy responsibilities from end users.

MCI WorldCom discusses these public policy and implementation issues below.

- II. The Commission must resolve how to size and replace implicit interstate Universal Service subsidies with explicit Universal Service support funds.
  - A. Any explicit interstate Universal Service support fund must be matched by dollar for dollar reduction in implicit interstate Universal Service subsidies.

Section 254(e) of the Act requires that eligible carriers receive specific Federal Universal Service support that is “explicit and sufficient.” The conference report states “To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.”<sup>1</sup>

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<sup>1</sup> It is essential to distinguish between what Congress requires in the Act, that all *Universal Service* funding be made explicit, and what GTE has argued, that all revenues generated by above-cost rates represent implicit Universal Service support funds and should be replaced by an explicit fund of tens of billions of dollars. GTE misidentifies what is Universal Service support funding and its argument must be rejected out of hand.

While the Joint Board Recommended Decision does not directly contradict this principle, it also does not endorse it, and if followed potentially could place roadblocks in its implementation. The Joint Board recommends that the task of reducing implicit Universal Service subsidies be separated from Universal Service reform and, with respect to implicit *interstate* Universal Service subsidies, left to the Commission to address *after* the explicit interstate Universal Service support fund has been established, justifying this two-step process on the grounds that reductions in implicit interstate subsidies represent an interstate issue best left to the interstate jurisdiction. Moreover, the Joint Board's proposed methodology for creating the new interstate Universal Service fund is nebulous and does not provide any means for identifying or measuring the magnitude of implicit interstate Universal Service subsidies in interstate access charges, no less explain how to replace them with explicit funds. The Joint Board proposal to create a new explicit Universal Service funding mechanism without simultaneously reducing implicit Universal Service subsidies does not meet the directives in the Act. If the Commission were to limit its actions to those proposed by the Joint Board, it would not meet its responsibilities under the Act.

Local competition that would erode the above-cost rates currently providing implicit Universal Service subsidies has not yet developed. The Joint Board therefore proposes that the calculation of the amount of explicit Universal Service funding needed be based on carrier study areas, thereby averaging costs across those often large and heterogeneous study areas and maintaining substantial implicit subsidy flows from urban to rural users. If the only relevant public policy issue were the assurance that sufficient Universal Service funds are available, the Joint Board proposal would be a reasonable *interim measure*. But, as will be discussed in greater detail in Section IIIA below, this partial step would create a number of public policy problems and does

not provide a solution that meets the requirements of the Act. The Act is very clear that explicit Universal Service funding be created to replace implicit Universal Service funding and this requirement must not be lost. Procedures must be put in place to ensure that implicit Universal Service support mechanisms will be replaced by explicit ones in a timely fashion.

As the Commission already has recognized, creating a new explicit interstate Universal Service funding mechanism or expanding the existing explicit interstate Universal Service funding mechanism must be accompanied by dollar for dollar reductions in existing implicit interstate Universal Service or (1) interstate providers and/or their customers will be double burdened, and (2) ILECs would receive a windfall gain.<sup>2</sup>

There are several reasons why it is inappropriate to create a new explicit interstate Universal Service fund and not have dollar for dollar decreases in existing implicit interstate Universal Service subsidies.

1. Simple fairness requires that any increase in the explicit Universal Service burden placed on interstate customers be matched by a decrease in the implicit Universal Service burden on interstate customers. Absent any instruction from the Act to increase the burden on interstate customers, there can be no justification for doing so. The Act instructs that rates be affordable, and that rates in rural and high cost areas be reasonably comparable to those in urban and low-cost areas. It also instructs that Universal Service funding be made explicit. Thus, the only justification for increasing the Universal Service burden on interstate customers

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<sup>2</sup> Access Charge Reform Order, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd at 16148, para. 381.

would be a finding that existing interstate Universal Service subsidies provide inadequate support to maintain affordable and reasonably comparable rates. The Joint Board has made no such finding. In its earlier Recommended Decision, the Joint Board found existing local rates to be affordable. It has never shown that rates in rural and high-cost areas are not reasonably comparable, nor is it likely to make such a finding given that most state commissions require rate averaging across study areas. Finally, the Joint Board has opted not even to identify the level of implicit Universal Service funding already provided in interstate rates and therefore cannot justify any proposal to increase the interstate funding burden. The HAI model shows that the total — interstate and intrastate — Universal Service funding needed to keep rates affordable and reasonably comparable is about \$2.5 billion, and even if the Commission's HCPM were to yield a slightly higher number, it certainly will be many billions of dollars less than the \$10 billion gap between interstate access charges and interstate access costs. Thus, it is clear that interstate Universal Service funding already is fully meeting the interstate Universal Service responsibility. The only way to implement the requirements of the Act is to create an explicit interstate Universal Service fund and to make dollar for dollar reductions in the implicit Universal Service subsidies embedded in interstate access charges. The remainder of the gap between interstate access charges and access costs can then be eliminated in the access charge reform proceeding.

2. The non-rural high-cost fund is not supposed to have an impact on customers of

rural telephone companies, but creating an explicit interstate fund without dollar for dollar reductions in implicit interstate subsidies raises costs for rural customers. Interexchange carriers (IXCs) are required to average their rates across their entire serving areas. Thus, when IXCs raise their rates to cover the burden associated with the new explicit non-rural interstate fund, interstate long distance rates go up for rural as well as non-rural customers. The only way to avoid the increase in interstate rates is to simultaneously give the IXCs dollar for dollar decreases in interstate access charges, which would then be passed through to their customers, resulting in no increase in long distance rates for rural or non-rural customers.

3. The Universal Service provisions are in Part II of the Act, entitled, "Development of Competitive Markets." Some incumbent local exchange carriers (ILECs), such as GTE and Sprint, already offer interstate long distance services in competition with other interexchange carriers. If and when the Regional Bell Operating Companies (RBOCs) meet the requirements of section 271 of the Act, they too will be able to offer interstate long distance services in competition with interexchange carriers. Interstate access charges far exceed their underlying costs and therefore the input costs that IXCs face for access is far greater than the cost to the ILECs for providing access to themselves. Even assuming the impossible, that imputation or other regulatory rules could be established that would keep the ILECs from using this artificial cost differential to create a direct anticompetitive price squeeze in the long distance market, the flow of revenues from above-cost access charges would provide the ILECs with a war chest to use strategically

against their competitors. Since consumers seek one-stop shopping and ultimately we can expect the market to respond with various bundled offerings, the war chest would provide the ILECs a mighty weapon to use in strategically pricing their offerings. The size of the war chest can be controlled if the portion of the gap between access charges and access costs that is attributable to Universal Service support were calculated and replaced by an explicit fund. Moreover, removal of that portion of the gap attributable to Universal Service support would eliminate the false ILEC argument that the entire gap between access charges and access costs is attributable to Universal Service subsidies, and could expedite access rate reductions to cost. But if the explicit fund is instituted without dollar for dollar reductions in interstate access charges, the ILECs actually would be provided a windfall over and above the current war chest gained from access charges and would be better able to use those revenues to price strategically and undermine competition.

- B. The current source of implicit interstate Universal Service support funds is above-cost access charges, especially the CCL and PICC. There should be a dollar decrease in these revenues for each dollar collected from a new explicit fund.

Interstate access charges are well in excess of their economic cost. The subscriber line charge (SLC) generates revenues of approximately \$8.8 billion, total switched access charges paid by IXCs are about \$10.2 billion, and total special access charges are about \$4 billion. These exceed forward-looking economic costs by at least \$10 billion. The revenues currently recovered in SLCs fully cover the 25 percent share of the local loop costs assigned to the interstate jurisdiction by the Separations rules, so no additional Universal Service contribution is needed

from PICC or CCL. In addition, traffic sensitive switched charges are about 2.4 cents per access minute of use, while the forward-looking economic cost is only 0.3 cents.

Since the costs being subsidized by the Universal Service Fund are loop and switch port costs, the above-cost rates associated with those elements (CCL, PICC, and Port) should be the first ones reduced when the explicit fund is introduced. MCI WorldCom recommends that reductions first be made in the CCL; if additional reductions are needed, they should be made in the PICC; if still more reductions are needed, they should be made in the port charge.

III. The Commission must resolve the nuts and bolts of actually implementing a workable explicit interstate Universal Service support fund.

A. Define the services that comprise Universal Service and calculate the economic cost of providing those services.

The first step in rationalizing and making explicit any subsidy is to define the service being subsidized and calculate the economic cost of providing the service. The Commission and the Joint Board already have identified the services that comprise Universal Service and have correctly concluded that the proper costing methodology is forward looking economic cost, or more specifically the total element long run incremental cost, including a portion of overhead costs. The Commission staff has constructed a costing model, HCPM, that incorporates some aspects of the methodologies developed by both the ILEC and the IXC industry. MCI WorldCom and other interested parties continue to work with Commission staff in the open process the staff has created.

As indicated earlier, MCI WorldCom agrees with the Joint Board that local competition has not yet developed to erode the implicit subsidies in above-cost rates for access and certain

local services, and thus an explicit Universal Service fund is not needed to protect against any imminent shortfall in Universal Service support funds. But that does not justify calculating the Universal Service funding need based on study-area-wide cost averages that continue to bury implicit subsidies in those averages. Calculating costs at a study area rather than geographic cost zone level creates four dangers: (1) it understates the total size of the Universal Service subsidy by continuing to keep much of the subsidy hidden in the ILEC's existing rate structure, (2) in so doing, it also prevents the Commission from determining the size of implicit Universal Service subsidies; (3) it provides no guidance on how to distribute the funds when there are CLECs as well as the ILEC providing service in the study area since it does not distinguish between high-cost and low-cost areas within the study area; and (4) it could be misinterpreted to imply that the funds are intended for the ILEC or that the new entrant must offer service in the entire study area to be eligible for the fund, which would be contrary to the procompetitive spirit and letter of the Act. The method most consistent with the legal requirements of the Act is to perform cost calculations using geographic cost zones that reflect true underlying cost differences.

Relying on accounting data and rules rather than a forward-looking costing model to determine Universal Service subsidy needs is totally retrogressive and exactly the wrong approach to take. Ironically, those who have suggested relying on accounting data and rules in this proceeding have proposed eliminating or weakening these same accounting requirements and rules in other Commission proceedings. Reversing the earlier decision of the Commission and Joint Board, and retaining embedded costs as the basis for subsidies, weakens the incentive for ILECs to perform efficiently because it is exactly the high-cost areas where competition is least likely to develop to provide market incentives for efficiency. Historical accounting costs do not

reflect the costs that would be borne by a provider with the incentive to be efficient. Moreover, each ILEC has unique access to its own accounting data and therefore can manipulate the data to its advantage. It is ludicrous to believe that more parties have open access to the accounting data on individual ILECs than have open access to forward-looking cost models. The history of regulatory oversight of telephone companies is replete with examples of ILECs hiding and manipulating accounting data.<sup>3</sup> Also, while forward-looking cost models can and will be modified over time to take into account new low cost technologies such as wireless, accounting data and rules are tied to the embedded wireline technology. This conflicts with the pro-competition and non-discrimination provisions of the Act.

- B. Construct a meaningful benchmark that incorporates the Act's Universal Service objectives of ensuring that rates in high-cost areas are affordable and reasonably comparable.

The purpose of Universal Service support is to ensure that residential and small business users in high-cost areas enjoy affordable rates that are reasonably comparable to rates in low-cost areas by providing carriers with a subsidy for the shortfall between the revenues likely to be generated when rates in the high-cost areas are maintained at levels that are affordable and reasonably comparable to levels in low-cost areas.

The only meaningful benchmark to use (to compare to the cost of providing service in high cost areas) is the projected revenue that would be generated in high-cost areas if rates were set at levels that are deemed affordable and reasonably comparable to urban rates. This is exactly what the Commission proposed in its earlier order.

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<sup>3</sup> See, for example, *In the Matter of GTE Telephone Operating Companies; Release of Information Obtained During Joint Audit, Memorandum Opinion and Order, AAD 98-26, 13 FCC Rcd 9179 (March 11, 1998).*

The Joint Board and the Commission already have found that the nationwide average rates used as the basis for the proposed \$31 and \$51 benchmarks are affordable. By developing a benchmark based on a nationwide average, the underlying rates used to construct the size of the subsidy needed build in reasonably comparable rates at that nationwide average. The Joint Board criticism of a price benchmark — that it will vary from state to state depending on each state's decisions and therefore cannot be used for a national benchmark — does not apply to the earlier Commission decision on a revenue benchmark because the revenue benchmark proposed is a national benchmark unaffected by rates in individual states.

In contrast, a cost benchmark of the sort recommended by the Joint Board is not a meaningful benchmark because it is not related to any agreed upon measure of affordable or reasonably comparable rates. There is no record evidence on the effect of, or in support of, the Joint Board proposal. Calculating Universal Service by comparing costs in a geographic area to a cost benchmark, as proposed by the Joint Board, does not identify the expected revenue shortfall and therefore does not identify the overall size of the subsidy needed or the size of the interstate portion of the subsidy. The methodology proposed by the Joint Board would not allow the Commission to meet the requirements of the Act.

- C. After comparing the economic costs of providing Universal Service to a meaningful benchmark to identify the level of Universal Service support needed, develop a process for determining the portion of that support to be provided by the interstate jurisdiction.

The proportion of explicit Universal Service support to be provided by the insensate jurisdiction is a separate task, distinct from the costing and benchmark tasks, because this task is inherently one of reaching political consensus on equity issues, but the others should not be. The

total revenues generated by interstate services and intrastate services whose rates are above economic costs are very much larger than the total level of revenues needed to provide Universal Service support. While both the interstate and the intrastate jurisdictions believe some of their rates have been maintained above cost to provide implicit Universal Service subsidies, it is impossible to unambiguously identify which of the above-cost rates actually provide that Universal Service subsidy. Because it now is necessary to replace the implicit Universal Service subsidies with explicit subsidies — an explicit interstate Universal Service support fund and, if individual states choose to provide Universal Service support, explicit intrastate Universal Service support funds -- a political decision is needed on how to share the Universal Service burden between jurisdictions going forward.

One approach for which a consensus seems possible is to compare the costs in different geographic cost zones to the revenue benchmark to identify the amount of Universal Service subsidy needed in each cost zone, but then to recover a larger proportion of the subsidy from the interstate jurisdiction for the higher cost zones. This has been referred to as a “superbenchmark” or “multiple benchmark” approach, but it is essential to understand that the calculation of the total Universal Service subsidy needed is based on the revenue benchmark; the superbenchmark or multiple benchmark just refers to cost cutoffs relating to the portion of the Universal Service subsidy borne by the interstate jurisdiction.

Using the HCPM and the revenue benchmark to calculate the total subsidy needed, and the cost benchmarks to determine the proportion of the total borne by the interstate jurisdiction, the total size of the explicit interstate Universal Service fund can be calculated. That new fund must be matched by dollar for dollar reductions in the implicit subsidies currently embedded in

interstate access charges, using the method described in Section II above.

The safety valve allowing a state to petition the Commission for additional interstate funding if it can make a showing that the state lacks the “tax base” to provide its share of support funds, which the Commission already has proposed, should be maintained. But creation of such a safety valve raises two issues that must be addressed prior to implementation. First, objective criteria must be developed to measure lack of tax base. Certainly one criterion must be that the local rates in the state seeking additional funding are at least at the national average. Additional funding should not be provided to states who set low rates and then seek subsidies from other states. Second, if the safety valve is employed and the interstate jurisdiction does make a greater contribution, should that addition to the explicit interstate subsidy fund be matched by dollar for dollar decreases in implicit interstate subsidies or should there be a net increase in the burden on interstate customers? Take the most extreme situation, in which use of the safety valve results in the explicit interstate fund bearing 100 percent of the state’s Universal Service burden. In this situation, the state no longer bears any Universal Service burden and therefore has no need to maintain any intrastate rates above cost to meet Universal Service responsibilities (unless it wants to set up its own fund to maintain rates below the national revenue benchmark). Thus, there is no need to receive an inflow of implicit subsidy from the interstate jurisdiction and no basis for double charging interstate customers; there must be dollar for dollar reductions in interstate access charges so long as these rates are above cost. The same logic holds when the safety valve is used but the interstate portion is less than 100 percent.

- D. Create policies and rules for determining which providers should receive the funds, i.e., how the money should be distributed.

The pro-competition and non-discrimination provisions of the Act mandate that all eligible providers must have non-discriminatory access to the explicit interstate Universal Service funds. The Joint Board recommendation that cost calculations be done at the study area level because competition has not yet developed to erode implicit subsidies must not be interpreted to mean that only the incumbent LEC can receive the funds. The funds must be portable to whichever carrier provides the subsidized service to the high-cost customer. As indicated earlier, calculating costs at a study area rather than geographic cost zone level provides no guidance on how to distribute the funds when there are CLECs as well as the ILEC providing service in the study area since it does not distinguish between high-cost and low-cost areas within the study area, and could be misinterpreted to imply that the funds are intended for the ILEC, or that the new entrant must offer service in the entire study area to be eligible for the fund, which would be contrary to the procompetitive spirit and letter of the Act.

Footnote 6 of the Joint Board Recommended Decision states that “We also recommend that the Commission take steps to hold state harmless, so that no non-rural carrier will receive less federal high cost support than the amount it currently receives from explicit federal support mechanisms.” This notion that individual carriers should maintain their current support must be rejected out of hand. Individual carriers cannot be held harmless or that would undermine non-discriminatory access to the explicit funds.

The basic policy must be that the eligible carrier who serves an eligible customer in a high-cost area receives the explicit interstate subsidy associated with that customer. This requires use

of the HCPM at a disaggregated geographic cost zone level. This is the only way to meet the statutory requirement that “a carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.”

- E. Implement mechanisms that prevent ILEC over-recovery of costs as explicit Universal Service support mechanisms are established.

Concurrent with the establishment of an explicit interstate Universal Service fund, there must be dollar for dollar decreases in the implicit Universal Service subsidies currently recovered in interstate access charges. As explained in detail in Section IIA above, this must be concurrent or it will unfairly harm interstate consumers and place IXCs at an artificial competitive disadvantage with ILECs.

- F. Determine the level of state discretion, if any, in distributing the federal Universal Service support funds.

States must use the criteria developed in (D) above as the basis for directing funds to a provider. In particular, states must distribute the funds to the carriers actually serving the high-cost customers for whom support is needed to make it viable to serve. States must not be allowed to redirect the funds to meet other objectives or to direct funds to individual carriers for any purpose other than providing support for serving the high-cost customers. In particular, states must not be allowed to distribute funds for infrastructure projects. States must not allow the recipients of the funds to use those funds for purposes other than meeting the statutory Universal Service requirements.

G. Develop a process for reviewing the support fund size over time.

The Joint Board hold harmless proposal must be transitional only and the fund size must be recalculated periodically. If it were maintained over time then it would force interstate customers to continue to fund subsidies even if Universal Service could be provided more cheaply by new technologies. In an industry characterized by rapid technological change, declining costs, and converging markets, it is especially important to review subsidy mechanisms frequently. In stagnant industries, a market distortion caused by a subsidy may not have significant impact, but in a dynamic industry, these distortions can have a major impact on the direction the market takes. This would be especially troubling if the initial need for the subsidy had disappeared or lessened due to declining costs. Moreover, when markets are converging, subsidy mechanisms must be reviewed to determine if they are being imposed disproportionately on certain segments of the newly converged market.

H. Give carriers discretion in how they recover their Universal Service subsidy responsibilities from end users.

In the Second Recommended Decision, the Joint Board recommends that the Commission standardize the name used by carriers to identify charges that recover Universal Service contributions, and require carriers to provide explanations of such line items on customers' bills. The Joint Board also recommends that, for carriers that choose to pass through a line item charge to consumers, the line item assessment be no greater than the carrier's Universal Service assessment rate. The Joint Board believes that such rules will help prevent consumers or classes of consumers from being charged excessively for a carrier's Universal Service contribution. The Joint Board is concerned that, absent such rules, "some carriers may attempt to exercise market

power and recover through universal service charges in a non-competitive fashion more than they are contributing to universal service....”

First, it is unlawful to restrict carriers to charging customers only the direct assessment rate imposed on them. MCI WorldCom and other IXC's bear not only our direct assessments, but also bear indirect Universal Service charges that we receive from ILECs who pass through their Universal Service burden to us through higher access charges. MCI WorldCom has elected to recover the totality of our Universal Service charges from customers in one fee, so that our customers can be informed of the entire Universal Service subsidy amount that they pay in their long distance rates. We include in our charge both the costs of the direct assessment we receive from Universal Service Administrative Corporation (USAC) and the indirect charges we receive from ILECs that are built into our per minute access rates.<sup>4</sup> If we are limited to the direct assessment charge only, we are being denied the ability to set our rates according to the dictates of the competitive market, and the result will be that if we cannot recover Universal Service costs in our line charge we must recover them in per minute charges. By limiting our recovery options, the Commission would have, in effect, introduced “back door” rates regulation of the IXC industry, contrary to twenty years of precedent.<sup>5</sup>

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<sup>4</sup> See In the Matter of MCI Emergency Petition for Prescription, CC Docket No. 97-250, filed February 24, 1998, decision pending.

<sup>5</sup> This problem would be less acute if all providers were required to recover their Universal Service funds only from end users. Without that requirement, providers with wholesale and retail customers, such as the ILECs, will have the incentive and ability to impose their Universal Service costs on their wholesale customers, thus placing a double burden on the end user customers of those wholesale customers. Thus, ILECs should not be allowed to pass through their Universal Service funding responsibilities to their competitors by recovering their funds from wholesale rates. Nor should the Commission require the ILECs to recover their contribution in increased access charges to the IXC's.

Second, as MCI WorldCom explained in the Commission's Truth In Billing proceeding,<sup>6</sup> there can be no question that the long distance industry is competitive, and consequently, that consumers have many choices of providers. As the Commission recently noted, there are more than 600 carriers in the United States that provide long distance services.<sup>7</sup> Additionally, as the Commission points out in its report entitled "Long Distance Market Shares, Second Quarter, 1998," based on the Hirschman-Herfindahl Indices (HHI), market concentration within the long distance industry has fallen dramatically since 1984, from 8,155 to 2,508 when based on long distance revenue.<sup>8</sup> When these statistics are coupled with the fact that last year over 26 million customers were reported to have changed long distance service providers,<sup>9</sup> it is clear that not only do customers have a choice of long distance providers, but they can and do switch providers often.<sup>10</sup> The Joint Board's concern that long distance carriers could attempt to exercise market power to recover through Universal Service charges more than they are contributing is misplaced.

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<sup>6</sup> Truth-In-Billing Format, Notice of Proposed Rulemaking, CC Docket No. 98-170, FCC 98-232 (rel. Sept. 17, 1998).

<sup>7</sup> In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., Memorandum Opinion and Order, CC Docket No. 97-211, released September 14, 1998, at ¶32.

<sup>8</sup> Long Distance Market Shares, Second Quarter, 1998, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, September 1998, at 10. The Hirschman-Herfindahl Indices (HHI) are the sum of squares of the market shares of the companies in a particular industry and is used by the Department of Justice to measure changes in industry concentration resulting from horizontal mergers or acquisitions.

<sup>9</sup> According to The Yankee Group's 1998 Technologically Advanced Survey (TAS), September 1998.

<sup>10</sup> The Commission itself pointed out in its "How To Select a Long Distance Telephone Company" Fact Sheet, released March 1996, that if a customer is unhappy with the long distance provider he or she selected, the customer can change to another long distance carrier at any time.

Third, given the strong competitive forces that exist in the long distance industry today, which drive most carriers to devote constant attention to billing and other customer communications, the Commission should proceed carefully as it decides whether to regulate carrier billing, and to what extent it should exercise its jurisdiction. The Commission correctly concluded in its Notice that "it is in the interest of IXCs and other carriers to inform fully their end user customers of the nature and amount of all charges they assess, including any separate line item charges they choose to impose for universal service and access, in order to preserve their customers' belief in the integrity of carrier billing."<sup>11</sup> The market place and competition are the most effective means for protecting consumer interests. Carriers that do not communicate effectively with their customers in the long distance market will lose those customers. The same is true in other competitive telecommunications segments.<sup>12</sup>

Fourth, competitive carriers must be given the flexibility to recover their costs as permitted by the market.<sup>13</sup> Because the Commission treats USF as a cost to carriers, when carriers recover that cost they must also consider uncollectibles, billing expenses, administrative

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<sup>11</sup> Truth in Billing Notice at 7.

<sup>12</sup> Unfortunately, there are a few carriers who are interested in the short term benefits to be gained by misleading or taking advantage of customers in a purposeful way. These are the minority of carriers who tend to generate the most significant complaints. For these carriers, the Commission's enforcement powers should be utilized to stop activity that results in customer abuses. And as previously discussed, a set of policy guidelines against which specific behavior can be measured would assist the Commission in its efforts.

<sup>13</sup> While it is true that decisions about how to charge our customers to recover these costs are ours and ours alone, MCI WorldCom has taken great efforts to ensure that both our customers and regulators understand that our new rate structure (lower per minute charges coupled with fees intended to recover new costs that we incur) is just and reasonable, and in no way over-recover the same costs.

expenses, etc., which will vary by carrier. If the Commission wants all carriers to charge the same amount, then they can do so by making the IXCs mere billing agents for USAC with no obligations to recover some fixed assessment. This would work by having carriers assess a specific percentage surcharge on consumer bills and then remit the amount collected to USAC or the ILECs.

Fifth, in addition to the First Amendment issues that could be raised,<sup>14</sup> there is no need for the Commission to consider micro-managing the billing statements generated by competitive carriers. MCI WorldCom takes seriously our obligation to provide our customers truthful and accurate information with respect to all charges, including Universal Service charges. However, even if the Commission erroneously decides to go down this path, it must recognize the limitations of such a strategy since carriers typically rely extensively on account representatives to manage large business accounts, and "safe harbor" language or standardized nomenclature, even if applicable, may be not be workable due to system and/or time limitations.

Finally, as MCI WorldCom explained in its Truth In Billing comments, if the Commission believes that regulatory intervention into long distance billing is required, then guidelines rather than rules and regulations should be developed. As MCI WorldCom demonstrated in its initial comments, such guidelines would allow the Commission to initiate enforcement activity, and would provide policy guidance to the Commission in adjudicating customer complaints. Guidelines also rest on firm legal ground as the Commission prepares to regulate in an area that has not previously been subject to Commission regulation. Moreover, guidelines would help

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<sup>14</sup> A truthful non-misleading message that differed -- even substantially -- from "safe harbor" language would have to be permitted.

ensure that customers receive clear and understandable bills without imposing costs on carriers that ultimately would be borne by end users through higher rates.

V. Conclusion

The Joint Board's Recommended Decision fails to provide guidance to the Commission on (1) how to reduce implicit Universal Service subsidies embedded in interstate access charges concurrent with the creation of an explicit interstate Universal Service fund, and (2) the nuts and bolts of actually implementing a workable explicit interstate Universal Service support fund. As a result, the Joint Board recommendations provide incomplete and insufficient guidance on the implementation of the comprehensive Universal Service reform required by the Act. The Commission must address and resolve all the policy and implementation issues identified in the Universal Service sections of the Act, not just the small subset of issues addressed by the Joint Board, in order to meet its statutory responsibilities.

Respectfully submitted,

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December 23, 1998

**STATEMENT OF VERIFICATION**

I have read the foregoing and, to the best of my knowledge, information and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on December 23, 1998.

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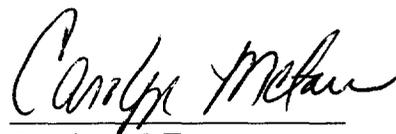
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