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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 14, 1999

Office of the Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington , DC 20554

96-45

To whom it may concern:

The Rural Utilities Service filed reply comments on January 13, 1999, in the matter of the Federal-State Joint Board on Universal Service and its Second Recommended Decision (CC Docket 96-45, DA 98-2410). On looking at our copy today, I noticed that we accidentally indicated the wrong docket number, i.e., we used 96-145 instead of 96-45. I have attached an additional seven copies of our stamped copy to ensure that the comments reach the appropriate place.

Sincerely,

Gary B. Allan
Chief, Transmission Branch
Rural Utilities Service

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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

JAN 13 1999

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service and its	)	
Second Recommended Decision	)	

Reply Comments of the
Rural Utilities Service

The Rural Utilities Service (RUS, the Agency), a rural development agency of the United States Department of Agriculture, actively supports and promotes the universal availability of a broad range of telecommunications and information services in rural America. The RUS appreciates the opportunity to offer comment to the Commission on the Second Recommended Decision (Recommended Decision) of the Federal-State Joint Board on Universal Service (Joint Board).

Our comments are intended to be helpful to the Commission and Joint Board in their efforts to develop the proper and most reasonable method for determination of high cost universal service support. All previous RUS comments are available at our website: www.rurdev.usda.gov/rus.

Positive Features of the Second Recommended Decision

Balance of Federal and State Support ("25/75")

The Joint Board has taken a positive step by recommending that the Commission not set a fixed balance between federal (25%) and state (75%) universal service support. The RUS has maintained that the 25% limitation on federal universal service support violates several of the principles of Section 254 of the Telecommunications Act of 1996 (Act of 1996). A fixed balance is inappropriate because the needs and resources are not the same in every state and the Act of 1996 calls for a national response to the challenge of providing affordable, quality telecommunications services to all Americans in a competitive environment.

Interstate and Intrastate Revenues

The RUS appreciates the Joint Board's acknowledgment that "a non-jurisdictional assessment base would enable both the state and federal mechanisms to tap broader revenue bases, thereby lowering the assessment rates needed." The Act of 1996 requires that all telecommunications carriers contribute to universal service support on a competitively neutral basis. The Act also contains a broad definition of telecommunications. The broadest based support ensures that the burdens of universal service support do not unfairly fall on any one segment of the telecommunications industry.

Cost Models

The RUS applauds the Joint Board for recognizing that the development of a cost model is not complete. We also agree with much of the analysis of cost model shortcomings contained in the member's attached statements. The self-imposed deadline of July 1, 1999, should not propel the Commission to a premature judgment on the appropriateness and use of a model-based system. The guiding principle should be to get it right.

In previous filings, the RUS has expressed concerns about the adequacy of the various cost models under consideration. Even at this point in model development, a mere five months before the Commission's target date, verification of the accuracy of a cost model is as distant as it was a year ago. Whether it is possible to develop a reliable and accurate model is still an open question. The issue cannot be settled until the model is verified using a readily available set of inputs tested against real-world examples. Before adopting an untested mechanism, the RUS recommends a road test of a model-based support system in one or two states.

No Precedent for Rural LECs

The RUS agrees with the recommendation of the Rural Task Force that the mechanism adopted for non-rural LECs not be considered a precedent for rural LECs. Given the demonstrated difficulty of developing a workable mechanism for non-rural LECs, their greater resources to withstand any negative consequences of that mechanism, their broader customer base, and the crucial importance of rural LECs to rural America, it is critically important that this mechanism not be automatically applied to rural LECs.

The Commission should give full consideration to the recommendations of the Rural Task Force. While the Recommended Decision contained a reminder that the Commission has pledged not to alter rural LEC support systems before January 1, 2001, at the earliest, the looming deadline creates uncertainty which has depressed investment in rural telecommunications. Because the RUS believes that more should be done to remove that uncertainty, the Agency appreciates the positions taken by Commissioners Ness and Furchtgott-Roth in their separate statements, that the

non-rural mechanism should not be a precedent for the rural LECs. The RUS also appreciates the characterization of the rural LEC support mechanism made by Chairman Kennard in a speech last year, "if it ain't broke, don't fix it."

Rate Comparability

The RUS concurs with the Joint Board that specific high cost area rate comparability needs to be addressed. Rate and service comparability is not just a state issue.

Areas of Concern

1. Statewide Study Areas Based on Cost Models

The RUS recognizes the practical considerations which led the Joint Board to recommend that forward-looking costs be based on a cost model and that the costs be aggregated at the current study areas. This pure model-based approach, however, could sever the link between investment and support and could distort competitive markets. The RUS believes that when combined with other policy decisions in place, study area averaging is not the best way to preserve and advance universal service. While we recognize the practical considerations, we believe that this Joint Board recommendation is founded on two assumptions which are now in question:

> Assumption 1. Forward-looking Costs are Lower. When this process began, it was "common knowledge" that forward-looking costs in the telecommunications industry were falling. Given that the Act of 1996 is designed to encourage competition and investment, and preserve universal service, it seemed reasonable that support should be based on forward-looking costs, the cost a facilities-based competitor would face entering the market. It would be unfair for incumbents' support to be based on more expensive, embedded plant, particularly when that plant is not capable of providing the advanced services inherent in the design of a forward-looking system.
>
> The RUS and others have repeatedly commented that declining forward-looking costs might be true in urban areas where electronics dominate, but that cable dominates in rural areas and the cost of installed cable continues to rise. As the models have improved, the cost estimates for rural areas are now above, not below, embedded cost.
>
> Assumption 2. A Cost Model is Feasible. Cost models have been under development for many years yet not one has passed a real-world verification. Even if a reliable model were available, it would require frequent revisions and maintenance.

Although the Commission has not completed a final version of its model, preliminary results are clear: model-developed forward-looking costs in rural areas are higher than embedded costs and in some areas, they are much higher. As a result, if support were to be based on these costs

aggregated at the wire center level, non-rural LECs would receive large amounts of support regardless of the quality of service they provide. Such a result would be contrary to the letter and the spirit of the Act of 1996.

Some thought that a cost based system would unjustly reward carriers for old plant that could be built less expensively today. Now it seems that a pure model-based system risks unjustly rewarding carriers for old plant as if their entire system were the modern plant contemplated by the cost models. Based on our experience with State Telecommunications Modernization Plans, even if LECs started modernizing their rural plant today, it would take at least ten years for extensive deployment of modeled plant.

Universal service support is crucial to rural America and a mechanism which unjustly and prematurely rewards a carrier could destroy support for the concept just as surely as too little support will destroy the service itself. We believe that preventing such improper support is the driving force behind the Joint Board's recommendation that costs be aggregated at the current study area rather than the wire center. But this solution creates problems of its own.

Problems of Study Area Averaging:

- The larger the area over which forward-looking costs are averaged, the less likely it is that that area's average cost will exceed a national average cost by a fixed percentage. For example, if the study area were the entire country, the study area forward-looking cost would be identical to the national benchmark. Average per-line costs increasingly diverge from the national average as the study area shrinks from statewide to wire center to individual subscriber.

  Given that the non-rural LECs serve urban areas, the effect of rural costs will be substantially diluted when the per-line estimate is averaged over a statewide study area. This means that many non-rural ILECs will not exceed a national average threshold by a fixed percentage unless that percentage is relatively low. Such a carrier would not be eligible for support even though its cost to build and maintain rural lines would be high. In a competitive market, no carrier can justify investing in an area that will not bring a return and, as a result, there would be no incentive to preserve and advance universal service in those rural areas.

- A carrier whose costs exceed the threshold would be eligible for support, but the support would be much less than if calculated on a wire center basis and would not be sufficient to build and maintain high cost lines were the carrier to build them. Further, the carrier need not use the support for its highest cost lines because, on average, every line is high cost line. Even if that carrier were to support its rural lines internally, it would lose a portion of its support for every line that an urban CLEC took away from it.

- Compounding the problems of study area averaging is a Commission decision on portable support, i.e., that the per-line support available to a CLEC is to be equivalent to that available to the incumbent. Since study area averaging will provide no support, or inadequate per-line support, no competitor could feasibly enter a high cost area served by a large LEC. Not only will the non-rural LEC have no incentive to invest in its high cost areas, it will be essentially exempt from competition in those areas. This may divert competition to rural LECs with smaller study areas even though there is a more rational basis for competition in the non-rural LEC territory

The Joint Board has recommended that LECs certify that universal service support funds are used in a manner consistent with Section 254. This is a step in the right direction, but it is not enough. A proper mechanism should ensure that support goes to the high cost lines.

An Alternative Proposal

While the RUS has expressed and maintains reservations about the state of forward-looking cost models, we acknowledge that there are good reasons for using forward-looking costs as a tool of policy and market analysis. Models should not be used as a substitute for policy. A well-developed model could provide signals for entry, investment, and innovation.

Rather than enlarge the study area to the point where the per-line support bears no relation to the excess cost of high cost lines and where it no longer creates the proper signals that forward-looking costs are intended to create, the RUS believes the Commission should consider melding an actual cost approach with the cost model approach. Cost model results could serve to check the reasonableness of actual expenditures.

Such a system, perhaps using exchange level data already collected for toll settlement purposes, would have advantages over study area averaging based on cost models. Among the advantages are:

- Support would be closely and automatically linked to actual investment in high cost rural exchanges. LECs that do not invest in their rural areas would receive less support. LECs that do, would receive more. It would be a simple and effective tool to *preserve and advance* universal service.

- The per-line support in each exchange would be *specific, predictable, and sufficient.*

RUS would be happy to provide the Commission additional details on how a melded system could operate.

2. Federal and State Responsibility

Section 254 (e) clearly establishes that federal support must be explicit and sufficient to achieve the purposes of Section 254. The Joint Board's recommendation as seen in paragraphs 5, 16, 37, 42, and 45, of the Recommended Decision would invert this process. It envisions federal support as a supplement to a reasonable state effort. Although the Recommended Decision frequently repeats that there is no mandate on the states, a *presumed responsibility,* as discussed in paragraph 45, would be indistinguishable from a mandate.

The federal commitment to universal service predates the Federal Communications Commission. The Act of 1996 changed many things but it did not change this fundamental federal responsibility. The recommendation to abandon the 75/25 decision and the consideration of basing support on interstate and intrastate revenues are significant steps in the right direction. The Act calls for a coordinated federal and state universal service support system where state support mechanisms were intended to augment federal support mechanisms, not the other way around.

3. Bandwidth

The RUS is disappointed that the Commission did not request guidance from this Joint Board on the question of the bandwidth of supported services. The prior Joint Board had recommended that voice grade service be defined as having a frequency range (bandwidth) of 500 to 4000 hertz. This definition was recommended after extensive public input was obtained in hearings and written comments, including comments filed by the RUS. The Commission adopted the prior Joint Board's recommendation concerning voice grade bandwidth in its *Universal Service Report and Order* dated May 8, 1997, after having received further comment including extensive comment on the prior Joint Board's recommendations.

In the Fourth Order on Reconsideration, issued December 30, 1997, the Commission significantly changed the definition of voice grade bandwidth without seeking comment. The new definition of voice grade access is 300 to 3000 Hz.

The reduction in supported bandwidth from 3500 to 2700 Hz is a serious blow to rural areas. A 300 to 3000 Hz telephone channel, with unstated tolerances, cannot support a V.34 standard modem (28.8 kilobits per second) or any of the other advanced services that can be provided over the modern plant design (carrier serving areas, unloaded loops, etc.) of the Commission's hybrid cost model. The RUS believes the Commission should adopt a frequency response consistent with the modern plant design of the cost models.

4. Unserved Areas

Assuming competitive pressure and a need for rate comparability, unserved areas could not be economically served by a non-rural ILEC under a study area support system. While we believe

the Commission should pursue innovative and open approaches, the universal service support mechanism should encourage either an ILEC or CLEC to serve most unserved areas where the inhabitants seek affordable service. Lower income unserved areas certainly deserve further attention of the Joint Board and Commission as recommended by the Joint Board. The Commission has a special federal responsibility to address lack of service in Native American communities. The Commission must also ensure that when a rural exchange is sold or transferred, support should be sufficient to ensure quality service to the customers. Support should not depend on the identity of the previous owner. RUS has observed that exchanges transferred from non-rural LECs to RUS Borrowers require significant investment to bring plant and service quality to modern standards.

5. Hold Harmless

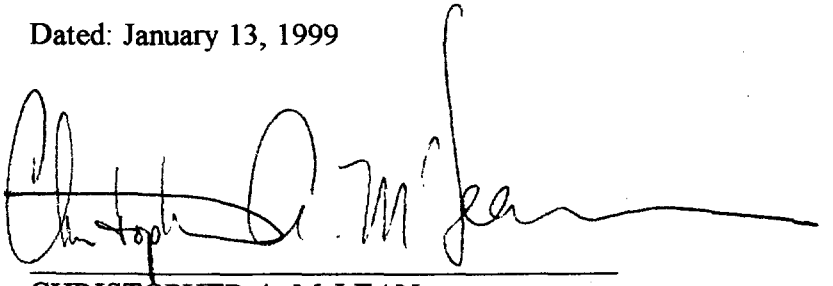
A hold-harmless policy must consider more than explicit support. For example, current access charges, rates of return, and separations support universal service. The Commission must take great care in reforming implicit support mechanisms because it is the rural American who should be held harmless.

Conclusion

The link between support and investment must be preserved because it is critical to the preservation and advancement of universal service. Adherence to this principle will ensure comparable services and comparable rates that are just, reasonable and affordable.

Universal service is the core mission of the Commission and the RUS and will have a profound effect on millions of Americans. Universal service is about one nation - indivisible. We cannot enter a new century a nation divided into information haves and have nots.

Dated: January 13, 1999



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