Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	DA 98-2410

Reply Comments of Communications Workers of America

on the Second Recommended Decision

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The Communications Workers of America (CWA) submits these reply comments on the Second Recommended Decision of the Joint Board on Universal Service.[1] CWA represents 630,000 workers who are also consumers of telecommunications services. The majority of CWA members are employed in the telecommunications industry. CWA seeks to ensure that public policy in the competitive environment protects and advances the provision of saffordable, quality telecommunications services to all Americans.

In these reply comments, CWA will discuss two issues: 1) the size of the study area over which costs are averaged for determination of universal service support; and 2) the need to make embedded implicit support explicit and to ensure that any proxy cost model be based on actual costs, including actual labor costs.

I. The Commission Should Ensure that Study Area Size Does Not Create Market Distortions which Incent Incumbent Local Exchange Carriers to Sell Rural Exchanges

[1] *In the Matter of Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Second Recommended Decision, FCC 98J-7, rel. Nov. 25, 1998 (ASecond Recommended Decision≅).

One of the key decisions before the Commission in this docket is a determination regarding the size of the study area over which costs of providing telephone service are averaged. The size of the study area is one key element in determining the ultimate size and targeting of universal service support. The Joint Board=s Second Recommended Decision proposes that federal support be determined by measuring costs at the study area level, as is the practice under the current system. In general, a study area is an area served by a local exchange carrier in a single state.[2]

CWA urges the Commission that if it concludes, as the Joint Board recommends, that the study area is the appropriate size over which costs should be averaged, then the Commission should also adopt a distribution mechanism--such as the one proposed by USTA and BellSouth-- that

[2] Second Recommended Decision, 32. The Commission recommended in its May 7, 1997 Universal Service Order that costs be determined at the wire center level or below. *In the Matter of Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, FCC 97-157, rel. May 8, 1997, 277 (AUniversal Service Order≅).

The Joint Board recommends a two-step process in determining the level of support a carrier receives. First, the carrier=s costs across the entire study area must Asignificantly≅ exceed the national average cost (based on a forward-looking methodology). Second, federal support should be used only to supplement a state=s ability to address its own universal service needs (determined, for example, based on a ratio of high-cost to low-cost loops in a state). Second Recommended Decision, 42-45.

would permit carriers to target that support to the higher cost regions within a study area.[3] CWA also urges the Commission to require an annual report to monitor the impact of sale of rural exchanges on the flow of federal universal service support.

A below-study level distribution mechanism and monitoring requirement would serve to minimize the economic distortions built into today=s universal support system. The Commission is well aware of the economic distortions that result from averaging costs across a large study area that includes high-cost rural and low-cost urban areas. First, averaging costs across a large study area creates incentives for large incumbent local exchange carriers (ILECs) to sell off rural exchanges. Purchasing carriers become eligible for federal universal service support that was not available to the ILEC when it owned the high-cost rural properties (since the ILECs= costs were averaged across an entire state.) Second, the ILECs are able to realize supra-profits from these sales because the purchase price is inflated by the anticipated large cash flows derived from universal service subsidies.

[3] USTA Comments, 7; BellSouth Comments, 8. USTA recommends that carriers should be allowed to use zones to distribute support. BellSouth recommends that support be distributed on a wire center basis.

To illustrate this phenomenon, CWA analyzed the impact on the flow of federal universal service support of U S WEST=s 1995 sale of 94 rural exchanges totaling 86,000 access lines in the three states of Colorado, Oregon, and Washington.[4] In three separate transactions, Pacific Telecom (which was purchased in 1997 by Century Telephone) bought 45 exchanges with 50,000 access lines in Colorado for $200 million; 26 exchanges with 20,000 access lines for $86 million in Washington; and 23 exchanges with 16,000 access lines for $81.5 million in Oregon.[5] (See Appendix A.)

Prior to the sale of these exchanges, U S WEST received no subsidies from the federal universal service support high cost fund in any of these three states.[6]

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[4] *Id*

[5] APacific Telecom, U S WEST Close Sale of Exchanges in Washington,≅ *Portland Oregonian*, Oct. 3, 1995. Pacific Telecom (which was purchased by Century Telephone in 1997) was then the holding company for Eagle Telecom (Colorado), Tel Utility of Washington (Washington), and Tel Utility of Oregon (Oregon).

[6] FCC, Federal-State Joint Board 1998 Monitoring Report, Section 3, Table 3.24.

And yet, the purchase of these properties significantly increased the flow of federal universal service high cost fund subsidies to Pacific Telecom by a total of $26.9 million. In Colorado, Pacific Telecom=s purchase of U S WEST=s 50,000 rural loops in February 1995 boosted its federal high-cost universal service subsidy in that state from just $407,000 in 1994 to $13.7 million in 1995. In Washington, Pacific Telecom=s purchase of U S WEST=s 20,000 rural loops in late 1995 boosted its federal high-cost universal service subsidy from $8 million in 1994 to $16.2 million in 1996. And in Oregon, Pacific Telecom=s purchase of U S WEST=s 16,000 rural loops boosted in late 1995 increased its federal high-cost universal service subsidy from $4.3 million in 1994 to $9.8 million in 1996.[7] Thus, the total impact of these sales was an increase from $0 in federal universal service support (to U S WEST) to $26.9 million (to Pacific Telecom, now Century Telephone).[8]

This was not the only U S WEST sale of rural exchanges in recent years. In fact, over the

[7] *Id.* These statistics cover only the universal service high cost loop fund, but do not include long-term support or local switching support, which could boost the subsidies even higher.

[8] *Id.* The calculation is: $13.2 million (Colorado) + $5.5 million (Oregon) + $8.2 million (Washington) = $26.9 million. As noted in footnote 7 above, this does not include additional payments for long-term support or local switching. Since the Oregon and Washington sales were completed in 1996, we use 1996 universal service support data in those states. The Colorado sale closed in Feb. 1995 so we use 1995 universal support data in Colorado. By 1996, Pacific Telecom=s universal service support payment increased to $18.3 million in Colorado.

1994-97 period, U S WEST has realized large profits from the sale of rural properties. According to U S WEST filings with the Securities and Exchange Commission, over the 1994-97 period,

U S WEST sold rural exchanges in almost every state throughout its 14-state region for a total of $1.1 billion, realizing a profit of $354 million on these sales.[9] While many factors contributed to U S WEST=s decision to sell these rural exchanges, the ability of exclusively rural carriers to capture federal universal service subsidies not available to ILECs that serve an entire state created market distortions in these transactions.

The trend among large incumbent local exchange carriers to sell rural exchanges continues. Recently, Ameritech sold 17 rural exchanges in Wisconsin to Century Telephone (the company that bought Pacific Telecom in 1997).[10] Prior to the purchase, Ameritech received no federal universal service subsidies in Wisconsin. The data on loop costs in these 17 exchanges is not publicly available, but based on loop costs of small carriers in surrounding exchanges, CWA anticipates that under the current system, Century Telephone will be eligible for federal high-cost support for its newly-acquired properties in Wisconsin.[11]

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[9] U S WEST Securities and Exchange Commission Form 10-K, 1996 and 1997.

[10] ACentury Tel Completes Purchase of 19 Wisconsin Telephone Exchanges from Ameritech,≅ Business Wire, Dec. 1, 1998.

[11] Federal-State Joint Board Monitoring Report, Table 3.24, 1998.

The Commission should take the opportunity of this reform of the universal service support system to minimize the economic distortion that we have described above. CWA recognizes, as Bell Atlantic, Ameritech, AT&T, and other commentators point out, that sizing the area over which high-cost support is determined at the wire center or another smaller geographic area would create its own market distortions.[12] Therefore, CWA urges the Commission to strike an appropriate balance by permitting carriers that receive universal service support to target distribution of these subsidies below the study area level. Furthermore, CWA encourages the Commission to establish a monitoring mechanism--in the form of an annual report--to assess the impact of the sale of rural exchanges on the flow of federal universal service support payments.

II. The Commission Should Act to Make Implicit Support Explicit and to Ensure that Proxy Costs Models are Transparent and Reflect Actual Costs.

The Joint Board acknowledged that the Commission has jurisdiction to determine what implicit universal service high cost support is in interstate access rates and to take appropriate action to make that support explicit. The Joint Board further encouraged the Commission to continue to Asynchronize the access reform and universal services proceedings with any action it takes to remove implicit universal service support from interstate access charges.≅[13]

[12] Bell Atlantic Comments, 5; Ameritech Comments, 5; AT&T Comments, ii.

[13] Second Recommended Decision, 22-23.

CWA agrees with USTA and other commentators that the Commission should act expeditiously on this authority. The Telecommunications Act requires such action, as the do market dynamics of a competitive environment.[14] CWA also agrees with the Joint Board and other commentators that should the Commission require reductions in access charges, it should ensure that the benefit of such reductions are passed through to consumers.

Finally, CWA agrees with the USTA and other commentators who raise concerns regarding the Joint Board=s recommendation that the Commission complete its work on a forward-looking cost model and use that model as the basis for determining federal high cost support. In prior comments, CWA expressed our concerns that any model that the Commission adopts must be based on data that reflects the actual labor costs of building, maintaining, and servicing the telephone network.[15] CWA believes that this goal is best served by using actual cost data, rather than hypothetical forward-looking cost data. In any event, CWA agrees with the Joint Board that the model that the Commission adopts must use publicly available data. [16]

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[14] USTA Comments, 2-5; U S WEST, 10; BellSouth, 2; SBC, 3.

[15] CWA Comments on Joint Board Recommendation, CC Docket No. 96-45, Jan. 9, 1997, 14-16. In those comments, we noted that Aany proxy cost model that does not base labor expenses on the actual cost of labor in the local exchange, including realistic productivity and inflation factors, would serve to undermine legally binding collective bargaining agreemens and existing labor standards.≅

[16] Second Recommended Decision, 29.

III. Conclusion

CWA fully supports the Joint Board=s recommendation that the purpose of federal universal service support is to ensure Areasonably comparable≅ rates (at reasonably comparable service quality, CWA would add) are available in all regions throughout the country. To ensure that this is achieved with the least amount of market distortion in a competitive environment, CWA encourages the Commission to allow carriers to target distribution of support to high-cost areas within a study area; to monitor and report annually on the impact of the sale of rural exchanges on the flow of federal universal service subsidies; to make explicit all implicit subsidies in interstate access charges that support universal service; and to ensure that any cost proxy model be based on actual costs (including actual labor costs) and adhere to openness criterion for input values.

Respectfully Submitted,

Communications Workers of America

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