Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	

COMMENTS OF BELL ATLANTIC ON FURTHER NOTICE OF PROPOSED RULEMAKING

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ON FURTHER NOTICE OF PROPOSED RULEMAKING

In the order accompanying this notice, the Commission made the correct policy choice: the future federal universal service high cost fund must be comparable in size to the current fund. The federal role complements the primary responsibility of the states, and the Commission's decision is consistent with that role as set forth in the Act and by the Joint Board. As explained further in Bell Atlantic's comments in the parallel proceeding, the Commission's reliance on a cost proxy model continues to be fundamentally flawed. The proposed model is unreliable, riddled with errors, and cannot reasonably be used for any purpose. Nonetheless, if the Commission continues to rely on its flawed model, it should only be used as a tool to determine how to *distribute* a pre-set level of funds among carriers in the states. The parameters of the funding mechanisms should therefore be set at levels that meet the Commission's policy goals for fund size, and minimize any distortions in distribution proportions.

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1 The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

In particular, the Commission should not run the model below a study area level. Such aggregation keeps the fund size reasonable and masks other errors in inputs. The Commission should phase out hold harmless protection to avoid institutionalizing subsidies that are unnecessary under the Commission's own standards. In addition, the Commission should not use universal service as an excuse to interfere with state rate setting. Finally, as with the federal mechanism to support intrastate services, any new universal service support for interstate services should be the minimum necessary.

I. The Commission Has Appropriately Established The Fund Size

The Commission correctly treated the size of the federal fund as a policy matter that should be decided directly by the Commission and not as the result of the black box output of any model. Consistent with the recommendation of the Joint Board, the Commission cited several reasons for limiting the fund to an amount approximating current funding levels.

The Commission reconfirmed that "telephone service currently is largely affordable." Order, ¶ 70. As a result, the Commission can meet its duty to assure sufficient, specific and predictable support "without imposing an undue burden on carriers, and potentially, consumers to fund any increases in federal support." *Id.*, ¶ 69.

The Commission also recognized that states have a primary role in preserving universal service and that "it would be unfair to expect the federal support mechanism" to bear the support burden "that has historically been borne within a state by intrastate, implicit support mechanisms." Order, ¶ 46. As a result, the Commission's proposed high cost mechanism would recognize an amount of state support that would further limit the potential federal fund size. This is consistent with statutory mandate, which recognizes that sufficiency must be judged by looking at both "Federal *and State* mechanisms" to preserve and advance universal service. 47 U.S.C. § 254 (b)(5) (emphasis added).

Finally, the Commission recognized that it was seeking to apply a nationwide forward looking cost model that neither the Commission, nor anyone else, had any experience in analyzing. As a result, the Commission sought to limit any changes based on the model, at least until there is a period of time for the Commission to "gain experience" with its use. Order, ¶ 16.

Because of the sound policy justifications, and consistent with the recommendation of the Joint Board – the Commission has therefore already sized the federal fund. The details raised in the notice -- including the benchmark, the geographic scope, and the measure for state support -- must be set consistent with the Commission's policy decision that there will be no substantial increase to the federal fund. These parameters should be used only to determine the distribution of the fund, and then in a manner that minimizes distortions and avoids the creation of new or inappropriate subsidy elements.

As demonstrated in Bell Atlantic's comments filed today in the Commission's parallel proceeding on model inputs,[2] the latest attempt at producing a viable cost model has failed. The current model, together with the proposed inputs, is riddled with inaccuracies and systematically understates the actual forward looking costs of providing universal

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[2] Comments of Bell Atlantic, *Federal State Joint Board on Universal Service; Forward Looking Mechanism for High Cost Support for Non-Rural LECS*, Docket Nos. CC96-45, CC97-160 (filed July 23, 1999) ("Bell Atlantic Model Comments").

service in the real world. Applying this defective model to make real world decisions would be an abandonment of the Commission's and the Joint Board's obligation to distribute universal service funds in a reasonable manner.

Results from test runs of the model also make no sense. Attached here as Exhibit 1 is a run of the state-by-state impacts of the proposed model.[3] Virtually all of the increased non-rural universal service funding goes to just a handful of states and all others end up as incremental losers when compared to the status quo. For example, relatively rural states like New Mexico (more than $2 million), South Carolina (more than $4 million) and Arizona (more than $6 million) all are net losers. States with a bigger mix of urban and rural like Texas (more than $19 million) and New York ($22 ½ million) give back even more. The few beneficiary states reap unrealistic windfalls. For example, using these same assumptions, Mississippi comes out net with over $124 million more in non-rural funding than they receive under the current system.

Given the number and the scope of the infirmities of the model, combined with the relatively small proportion of universal service dollars at stake for non-rural carriers, the best policy option would be to abandon the model development process altogether and simply adjust current funding mechanisms so that they are portable and vary by unbundled network element zone. *See* Bell Atlantic Model Comments at 5-6. If the Commission nevertheless decides to continue in its effort to apply the proposed model for

[3] For illustrative purposes, the run assumes a 135% benchmark run at the zone density level and a $2 per line offset representing state universal service responsibility. Changes in the parameters would change the dollar amounts, but not the inequity of the distribution.

this purpose, which it should not, it should institute the policies described below in order to limit its impact and avoid irrational decision making.

II. The Model Should Be Calculated At A Study Area Level

Consistent with its commitment to limit the size of the fund and recognize a state's ability to manage its own universal service issues, the Commission should adopt the Joint Board recommendation and calculate the model results at a high level of aggregation. Joint Board Recommendation, ¶¶ 32-33. As the Commission recognized, calculating costs at the study area level is "more likely to prevent substantial increases in the size of the high-cost support mechanism because high-cost areas within the study areas are averaged with lower-cost areas within study area." Order, ¶ 105. This conclusion is confirmed by doing test runs of the current model proposal. Regardless of the benchmark chosen, the fund size is several times larger when run at the wire center level when compared to running the model at the density zone level. *See* attached Exhibit 2. The effect is even greater if the model were to be run at the study area level. Unfortunately, the proposed model data does not allow for such a run.

At the same time, viewing the model's results at a less granular level reduces some of the errors. Because of inappropriate input data, the model consistently does a very poor job of matching actual line counts and loop lengths at the wire center level. Bell Atlantic's analysis of the wire center level line counts indicates that, when compared to actual line counts, the model's wire center line counts are often in excess of 50% off from actual line counts. Similarly, the model's wire center average loop lengths show no correlation with actual loop lengths. These differences, however, are less exaggerated at the study area level. For example, based on a wire center comparison for one of Bell Atlantic's study areas, the proposed model's average loop length was as much as 130% different from actual wire center average loop length. However, because of averaging, the model's study area average loop length differed from the actual study area average by only approximately 5%.

III. The Commission Should Phase Out Any Hold Harmless Protection

The hold harmless protection stands in tension with the fundamental decision in the Commission's Order. For the policy reasons discussed above, the Order will establish a sufficient fund, which will approximate today's fund size. The hold harmless provision works against this goal and instead forces the fund size up. By starting at a base of the existing fund size, it virtually guarantees a larger fund in the face of a policy determination that a larger fund is not needed.

The Commission should allow the hold harmless subsidy flows to dissipate over time. A specific multi-year phase-down, prescribed at the outset, will protect those areas that are dependant on the current flows, while not institutionalizing subsidies that are unnecessary under the Commission's own standards.

In the meantime, the Commission should distribute hold-harmless funds in the least disruptive manner possible. The best way to avoid the creation of new mechanisms solely to distribute these funds would be to calculate the total amount of hold-harmless extra funding -- the amount above what the Commission otherwise determines is a sufficient fund -- on a statewide basis and then distribute these extra funds to carriers based on a pro-rata number of high cost lines serviced in that state. This would also ensure that these funds remain portable.

IV. Section 254 Does Not Require Commission Interference In State Rate Setting

The Commission properly recognizes that universal service rules do not undermine the traditional state primacy over local service. Indeed, the Commission properly defers to the states for their own role in solving local universal service problems. The continuation of prior federal support for universal service does not trigger a new right of the FCC to interfere with state rate setting.

Under the prior universal service regime, the federal support for universal service was distributed to the carriers. States were responsible for setting maximum allowable intrastate rates. In exercising their oversight function and determining whether rates were just and reasonable, local regulators were aware of any universal service support that a carrier received and that information was taken into account in the rate setting process.

Nothing has changed with universal service distribution under the Act. Indeed, to the extent the federal universal service support to a carrier within a state is unchanged from prior levels, no reasonable adjustment to state rates is appropriate. Regardless, it is up to the state regulators to determine the appropriate level of local rates.

The FCC has already protected against double recovery by limiting the size of the federal fund to recognize the role of state support. By providing for funding only to cover costs that are beyond a state's ability to finance, the Commission has established protection against double recovery. It is the state's responsibility to assure that the combination of federal support, state support, and state rates are together sufficient to support the provision of state local service. The FCC's involvement in the collection and distribution of federal universal service support does not give it authority to supercede or oversee these traditional state functions. Quite the contrary, § 2(b) prohibits the FCC from doing so, and Congress chose not to amend to limit the reach of § 2(b) when it passed the Act. Congress expressly considered and rejected an amendment to § 2(b) that would have excluded the universal service provisions (along with other provisions in the local competition parts of the bills) from that section's jurisdictional limitation on the FCC's authority. To address State concerns, the proposed change was deleted by the Conference Committee. *See* S. 652, 104th Cong. § 101(c)(2) (1995); H.R. 1555, 104th Cong. § 101(e)(1) (1995).

V. Universal Service Support For Interstate Rates Should Rely On The Same Principles That Guide Support For Intrastate Service

As with the federal fund to support intrastate rates, any federal universal service fund to support interstate rates should be the minimum necessary to accomplish its purpose. There are a number of opportunities for the Commission in the Access Reform docket to modify rate structure and thereby reduce subsidies – whether classified as implicit or explicit -- without additional universal service assessments. Regardless of what the Commission does there, however, there is no obligation to eliminate all subsidies in rates.

There undeniably are certain aspects of the current rate structure for interstate access rates that could be characterized as subsidies – although they are properly classified as explicit rather than implicit in at least some instances. For example, under current price cap rate structures for interstate end-user charges, the multiline business rate and non-primary line residential rate are higher in part to support a subsidized single-line residential rate. These artificial subsidies can be removed, however, through rate structure changes with no need to create a separate or increased universal service funding mechanism. Moreover, the current price cap rules do not permit carriers to charge a lower per-line charge in lower cost urban areas. The Commission can significantly reduce what amounts to subsidies between rate zones by allowing carriers to deaverage line charges based on those zones.

To the extent some parties may claim the Act requires all implicit support to be removed from rates, they are simply wrong. Indeed, it would be impossible. So long as averaged rates are charged (even over a smaller geographic unit such as rate or density zones) there must be some implicit support embedded in rates. Indeed, Congress considered and rejected a radical overhaul of cost recovery that would have come closest to imposing such a requirement.

Senator McCain made a proposal for a radical change that would strip all support payments out of carriers' rates and substitute a voucher system, under which carriers would accept vouchers in payment for services and the Commission would redeem the vouchers using a fund collected from the prescribed contributions of carriers. 141 Cong. Rec. S8209-10 (June 13, 1995). The essence of the proposal was to remove all subsidies from rates (apparently intrastate as well as interstate) and substitute direct payments from a federal fund administered by the Commission. Senator McCain himself observed that this proposal was so far beyond what Congress was ready to do that it would fail. *Id.* at S8209. It was, in fact, overwhelmingly defeated. 141 Cong. Rec. S8239 (June 13, 1995) (vote: 18-82).

In any event, the terms that were adopted in section 254 do not require elimination of all implicit subsidies or even all implicit subsidies in interstate rates as suggested in the Notice (¶ 126). Section 254 provides for the Commission to establish specific federal universal-service support mechanisms, but at no place does it state that *all* subsidies -- a term that does not even appear until subsection (k) -- must be removed from marketplace rates and replaced with such explicit government-run funding. The specific programs created by the Commission must be specific and predictable, must be funded by equitable and nondiscriminatory contributions from carriers and other service providers, must distribute its benefits only to eligible carriers using those benefits only for designated purposes, and should be explicit and sufficient. 47 U.S.C. §§ 254(b)(4) & (5), (d), (e). But once the Commission's specific programs satisfy those conditions, section 254 is satisfied. There is no free-floating command in section 254 to remove all implicit subsidies from rates or to make all subsidies explicit.

Regardless, to the extent the Commission determines that identifying and removing a portion of implicit subsidies in rates is appropriate, it must be careful not to undermine the interstate operations of local exchange carriers. In particular, the Commission should not expand use of the model to identify amounts to be adjusted in interstate rates. As previously discussed, the proposed model is not useful for any regulatory purpose, but at a minimum the Notice proposes to limit use of the model to distribute, but not to size, the amount of federal support for intrastate universal service. The model is no more reliable in determining interstate support levels and should not be used to size an interstate support fund.

Once the Commission determines the amount, if any, of implicit subsidies in current interstate rates that should be recovered through an interstate universal service fund, the Commission is correct that interstate rates should be proportionately reduced as an offset to any new universal service support received. Absent an industry consensus as to how to distribute those funds, the Commission should adjust rates in the Common Line Basket, starting with the carrier common line charge. Once the carrier common line charge is eliminated, further reductions should be used to reduce the multiline business and non-primary residence subscriber line charges, as well as reducing the presubscribed interexchange carrier charge ("PICC") rates for multiline business and non-primary residence lines. In contrast, a further reduction of the primary line PICC without reduction of the other elements will result in a *larger* subsidy than is already in current rates, and must be rejected.

As the Notice suggests (¶ 131), the Commission should allow reductions on a geographically deaveraged basis by zone. This would further reduce the subsidies in averaged rates and reduce the need for additional restructures or other service disruptions.

If there is a direct reduction in rates, then there is no reason for a reduction in the base factor portion ("BFP") calculation. Indeed such an adjustment could double count the impact of the universal service recovery, at least with respect to the end-user charges that are calculated based on BFP levels. In fact, as Bell Atlantic has previously recommended, the Commission should eliminate the calculation of the BFP based on forecasted data. The BFP's use in rate making is diminishing as the carrier common line charge is eliminated. Regardless, the Commission should use historical data to avoid the confusion and controversy generated by the current BFP forecast requirement.

Conclusion

Consistent with these comments, the Commission should set the universal service fund parameters consistent with its policy determination to limit the size and scope of the fund to the greatest extent possible.

Respectfully submitted,

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