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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 13, 1999

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, D.C. 20554

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

Dear Ms. Salas:

Enclosed herewith for filing are the original and four (4) copies of MCI WorldCom's Reply Comments regarding the Federal-State Joint Board on Universal Service Second Recommended Decision in the above-captioned matter.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI WorldCom Reply Comments furnished for such purpose and remit same to the bearer.

Sincerely yours.

Chuck Goldfarb

Enclosure
CBG

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY
1919 M STREET, N.W.
WASHINGTON, D.C. 20554

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

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

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

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January 13, 1999

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Executive Summary

MCI WorldCom is optimistic that the Commission can forge a decision on comprehensive Universal Service reform that includes the replacement of all implicit interstate Universal Service subsidies currently embedded in interstate access charges with an explicit interstate Universal Service support fund. That explicit Universal Service support fund must be based on an accurate calculation of the Universal Service support funds needed. The Commission already has determined how to perform that calculation. The ILEC proposal that Universal Service obligations be imposed on all interstate and intrastate telecommunications providers based on end-user revenues and that these obligations be recovered through a percentage charge on end-user interstate and intrastate revenues as a separate line item on all bills has many merits if implemented correctly.

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**MCI WORLDCOM, INC. REPLY COMMENTS ON
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I. Introduction and Overview

More than 30 parties submitted to the Commission comments on the Second Recommended Decision of the Federal-State Joint Board on Universal Service. Despite the disparate views expressed in the comments, MCI WorldCom believes that at least the private sector parties are moving closer together in their positions and that the Commission can forge a decision on comprehensive Universal Service reform. There is growing industry recognition that the new regulatory framework provided by the Telecommunications Act of 1996 (the Act) requires major changes in, not just tinkering with, existing Universal Service funding mechanisms. In these reply comments, MCI WorldCom focuses primarily on two major policy issues raised by a number of commenters:

- Many parties shared the concern expressed by MCI WorldCom in our comments that the Joint Board Recommended Decision failed to provide guidance to implement the comprehensive Universal Service reform required by the Act. These parties agreed that the Commission must undertake comprehensive reform that includes the replacement of all implicit interstate Universal Service subsidies currently embedded in interstate access

charges with an explicit Universal Service support fund (though there was disagreement on how to identify and calculate the size of the Universal Service subsidies). Other parties supported only partial reform that would not have eliminated all existing implicit Universal Service subsidies, but appeared to be open to comprehensive reform if their primary concerns were addressed.

- Several ILECs and ILEC associations have proposed that Universal Service obligations be imposed on all interstate (including international) and intrastate telecommunications providers based on end-user revenues and that these obligations be recovered through a percentage charge on end-user interstate and intrastate revenues as a separate line item on all bills. MCI WorldCom agrees that this would be an efficient and non-discriminatory recovery method, but a number of knotty legal and implementation issues remain that must be satisfactorily resolved before this approach can actually be employed.

II. The Commission Must Implement Comprehensive Universal Service Reform

MCI WorldCom finds itself in the unusual position of agreeing with most of the incumbent local exchange carriers (USTA, BellSouth, GTE, SBC, Sprint, and U S West) on the global issue of comprehensive Universal Service reform, and specifically on the need to replace all implicit interstate Universal Service subsidies currently embedded in interstate access charges with an explicit Universal Service support fund. We differ, however, on how to identify and calculate the size of the Universal Service subsidies. At the same time, review of the comments of parties that favored partial reform suggests that they would not be opposed to comprehensive reform if such reform were not marred by creation of an inflated explicit Universal Service fund that would

impose inappropriate and unnecessary burdens on certain industry sectors and telecommunications customers.

MCI WorldCom is optimistic that the Commission can forge a fair decision that is satisfactory to all parties, if the parties demonstrate some flexibility. Indeed, the Commission already has taken many of the steps necessary for comprehensive Universal Service reform. Now the Commission must complete implementation of the Act's requirements.

The Act provides clear guidance about the Universal Service subsidy. It is the level of funding needed to provide all residential and small business users affordable, reasonably comparable basic service. And it must be provided through explicit funding mechanisms in order to remove the implicit Universal Service subsidies currently embedded in certain telecommunications rates that distort market decisions and undermine competition. These statutory directives do *not* equate Universal Service funding with maintenance of the ILECs' revenue streams. The claims of some ILECs that all the net revenues generated by their above-cost rates represent implicit Universal Service subsidies¹ simply is not correct and, if accepted, would create inflated explicit Universal Service funds that could not be eroded by competition. The "gap" between revenues and economic costs far exceeds the subsidy needed for Universal Service. As the Commission found in 1997, the proper identification and calculation of Universal Service subsidies is the difference between the forward looking economic cost of providing basic service to high-cost customers and a benchmark set to reflect the revenues that a provider can expect to be generated by providing that service. This would yield an explicit Universal Service

¹ See, for example the comments of BellSouth at 3, GTE at 4 and 8, SBC at 3, USTA at 2, and U S West at 10.

fund sufficient to compensate efficient providers (ILECs or CLECs) for the shortfall between the costs and projected revenues of serving high-cost customers.

At the same time, the requirements of the Act will not be met by partial reform that fails to replace *all* implicit Universal Service subsidies with explicit Universal Service funding. No matter how well crafted, partial steps will not identify the total amount of Universal Service support needed or the amount of implicit Universal Service subsidies embedded in interstate or intrastate rates. These partial steps will leave in place unspecified levels of implicit Universal Service subsidies and perpetuate disagreements on how much they have eroded over time. The inevitable result will be contentious on-going battles over the size of the explicit fund needed. Partial steps also will leave significant questions about whether the literal requirements of the statute have been met. MCI WorldCom shares the concern of the Joint Board and a number of parties that creation of an explicit fund before competitive forces erode all the implicit Universal Service subsidies would place an undue burden on interstate customers and providers if those implicit subsidies were not eliminated simultaneously. Indeed, we previously proposed that basic service costs (and thus the total Universal Service subsidy) be calculated using the same level of geographic deaveraging as used in setting unbundled loop rates, since limited rate deaveraging does not allow loop rates to reflect underlying costs and impedes the development of competition that would erode implicit subsidies. Because most states have not deaveraged these rates significantly (or at all), in many cases the old MCI WorldCom proposal was equivalent to the Joint Board proposal to restrict the size of the interstate fund by calculating the Universal Service support needed on a study area basis. But this approach is not a magic elixir; it only reduces the size of the explicit fund for some period of time by maintaining the implicit subsidies embedded in the study-area-

wide averaged rates. And as long as those implicit Universal Services are not explicitly identified and calculated, they create a smokescreen for justifying all above-cost rates in the name of Universal Service. This perpetuates the existing system that Congress had the foresight to seek to reform. Thus, MCI WorldCom supports comprehensive Universal Service reform through creation of explicit interstate (and intrastate) funds that fully meet accurately calculated Universal Service needs, with simultaneous dollar for dollar reductions in implicit interstate (and intrastate) Universal Service subsidies.²

Regulators in some “low tax base” states are resisting comprehensive Universal Service reform because they do not seem to understand that an explicit interstate Universal Service fund could provide support that keeps basic local rates affordable even as interstate access charges are reduced. But they should not resist these reductions in interstate access charges; the total amount of Universal Service subsidy funds needed for non-rural LECs (to meet both interstate and intrastate responsibilities) is in the vicinity of two to three billion dollars, far less than the ten billion dollar differential between interstate access charges and access costs. Thus, in the extreme, the interstate jurisdiction could assume the entire Universal Service burden and reduce interstate access charges dollar for dollar, while freeing states entirely of any Universal Service burden (unless a state chose to subsidize rates set at levels set too low to generate the nationwide revenue benchmark threshold).

² MCI WorldCom believes that the Commission has the authority to order the states to create explicit intrastate funds and make dollar for dollar reductions in implicit intrastate subsidies (though only the states have the authority to determine which above-cost intrastate rates should be reduced). But even if it lacked that authority, it could implement comprehensive interstate Universal Service reform that is so compelling that states are inspired to follow the federal model. The ILEC funding and recovery proposal discussed in section III below represents one possible solution.

At the same time, regulators in “payor” states should not resist comprehensive reform because they should be comfortable in the knowledge that dollar for dollar reductions in interstate access charges will reward the customers in “payor” states with lower interstate long distance rates, and thus protect them from a double burden.

The Commission already has taken many of the steps needed to implement comprehensive Universal Service reform. It has identified the services that comprise Universal Service and has correctly selected the TELRIC forward looking economic costing methodology. While it still has some additional work to do on the HCPM model and inputs, it has set the right course and this large task is almost complete. It has correctly determined that Universal Service costs should be calculated in narrow geographic cost zones, thus eliminating implicit subsidies embedded in calculations based on study area-wide averaging. As explained in MCI WorldCom’s comments (at 11-12), the Commission already has constructed meaningful revenue benchmarks that incorporate the Act’s Universal Service objectives of ensuring that rates in high-cost areas are affordable and reasonably comparable. Thus, the Commission has constructed all the tools needed to accurately calculate the total amount of Universal Service support funds needed.

The Commission must work with the states to determine how to share jurisdictionally that total Universal Service funding burden. One reasonable approach is to use a “superbenchmark” or “multiple benchmarks” to identify cost thresholds above which the interstate jurisdiction would assume a greater share of the Universal Service funding burden.³ A second approach, proposed

³ These cost benchmarks should not be used as the basis for determining the total Universal Service subsidy needed, which must be based on a comparison of forward looking economic costs to revenue benchmarks. But once the total Universal Service subsidy is determined, the cost benchmarks could be used to determine the share of that subsidy burden borne by each jurisdiction.

by several ILECs and discussed in greater detail in section III, is to impose the entire Universal Service burden equally across all telecommunications providers (of international, interstate, and intrastate services), which would then allocate the burden in proportion to revenues in these jurisdictions.

With a properly defined and calculated explicit Universal Service fund, it should be easy to create policies and rules for determining which providers should receive the funds. The provider who serves a high-cost customer should receive the associated support funds, based on the difference between the TELRIC cost and the revenue benchmark. No provider should receive funding not earned by serving a customer; no provider should enjoy the protection of a hold harmless clause.⁴ The states' role must be limited to determining provider eligibility.

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, starting with reductions in the CCL, then if needed reductions in the PICC, and if still needed reductions in port charges.

Technological change and competitive market forces are likely to drive costs down over time, so the Commission must review and recalculate the level of total Universal Service support needs, and the size of the explicit interstate Universal Service fund, periodically.

⁴ SBC (at 6) makes a potentially dangerous call for protectionism, proposing “that no non-rural carrier...receive less federal high cost assistance than the amount it currently receives from explicit support mechanisms. However, this assurance should also be made with respect to the implementation of any new mechanisms. This clarification is required to address states where there are multiple non-rural carriers. In such cases, the total support for that state should not be redistributed among the companies.” While SBC may be stating opposition to the redistribution of support across existing ILECs, a literal interpretation of its language would be that new entrants could not receive Universal Service support funding because that would redistribute that funding away from the initial recipients.

III. ILEC Proposals for All Telecommunications Providers to Be Assessed Their Universal Service Obligations Based on Interstate and Intrastate End-User Revenues and to Recover These Obligations Through a Percentage Charge on Those Revenues Have Many Merits But Require Further Investigation

Several ILECs and ILEC associations⁵ have proposed that Universal Service obligations be imposed on all interstate (including international) and intrastate telecommunications providers based on end-user revenues and that these obligations be recovered through a percentage charge on end-user interstate and intrastate revenues as a separate line item on all bills. This proposal has great appeal, given its simplicity and fairness. By imposing the same obligation on all telecommunications services, across jurisdictions, it would impose the same non-discriminatory burden on all telecommunications providers, as required by section 254(b)(4) of the Act. By treating all jurisdictions equally, it would eliminate the incentive for providers to mischaracterize the jurisdiction of their traffic to avoid their Universal Service obligations. It would minimize the costs associated with developing billing systems by mandating a single methodology across jurisdictions. It would eliminate the current loophole by which ILECs can (and, indeed, are required by the Commission to) pass through their Universal Service obligations to the IXCs by recovering their costs in the access charge price cap baskets. The latter would have two salutary effects. First, it would protect IXC customers from being double burdened. Second, it would reduce the call for billing oversight. The increases in access charges to recover ILEC Universal Service obligations currently are not broken out as a separate line item, but rather are hidden in the access charges. This makes it difficult to identify how high these additional Universal Service burdens are on the IXCs. When the IXCs have attempted to recover these hidden charges in their

⁵ See, for example, the comments of GTE at v, USTA at 2-3, and U S West at 15.

“Universal Service fees” on end users, some regulators have complained that they could not determine if those fees accurately reflect the underlying costs to the IXCs. This proposal would eliminate the pass through and thus make regulatory oversight simpler. More broadly, it would eliminate most of the contentious issues that led to the Commission’s truth in billing proceeding.⁶

Interestingly, the ILEC proposal also would meet the call of many states for the interstate jurisdiction to bear more than 25 percent of the total Universal Service support burden. Based on data from Table 1.5, “Revenue by Service Category for 1997,” of the December 1998 Universal Service Monitoring Report prepared by the Federal and State Staff for the Federal-State Joint Board in CC Docket No. 96-45, 63 percent of carriers’ telecommunications revenues from end-users were from intrastate services, 37 percent from interstate and international services.⁷ Interstate customers would not be harmed by the interstate jurisdiction bearing a higher portion of the Universal Service burden if the new charge was matched by dollar for dollar interstate access charge reduction.⁸

But there are a number of knotty legal and implementation issues that must be

⁶ As AT&T states in its comments at 9, “At bottom, many of the Joint Board’s concerns and, indeed, those of the industry would be resolved if the Commission were to adopt a simultaneous assessment and recovery mechanism that would be assessed against carriers’ retail services and collected by carriers from their retail customers.”

⁷ The Commission has been concerned that the reporting of wireless revenues is inappropriately skewed toward the intrastate jurisdiction and therefore has opened a proceeding to investigate that reporting. Excluding wireless revenues, the breakdown of total end-user revenues is 57 percent interstate, 43 percent intrastate.

⁸ For this reason, MCI WorldCom could support a solution that simultaneously imposed more than 37 percent of the total Universal Service burden on the interstate jurisdiction and had dollar for dollar reductions in above-cost interstate access charges such as the CCLC or PICC, if it were determined that some telecommunications providers could be assessed more heavily than others without breaching section 254(b)(4) of the Act.

satisfactorily resolved before this ILEC proposal could actually be employed. First, can the Commission order telecommunications providers to pay into a fund based on their intrastate as well as interstate revenues? It is MCI WorldCom's position that it would be lawful for the Commission to assess carriers based on their interstate and intrastate revenues, given the section 254(b)(4) requirement that "All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." However, while the Commission has the authority to require such an assessment, it should take care that its implementation not impose an unfair burden on those telecommunications customers currently paying implicit Universal Service subsidies. The new explicit recovery charge must be imposed concurrent with dollar for dollar reductions in implicit Universal Service subsidies currently borne by those customers. Thus, if the total high-cost non-rural Universal Service funding need were calculated to be \$2 billion, and 63 percent of that need were assessed on intrastate carriers and 37 percent assessed on interstate carriers, then above-cost intrastate rates should be reduced by \$1.26 billion and above-cost interstate rates should be reduced by \$0.74 billion.⁹ Pragmatically, this should be implemented by creating an explicit interstate Universal Service fund and explicit intrastate Universal Service funds whose size would be matched dollar for dollar by decreases in implicit interstate Universal Service subsidies and in implicit intrastate Universal Service subsidies, respectively.¹⁰

⁹ If part of the new Universal Service assessment and recovery charge were needed for a new Universal Service program for which there were no implicit subsidies embedded in above-cost rates, then that portion of the recovery charge would not have to be matched by dollar for dollar reductions in above-cost rates.

¹⁰ For those telecommunications providers who are not able to identify the jurisdiction of their traffic, there would be a payment into the new explicit fund, but how could one determine

Another legal implementation question is whether the Commission can order telecommunications providers to place a line item on the bills of intrastate customer to recover the intrastate share of the total Universal Service subsidy needed. Again, it is MCI WorldCom's belief that the Commission has the legal authority to do so, but if it so orders, it should not match these new revenues from intrastate customers with decreases in above-cost interstate rates. Rather, if the new explicit intrastate Universal Service fund is recovering funds for a Universal Service program that has been supported by implicit intrastate subsidies, it must require states to have dollar for dollar decreases in above-cost intrastate rates. Some parties have questioned whether the Commission has the authority to require states to execute these intrastate rate reductions, for example, to refuse to provide Universal Service support to a state until that state identifies and authorizes the reductions in above-cost intrastate rates. MCI WorldCom believes that the Commission does have the authority to require the states to implement dollar for dollar reductions in intrastate rates in order to fulfill the requirements of the Act. Just creating an explicit fund without removing implicit Universal Service subsidies does not complete Congress' mandate. MCI WorldCom emphasizes, however, that the Commission does not have the authority to determine which above-cost intrastate rates should be reduced; that is solely the responsibility of the state.¹¹

whether the dollars should flow to the explicit interstate or explicit intrastate fund — and thus which implicit subsidies should be decreased? On one level, this should not matter, for whichever jurisdiction were chosen, the increase in explicit funding would exactly equal the decrease in implicit funding. But this could become contentious since it affects which currently above-cost rates — interstate or intrastate — will be reduced dollar for dollar.

¹¹ By placing the Universal Service section in the Act, section 254, under "Part II — Development of Competitive Markets," Congress clearly was providing both the Commission and

The potential benefits from the ILEC proposal are sufficiently great that MCI WorldCom encourages all parties to work together to overcome the legal and implementation obstacles.

IV. Conclusion

MCI WorldCom is optimistic that the Commission can forge a decision on comprehensive Universal Service reform that includes the replacement of all implicit interstate Universal Service subsidies currently embedded in interstate access charges with an explicit interstate Universal Service support fund. That explicit Universal Service support fund must be based on an accurate calculation of the Universal Service support funds needed. The Commission already has determined how to perform that calculation. The ILEC proposal that Universal Service obligations be imposed on all interstate and intrastate telecommunications providers based on end-user revenues and that these obligations be recovered through a percentage charge on end-user interstate and intrastate revenues as a separate line item on all bills has many merits if implemented correctly.

the states guidance on which above-cost rates to reduce concurrent with implementation of explicit Universal Service funds — those that would most inhibit competition if maintained above cost. The rates that most affect competition are the rates for essential inputs required by all competitors. In the intrastate jurisdiction, the input rates that most affect the competitiveness of telecommunications markets are intrastate access charges. These are the above-cost rates that the states should reduce first when implementing an explicit intrastate Universal Service fund.

Respectfully submitted,

MCI WorldCom, Inc.

Chuck Goldfarb

Chuck Goldfarb

MCI WorldCom, Inc.

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January 13, 1999

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge 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 January 13, 1999

Chuck Goldfarb

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Service List

I, Carolyn McTaw do hereby certify that a copy of the foregoing **Reply Comments** has been sent by United States first class mail, postage prepaid, hand delivery, to the following parties on this 13th day of January 1999.

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