

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

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 GTE

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GTE Service Corporation and its affiliated domestic telephone operating companies (collectively "GTE")¹ respectfully submit their Comments on the Further Notice of Proposed Rulemaking in the above-captioned docket.² As GTE details below, the Commission must adopt high-cost support rules that assure that carriers throughout the country can continue to provide affordable, high-quality service in the face of growing competition that undermines implicit support at the state and federal levels.

¹ GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc.

² Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking (rel. May 28, 1999) ("Order and FNPRM").

I. INTRODUCTION AND SUMMARY

In its Order, the Commission adopted a new framework for estimating costs and computing federal universal support for high-cost areas. The Commission also issued a Further Notice of Proposed Rulemaking (FNPRM) requesting comments on specific implementation issues presented by this new framework.

The Commission's new framework improves upon its earlier version in two important respects: *First*, the Commission rejected its revenue-benchmark approach to calculating universal service support and replaced it with a cost-benchmark approach. If properly implemented, a cost-benchmark approach will more accurately measure explicit universal service support requirements. This is true because a cost-benchmark approach does not erroneously assume the continued existence of implicit support. *Second*, the Commission adopted the Joint Board's recommendation to institute a hold-harmless rule that would maintain current levels of federal high-cost support where the Commission's cost model would produce a lower level of support for specific carriers. As the Commission explained, this hold-harmless rule is intended "to ensure that [the] transition to a revised federal support mechanism does not cause sharp or sudden reductions in the level of support any individual carrier receives."³ GTE applauds these changes. As GTE has long maintained, universal service support must be based on the *actual* cost of providing service rather than the hypothetical costs produced by models.

³ *Id.*, ¶14.

While the Order takes several steps in the right direction, the FNPRM does not address all of the issues necessary for the Commission to fulfill its responsibilities under Section 254. Section 254 is quite clear: the Commission must develop, in a single proceeding,⁴ a specific, predictable, sufficient, explicit, and competitively neutral high cost support mechanism. To discharge this responsibility, the Commission must consider the following:

- It is the Commission's ultimate responsibility to assure achievement of the objectives of Section 254;
- The states are required by the Act to establish explicit support mechanisms;
- A competitively neutral high-cost support mechanism is a crucial ingredient to promoting local exchange competition;
- The mechanism adopted by the Commission will not calculate the total amount of funds needed to ensure adequate universal service support; and
- A fund capped at current levels will not satisfy the requirements of Section 254.

The Commission's new framework fails to meet the above objectives for two basic reasons. *First*, it addresses only the *federal* share of high-cost support for local service, while ignoring the *state* share of such support. This oversight is intentional: remarkably, the Commission believes that the Act does not require implicit subsidies to be removed from intrastate rates.⁵ This is simply not correct. Local service is local service regardless of jurisdictional separations, and *all* implicit support for local service

⁴ See 47 U.S.C. §254(a)(2) ("The Commission shall initiate a single proceeding to implement the recommendations from the Joint Board").

⁵ Order and FNPRM, ¶ 45.

rates must be addressed simultaneously. Addressing only 25 percent of the problem does not satisfy Congress's express requirements.

Second, the new framework (by focusing solely on high cost support) does not resolve the massive implicit support in interstate access charges and other interstate services. Instead, the Commission has left this issue for another day.⁶ Here, too, the new framework fails to recognize the link between *intrastate* rates and support mechanisms and *interstate* rates and support mechanisms. When an ILEC and a CLEC compete for a customer, they compete for all the revenues generated by that customer, including local service revenues, intrastate and interstate access charge revenues, and intrastate and interstate support, whether explicit or implicit. Thus, a piecemeal approach to universal service reform is meaningless – intrastate rates and intrastate high cost support are necessarily linked to interstate rates and interstate high cost support. Congress understood this relationship, and therefore required the Commission to address all universal service issues in a single proceeding. The Commission cannot ignore this mandate.

In the following comments, GTE responds to the specific issues identified in the FNPRM. In many instances, as summarized below and discussed more fully herein, GTE has proposed changes to the Commission's high cost support mechanism that would address some of the serious problems with the current framework. By way of summary:

⁶ *Id.*, ¶ 129.

Regarding the benchmark, the Commission must first quantify the amount of high-cost support needed and then set a benchmark that ensures that this level of funding is available. A benchmark set to the current level of high-cost support will only perpetuate the implicit support currently undermining competition in direct violation of Section 254. GTE supports the Commission's implicit assumption that the same benchmark should apply to all companies, regardless of their size. Discriminating in favor of smaller companies prevents high-cost customers of larger companies from receiving the support they need to ensure comparable rates, in addition to creating implicit support and making it more difficult for universal service to be portable.

The FNPRM asks a number of questions regarding the calculation and distribution of high cost support. Universal service must be calculated on a deaveraged basis in order to avoid implicit support and to ensure that sufficient explicit support is targeted accurately to high-cost areas. Without deaveraging, implicit support will continue to hold back the development of competition, particularly for customers in high-cost areas.

State zones comprised of granular geographic units will provide the most accurate means of calculating and distributing high-cost support. Using such zones as the basis for deaveraging will encourage competition, minimize arbitrage opportunities, take state knowledge of local conditions into account, and be practical from an administrative perspective. In contrast, study areas are too large and will create implicit support through averaging. In addition, density zones cut across wire center boundaries and would present significant practical difficulties. After calculating the support on a zone basis, the actual amount of funding should be based on a sliding

scale with multiple benchmarks and percentages. That is, the amount of support should increase as a zone exceeds specified percentage levels above the national average level of costs.

The proposed formula for calculating the states' ability to generate high-cost support is arbitrary and should be abandoned. Using the Commission's data, GTE has determined that if a substantial per-line amount of "state effort" is used to constrain the size of the fund to its current size, most states would receive no high cost support, with the majority of funds going to just two states. If the Commission intends to use a "state effort" calculation, it should adopt the same support schedule for larger, non-rural study areas that is currently used for smaller areas and limit the magnitude of the state contribution. This would spread the benefits of high cost funding among more states.

The Commission asks what restrictions are necessary to ensure that high cost support is used for supported services in high-cost areas. As long as USF support is portable, market forces will assure that funds are used in high-cost wire centers. However, to prevent carriers from serving only high-revenue customers, the Commission must require that any carrier receiving support offer an affordable basic local service package in addition to any other service bundles it may offer. This requirement will enable all customers in a high-cost area to benefit from competition, while also forcing carriers to use funds in high-cost areas.

To prevent rate shock, the hold-harmless principle recommended by the Joint Board should apply on a carrier-by-carrier basis. Applying the principle on a state-by-state basis would not ensure that carriers receive sufficient funding and therefore could lead to rate increases. Further, providing states with block grants may result in those

funds being used for other purposes and put a strain on state commission resources. There is no inconsistency between the hold-harmless principle and the portability of high-cost support. Funding should “move” with the customer to encourage competition and ensure that funds are used to support eligible services. The amount of support which is portable should be based on the amount the ILEC receives.

If the Commission’s cost model is not ready for implementation in January 2000, the Commission could, as an interim substitute, use average revenue per line as the basis for high cost calculations. This measure would reflect the levels of implicit support that have been used at both the state and federal level. Once this measure has been developed on a deaveraged basis, the comparison based on a nationwide mean could be performed as outlined in the FNPRM.

Finally, the Commission should eliminate the implicit support in interstate access rates through a combination of rate restructuring and explicit universal service funding. The current amount of subsidy flow can, and should, be greatly reduced by restructuring and deaveraging SLC rates. The remaining implicit subsidy should be replaced by an explicit, competitively neutral federal universal service mechanism.

II. THE COMMISSION MUST ADOPT RULES THAT DISCHARGE ITS FUNDAMENTAL STATUTORY OBLIGATIONS AND PROMOTE RATHER THAN IGNORE COMPETITION.

The FNPRM raises a multitude of important mechanical issues, including the level of the cost benchmark used to determine eligibility for federal high-cost support, the best means of distributing that support to carriers in a pro-competitive manner, and the effect of explicit support on interstate access charges. GTE commends the

Commission for focusing attention on these matters. At the same time, though, the Commission must not mistake the high-cost funding proposals dealt with in the FNPRM for the kind of fundamental reform required by Congress.⁷ There are several baseline realities, discussed below, that are not dealt with in the FNPRM, yet are essential to achieving Congress's pro-competitive universal service goals:

It is the Commission's Ultimate Responsibility To Assure Achievement of the Objectives of Section 254. Section 254 requires the Commission, in the final analysis, to assure achievement of the statutory universal service mandate. As the Commission pointed out in its April 1998 Report to Congress:

Congress assigned to the Commission, after consultation with the Joint Board, the ultimate responsibility for establishing policies that ensure that: 1) quality services are available at just, reasonable and affordable rates; 2) all consumers have "access to telecommunications and information services" at rates that are reasonably comparable to the rates charged for similar services in urban areas; and 3) there are "specific, predictable, and sufficient" federal *and state* mechanisms to preserve and advance universal service.⁸

The federal support mechanism adopted by the Commission will require states to continue to shoulder the major portion of universal service funding needs. Indeed, the Commission acknowledges "the states' central role in providing intrastate support for high-cost areas, and reaffirm[s] that the primary purpose of the federal support mechanisms is to enable federal support to be available to ensure that states have the resources to maintain reasonably comparable rates in all areas of the nation."⁹

⁷ See generally 47 U.S.C. § 254(b).

⁸ *Federal State and Joint Board on Universal Service*, 13 FCC Rcd 11501, 11510 (1998) (Report to Congress).

⁹ Order and FNPRM, ¶ 12.

Relying on state action is consistent with the Commission's plenary responsibility under the Act. However, this approach is dependent on two assumptions. First, the federal plan must provide a level of support that ensures that the resources in each state will be sufficient to maintain reasonable comparability. Second, states must effectively address universal service concerns. The Commission must monitor the states' action in reforming intrastate universal service mechanisms and, if states fail to meet their responsibilities, the Commission must be prepared to take whatever additional federal action is called for in order to discharge Congress's express directions.

The States Must Establish Explicit Support Mechanisms. As a corollary to the first point, the Commission must actively encourage the states to replace implicit support mechanisms with explicit support as rapidly as possible. GTE strongly disagrees with the Commission's conclusion that "the 1996 Act does not require states to adopt explicit universal service support mechanisms."¹⁰ Even more disturbing is its related conclusion that "states should not be required to alter their existing substantial universal service support mechanisms, such as intrastate rate averaging and value of service ratemaking, to receive federal support."¹¹ The first conclusion is flatly inconsistent with the Act, which, as discussed below, compels the states to replace implicit support with explicit funding mechanisms and likewise compels the Commission to assist the states in this process and to step in if a particular state fails to satisfy this

¹⁰ *Id.*, ¶ 45 (footnote omitted).

¹¹ *Id.*, ¶ 11.

bedrock requirement. The second conclusion gives the Commission's tacit support to one of the most pernicious and anticompetitive sources of implicit support – rate averaging as a result of value-of-service ratemaking – which essentially deprives customers in rural areas of any hope that they will enjoy widespread competition.

In suggesting that the states are permitted but not required to adopt explicit support mechanisms, the Order cites language in Section 254(f) providing that states “may adopt regulations not inconsistent with the Commission’s rules to preserve and advance universal service.” Reliance on this section is misplaced. Section 254 rules out the possibility that a state can continue to use the current implicit support mechanisms, such as geographic rate averaging. This leaves a state with two choices. It may eliminate the need for any subsidy, by rebalancing its rates. Or, if it finds that some subsidy is necessary to ensure that rates are affordable and reasonably comparable, it may implement an explicit support mechanism. Either of these, or a combination of the two, could satisfy the requirements of Section 254.

Notably, Section 254(f) confirms Congress’s expectation that the states would adopt explicit support mechanisms; it does not relieve the states of their responsibility to do so, if rates, without an explicit fund, would not meet the Act’s requirements of comparability and affordability.¹² First, Section 254(f) requires that state regulations be consistent with the Commission’s rules. The Commission has determined, in accordance with the plain language of the Act, that the USF mechanism must be

¹² Nor does Section 254(b)(5), which states that there “should be specific, predictable, and sufficient Federal and State mechanisms,” support the Commission’s conclusions. Read in context with the rest of Section 254, this is the language of command, not

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competitively neutral.¹³ Implicit support patently does not meet this standard. Rather, it promotes inefficient entry in markets where the incumbent is forced to charge above-cost rates (*e.g.*, business service, vertical services, intraLATA toll, and intrastate access), and it deprives consumers in high-cost areas of competition by forcing the incumbent to charge below-cost rates for basic service. These implicit support flows also “burden Federal universal service support mechanisms” by encouraging cherry-picking of low-cost customers by CLECs.

Second, Section 254(f) requires that state mechanisms be “specific, predictable, and sufficient.” Implicit support meets none of these requirements. By definition, implicit support is not specific; consumers have no clue that a portion of the rates they pay is used to underwrite the expense of serving high-cost areas. In addition, since implicit support is hidden, the amount involved is not predictable. Similarly, because it is impossible to know what level of support will be produced by an implicit mechanism (particularly in the face of growing competition), there is no way of determining whether the support will be sufficient.

Third, Section 254(f) requires that *all carriers* contribute to the preservation of universal service on an equitable and nondiscriminatory basis. If contributions are in the form of implicit support embedded in the rates of certain providers (ILECs), added to the rates of only certain services, or collected through the averaging of rates, they

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discretion. 47 U.S.C. § 254(b)(5).

¹³ See *Federal State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8801-03 (1997) (First Report and Order).

cannot meet this requirement. The only way that a state can ensure that all carriers will contribute, and that contributions will be equitable and nondiscriminatory, is through an explicit, competitively neutral funding mechanism.

In the Order, the Commission acknowledges that implicit support “is becoming less sustainable as competition increases,” that such support “can promote potentially inefficient competition in urban areas and for high-revenue, typically business customers,” and that it “can also delay or deny the benefits of competition to residential and high-cost consumers”¹⁴ Nonetheless, neither the Commission nor the Joint Board has made any effort to encourage the states to address this fundamental problem. At a minimum, therefore, the Commission must vigilantly monitor the states’ implementation of Section 254, encourage them to replace implicit support mechanisms with explicit, predictable, and sufficient alternatives, and be prepared to take action if states do not meet their responsibilities. Section 254 requires no less.

The High-Cost Support Mechanism Must Promote Rather than Ignore Competition. The Order effectively endorses the Joint Board’s position that regulators should “wait and see” how competition develops before implementing the universal service policies the Act requires.¹⁵ This is fundamentally wrong. As GTE explained in its comments on the Second Recommended Decision:

The point of universal service reform is not to make local rates still lower than they already are, but to replace the current implicit support mechanism with explicit support that is more efficient, more fair, and more sustainable, and that will provide a sound basis for competition to develop. The Commission cannot

¹⁴ Order and FNPRM, ¶ 7.

¹⁵ See, e.g., *id.*, ¶ 101.

expect to preserve universal service on a “wait and see” basis, because it will not be able to track the erosion of implicit support and respond to that development in a timely manner. It cannot expect to promote competition because it will be maintaining price signals that are preempting entry into many local markets. The “wait and see” approach thus runs the risk of becoming a self-fulfilling prophecy: competition does not develop because we do not correct the price signals, and we do not correct the price signals because competition does not develop.¹⁶

In short, a critical part of ensuring competition for residential consumers is providing strong incentives, such as portable and sufficient universal service funding, for new firms to enter local service markets, and to offer new service options to customers, including residential subscribers. If portable universal service support is sufficient, then new firms should have the same price signals, and the same incentives to compete, that they would have had if local prices had not been constrained for public policy reasons. Put another way, ignoring the distortions and disincentives created by the current, hidden support will render unachievable the competition that Congress mandated and the Commission is trying so hard to encourage.

The States’ Share of Funds Cannot Be Determined Using the Commission’s Federal Funding Mechanism. The Commission, state PUCs, and the industry must recognize that the mechanism adopted by the Commission will not calculate the total need for universal service support. Rather, by focusing only on high-cost support, it is designed to determine only the level of additional resources the federal plan must

¹⁶ Reply Comments of GTE, CC Docket No. 96-45, at 6 (filed Jan. 13, 1999); *see also* Comments of Western Wireless, CC Docket No. 96-45, at 6 (filed Dec. 23, 1998) (“the current system of implicit subsidies *itself* is a major barrier to the development of competition in rural and high-cost areas. Implicit subsidies *must* be eliminated and converted to explicit and portable support for the Commission to realize its commitment to competition”).

provide to enable states to achieve “reasonably comparable” rates. In its Order, the Commission has turned away from its previous methodology, adopted in May, 1997, which attempted to calculate support amounts for each area. Instead, the proposed method does not compare rates with costs at all, but simply compares the mean of the cost distribution in each state to the national mean. The result is an indication of the resources that would be required from the federal plan to shift the cost distribution in a high-cost state downward – in effect, making it more similar to that of an average state. States therefore cannot simply assume that the only intrastate support needed is the difference between the Commission-determined cost of service and the level of federal support. The total amount of support needed will vary depending on the prices and cost characteristics in each state.¹⁷

A Fund Capped at Current Levels Will Not Comply with Section 254. The Commission cannot expect that an artificial cap on the fund at current levels will be adequate to assure compliance with Section 254. In its Order, the Commission agreed with the Joint Board that the “explicit federal support mechanism should not be significantly larger than the current explicit federal mechanism” and endorsed “the

¹⁷ To see this, consider two states, A and B. Both have an average cost per line of \$25. State A has a wide variation in cost, from low to high, around that average. In state B, all the customers are the same – each has a cost of exactly \$25. Suppose both states decide that \$25 is the “affordable” rate they wish to maintain. State B does not have to fund anything; it can simply set its rate at its average cost. State A, however, must raise universal service funds to support customers whose costs are higher than \$25. These two states therefore have very different needs for explicit state funding, even though they have the same average cost. A further difference in funding need could arise if the two states chose to maintain different “affordable” rates. Thus, while from the standpoint of the federal plan, both might qualify for the same federal funds to maintain “reasonable comparability,” the states might require different levels of state

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concept of a hold-harmless provision.”¹⁸ Implemented together, these two policies will not allow for any real changes in the current USF mechanism. If the fund is kept at the same size and each carrier is given no less support than under the current system, there will be no additional funds to allocate for high-cost areas, no shift of support between states, and no ability to transform implicit support into explicit funding. This cannot be what Congress intended in adopting Section 254. The Commission should not set an arbitrary cap at the current level of funding, but rather should realistically assess the resources that must be provided to each state to allow rates to remain reasonably comparable.

Against this background and in light of the need for immediate action, GTE turns below to the specific questions posed in the FNPRM. The Company’s recommendations, however, must not be taken as an unqualified endorsement of the limited measures being proposed. Rather, recognition of and action on the hard realities outlined above is a critical and undeniable predicate to true universal service reform and achievement of Congress’s pro-competitive goals. Further, GTE’s proposals here are made in the context of the cost model estimates recently released by the Commission. If the Commission should subsequently decide to modify the model or its inputs so as to significantly change the cost estimates, or if the Commission should consider an alternative method of calculation, then parties should be given another opportunity to comment on the specifics of the plan parameters.

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funding.

¹⁸ Order and FNPRM, ¶ 48.

III. THE BENCHMARK MUST ENSURE SUFFICIENT FUNDING AND APPLY TO ALL CARRIERS REGARDLESS OF SIZE.

In its Second Recommended Decision, the Joint Board suggested that the average cost in each area (a study area or smaller geographic unit) should be compared to the nationwide average cost. For areas in which the cost exceeds the nationwide average by more than some benchmark percentage, the federal plan would fund all or part of the difference. The purpose of this calculation is not to determine the total universal service support needed in each area, but rather to estimate the resources the federal plan must provide to enable the state to maintain comparable rates in that area. The Joint Board suggested that the benchmark might fall somewhere in the range between 115 and 150 percent of the national weighted average cost per line.¹⁹ The Joint Board did not make any proposal with respect to the percentage of the difference between the area average cost and the benchmark that should be provided by the federal plan.

The FNPRM seeks comment on the level of the benchmark (or benchmarks) and on the proportion of the cost above the benchmark that the federal plan would pay.²⁰ The Commission asks whether “a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to

¹⁹ *Federal State and Joint Board on Universal Service*, 13 FCC Rcd 24744, 24761-62 (1998) (Second Recommended Decision) (“Second Recommended Decision”).

²⁰ For simplicity, GTE will refer to the latter parameter as the “payout schedule.” Under the current high cost fund, there are different payout schedules for large and small study areas.

enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals."²¹

The target level of support must not, as the FNPRM suggests, be set "in light of current levels of competition." The universal service plan of the future cannot be based on the assumption that the status quo can, or should, be maintained. Instead, the Commission must first determine the total amount of explicit funding necessary for reasonably comparable rates *in a competitive market without implicit support*. The benchmark and payout schedule should then be set to ensure that this level of funding is available. As explained above, the development of residential competition depends largely on the creation of appropriate entry incentives through the universal service process.

Because the policy set forth in the FNPRM relies primarily on the states to determine, and provide, the necessary universal service support, it is difficult to establish a clear demarcation between what must be funded by the federal plan and what can be left to the states to provide.²² The overall result can be sufficient, as long as states fulfill their responsibilities, and as long as the federal fund provides each state with sufficient resources to maintain reasonable comparability. However, GTE

²¹ Order and FNPRM, ¶ 99.

²² For similar reasons, the details of the support calculation at the federal level do not provide any guidance to the states as to the level of support they must generate. The federal calculation proposed in the FNPRM is nothing more than a comparison of two cost means, for the purpose of determining the federal funding needed for reasonable comparability. If, for example, the Commission chooses to pay only 50 percent of the difference between the area average cost and the benchmark, this does not imply that a state can choose to fund only 50 percent of its support requirement.

submits that a fund no larger than the current level of federal funding for non-rural companies is not consistent with any realistic assessment of what is needed. The current high cost fund supplies only a tiny fraction of the support that is provided today to maintain affordable local rates; the vast bulk of this support comes implicitly from the rates for other intrastate services, as well as from interstate access. It is not reasonable to expect that states, particularly those with limited resources, will be able to eliminate this implicit support and maintain comparable rates, with no federal resources beyond the relatively small amount provided by the current federal fund. Further, it is also not reasonable to assume that the intent of Congress when it created Section 254 was nothing more than to maintain the current level of explicit federal universal service funding.²³ Any reasonable assessment of the funding needed to maintain comparable rates should produce a fund significantly higher than the current funding level. The Commission therefore should not merely set out to establish fund parameters that will magically replicate the current levels of explicit support. Such a fund would perpetuate and entrench implicit support, distort retail rates, and artificially suppress competition, notwithstanding Congress's mandate to eliminate these undesirable market conditions.

GTE agrees with the Commission's implicit recognition that the same benchmark should apply to all companies, regardless of size. Similarly, the payout schedule that is provided by the federal fund should also be the same, regardless of the size of the

²³ Indeed the support provided to non-rural areas by the federal high-cost mechanism has fallen substantially since the Telecommunications Act of 1996 was passed, simply through the effects of the current formula as data have been updated.

company or study area. Establishing disparate benchmarks or support levels based on a company's revenues or access line count – as is true of the current high-cost fund – would be anathema to fair competition and would harm consumers.²⁴

As a group of rural states pointed out with respect to the Second Recommended Decision, “[t]he existing support mechanism for high-cost loops is insufficient for companies serving more than 200,000 loops” and “discriminates against states with high cost areas served by large companies.” These states noted that “[t]he FCC’s policy of preferentially supporting small companies prevents ratepayers of large companies with high costs from obtaining reasonably comparable rates.”²⁵ For similar reasons, this policy, if continued, would provide market signals for entry which varied arbitrarily according to the size of the ILECs’ study area. It is not clear why the portable support that a CLEC would need to provide universal service in a given community would depend on how many other such communities the ILEC happened to serve in the same state. The Joint Board’s recommended decision does not make any mention of varying the amount of support to be provided on the basis of company or study area size. Nor does the FNPRM establish any logical justification for determining that such a distinction would be good public policy. Discrimination in support levels on the basis

²⁴ However, the Joint Board’s Second Recommended Decision does not make any mention of varying the amount of support to be provided on the basis of company or study area size.

²⁵ Comments of Arkansas PSC et al., CC Docket No. 96-45, at 7 (filed Dec. 22, 1998). These commissions also explained that the current support mechanism for switching cost “is insufficient because it discriminates explicitly against larger companies,” and that “there is no existing support mechanism for trunking cost even though some trunking is necessary to provide the services supported by universal service.” *Id.*

of study area size is an anomaly in the current rules that must not be carried over into the new federal support mechanism.

IV. FEDERAL SUPPORT SHOULD BE DETERMINED ON A GEOGRAPHICALLY DEAVERAGED BASIS.

A. High cost support should be calculated and distributed on a geographically deaveraged basis.

The FNPRM asks a series of questions regarding the “granularity” of the geographic area or areas for which support should be calculated and distributed. As a general matter, the Commission seeks comment on the benefits and drawbacks of using wire centers, UNE cost zones, density zones, or study areas as the relevant geographic unit.²⁶ In particular, the Commission acknowledges that use of the wire center for both calculating and distributing support would best assure that support goes to those who need it and would encourage efficient entry in high- and low-cost areas alike.²⁷ Nonetheless, it expresses concern that such an approach would place substantial upward pressure on the size of the fund; consequently, it proposes a series of alternatives that attempt to obtain some of the benefits of wire-center level calculation and distribution while minimizing pressures to expand the fund.²⁸

In general, GTE believes that universal service support should be calculated on a deaveraged basis in order to avoid the perpetuation of implicit support through

²⁶ See generally Order and FNPRM, ¶¶ 102-105.

²⁷ *Id.*, ¶ 103.

²⁸ *Id.*, ¶¶ 108-109.

averaging, and to target portable support accurately. The FNPRM itself cites compelling reasons in favor of establishing a small area, such as a wire center, as the relevant geographic area:

As competition places downward pressure on rates charged to urban, business, and other low-cost subscribers, we believe that support deaveraged to the wire center level or below may ensure that adequate support is provided specifically to the subscribers most in need of support, because the support reflects the costs of specific areas. In addition, deaveraged explicit support that is portable among subscribers could encourage efficient competitive entry in all areas, not just in urban or other low-cost areas. By permitting the incumbent's rates to reflect actual costs in all areas, subject to explicit support assessments or portable support payments, explicit deaveraged support may provide incentives to competitors to expand service beyond urban areas and business centers into all areas of the country and to all Americans, as envisioned by the 1996 Act.²⁹

This analysis is correct. Calculating and distributing support on a deaveraged basis is the only way of eliminating the systemic arbitrage opportunities and competitive disincentives produced by currently distorted retail rates. Put another way, deaveraged, sufficient universal service support is an essential prerequisite to large-scale competition, not, as the Joint Board would have it, a luxury that can await the development of competition.³⁰

States should determine universal service support needs on a geographically deaveraged basis in order to ensure that support is sufficient and that implicit support in the form of rate averaging is minimized. Similarly, the Commission, in assessing the amount of federal funding that is needed to ensure reasonable comparability, should

²⁹ *Id.*, ¶ 103.

³⁰ *See id.*, ¶ 107 (“In recommending that costs be calculated at the study area level, the Joint Board was driven by concerns that the amount of federal high-cost universal service support be ‘properly measured’ in light of the current state of local competition.”).

not seek to “fudge” that amount by arbitrarily confining its analysis to a large area. Within the framework set forth by the Joint Board and in the FNPRM, the federal fund does not have the same need to determine the specific support requirement by small area that a state funding mechanism would have. However, if the Commission determines the amount needed for reasonable comparability on a basis that is too broadly averaged, it will, in effect, ask some states to make an infeasible amount of “state effort” in the form of raising and distributing intrastate universal service funds. For this reason, the Commission should determine the funding needed for reasonable comparability on a geographically deaveraged basis.

B. Constructed from a granular level, such as a wire center, and aggregated appropriately, UNE zones can provide a sufficient and efficient basis for deaveraging high-cost support.

The FNPRM seeks comment on several alternative geographic units for the calculation of federal support. Of these, zones built up from wire centers or other granular levels that share homogeneous characteristics present the best compromise.

1. Zones comprised of granular geographic units that share homogeneous characteristics can provide a reasonable basis for calculating and distributing federal high-cost support and maintaining reasonable comparability among rates.

As discussed in the next section, while wire centers or other granular geographic units represent a useful “building block” for the assessment of support, these areas could be aggregated into zones for the purposes of the calculation and distribution of support. Indeed, states could establish appropriate zones by aggregating granular geographic units. GTE believes the states, which have specific responsibility for

determining the support level needed in each area, should do so on the basis of wire centers. Nonetheless, GTE proposes that the geographic units used for federal support – the purpose of which is to maintain reasonable comparability – should be the zones established by each state for UNEs, as described previously.³¹ The use of UNE zones offers a number of advantages.

First, it is reasonable to determine USF support based on the same geographic units that ultimately are used for UNE, retail, and wholesale service rates. A CLEC relying on UNEs would receive targeted support that varied in the same manner as the UNEs that represent a portion of its cost. It is likely that retail rates will also be deaveraged along similar lines, and it is important that the geographic deaveraging of retail rates be consistent with the deaveraging of UNE rates.³² Consistency among the geographic units used for USF, UNEs, and ILEC retail rates will contribute to competitive neutrality and minimize artificial arbitrage opportunities.³³

³¹ A state would be free to adopt a different basis for its zones, after considering its circumstances and the record established by the parties in the state.

³² The Commission has recognized that deaveraged UNE rates will more closely reflect underlying costs and therefore send correct market entry signals. See 47 C.F.R. § 51.507(f); Local Competition Order, 11 FCC Rcd 15499, 15882 (1996) (First Report and Order). The competitive benefits of deaveraged UNE rates can only be realized, however, if ILEC retail rates are deaveraged on the same basis. In low-cost areas, averaged retail prices will create a price umbrella permitting windfall profits to entrants using cost-based UNEs, while in high-cost areas averaged retail rates will create an insuperable barrier to entry.

³³ The Order and FNPRM recognizes this in ¶ 104. In ¶ 106, the Commission seeks comment on “whether this disparity between support amounts and UNE rates among different rate zones may create incentives for carriers to engage in arbitrage or other uneconomic activities unrelated to the purpose of high-cost support.”

Second, properly constructed UNE zones can produce a reasonable level of deaveraging for the purposes of calculating federal support. For the reasons discussed below, the study area is too large a unit, and would require too much averaging. On the other hand, while states should adopt detailed targeting for their own plans, zones can offer sufficient specificity within the context of a federal plan that does not seek to determine the overall need for support, but merely ensures reasonable comparability. The use of zones necessarily would address the distribution of cost within a state, and would not focus solely on the mean of that distribution.

GTE suggests that the average cost per line for each UNE zone should be compared with the nationwide average cost per line, and that support should be provided to zones that exceed the nationwide average by more than the benchmark percentage adopted by the Commission. The mechanics of the plan would thus be those proposed in the FNPRM, but applied separately to each zone, rather than to each study area.

Third, reliance on UNE zones would allow the Commission to benefit from the knowledge of each state regarding its local conditions, as well as the input of all the parties – ILECs, CLECs, consumers, and others – in state proceedings where UNE zones would be established.³⁴ It is unlikely that the Commission could adopt a set of zones for each state that reflected all of this information.³⁵ The state zones would also accommodate practical considerations of administration and billing.

³⁴ See Order and FNPRM, ¶ 104 (“states will be able to develop zone boundaries based on local conditions, including cost characteristics and the status of competition”).

³⁵ The use of UNE zones would also allow the Commission, if it chooses, to make use
(Continued...)

In order to limit extreme variations in the design of zones, the Commission may wish to limit the number of UNE zones that could be used for federal USF purposes, perhaps to a maximum of four zones.³⁶ The state would be able to establish any number of zones for its own purposes; however, if the state chose to have more than four zones, then the ILEC would have to combine zones as necessary to collapse them to no more than four for the purpose of the calculation and distribution of federal support.

2. The other alternatives proposed by the Commission should not be adopted.

GTE opposes the use of study areas for calculating and distributing federal high-cost support. As the FNPRM implicitly acknowledges, providing equal support for all lines in a study area, when the costs for facilities-based competitors vary across the area, and UNE rates are deaveraged, will create massive arbitrage opportunities and inefficient entry incentives. In these circumstances, the high-cost subsidy increases the spread between deaveraged UNE rates and averaged retail and wholesale service rates in low-cost areas, creating artificial incentives for entry and placing immense pressure on implicit support flows.³⁷ Conversely, the support in high-cost areas will be

(...Continued)

of another source of information, namely the UNE rates. As will be discussed in more detail below, this would provide the Commission with an alternative methodology in the event that the model is not ready.

³⁶ Of those states where UNE zones have been established, most have chosen either three or four zones. As far as GTE is aware, the highest number of zones in any state is six.

³⁷ See *id.*, ¶¶ 105, 106.

insufficient to make competitive entry attractive. Establishing the study area as the relevant geographic unit for support calculations therefore would undermine Congress's pro-competitive goals and prevent carriers and the Commission from assuring that support reaches those who need it most.³⁸

The only rationale advanced in the FNPRM for calculating costs at the study area level is that doing so "may be more likely to prevent substantial increases in the size of the high-cost support mechanism because high-cost areas within the study area are averaged with lower-cost areas within the study area."³⁹ This purported advantage, however, actually provides a further compelling reason *not* to use study areas as the unit for determining the need for high-cost support. As GTE previously has explained, forcing states to average high- and low-cost areas places untenable burdens on states that have a large variation in cost levels:

[D]etermining support on the basis of average study area costs would essentially shift the mean of the distribution of cost in each high-cost state downward, toward the national mean. However, the universal service funding challenge faced by each state will depend on the distribution of cost within the state, and not simply on the mean. A state with a high variance in its cost distribution will have to raise and distribute more universal service funding than a state with the same mean, but a smaller variance.⁴⁰

³⁸ Use of the study area as the relevant geographic unit also discriminates against high-cost customers of larger ILECs. This is so because small ILECs, which are likely to have study areas with uniform cost characteristics, are essentially deaveraged already. Accordingly, customers of small ILECs are more likely to get sufficient per-line support than customers of larger ILECs.

³⁹ *Id.*, ¶ 105.

⁴⁰ GTE Comments, CC Docket No. 96-45, at 20 (filed Dec. 23, 1998). This is recognized by the Commission in the Order: "Another factor influencing a state's rate design choices, and its ability to achieve reasonably comparable rates, is the extent of the cost variations between high-cost and low-cost areas of the state." Order and FNPRM, ¶ 32 n. 63.

Ultimately, the Commission can not permit its desire to limit the size of the fund to dictate the calculation of support on a highly averaged basis. If the use of more targeted support produces a fund size that the Commission considers unacceptable, then it should adopt some other, more neutral constraint on the size of the fund.⁴¹

The Commission also suggests alternative geographic units for a deaveraged calculation of support. The first is the wire center.⁴² GTE agrees that the wire center is a reasonable building block around which deaveraged calculations can be performed. It is small enough to capture geographic differences in cost. At the same time, it offers administrative advantages, because pricing, billing, and data reporting are calculated along wire center lines. It is not necessary, however, that a distinct support level be implemented for every wire center. Wire centers may be grouped together in a reasonable manner to form zones. Zones constructed in this manner would simplify administration and billing and would allow the distribution of universal service to be consistent with the areas used for the determination of both retail and wholesale prices.

Another geographic unit which offers some theoretical advantages over wire centers is the density zones employed by the Commission's cost model, the HCPM.⁴³ These zones cut across wire center boundaries, so as to distinguish between lower-

⁴¹ At the very least, if the support is calculated on a study area basis, it should be distributed within the study area on a more deaveraged basis, as the FNPRM suggests at ¶ 108. While this approach is feasible, it begs the question of why the support should not simply be calculated on a deaveraged basis to begin with, aside from the desire to limit artificially the size of the fund.

⁴² Order and FNPRM, ¶ 105.

⁴³ *Id.*, ¶ 108.

cost areas close to the central office and higher cost areas farther away. The use of density zones as developed in the HCPM model, however, would present serious practical difficulties, given the constructs of the model and the input data and “clustering” algorithms used to develop them. GTE strongly opposes the use of the model’s density zones as the geographic unit for calculation of the fund.

C. Support for each zone should be calculated on the same basis, regardless of the size of the carrier.

The Commission seeks comment on the algorithm that should be used to determine the support provided to each geographic area.⁴⁴ GTE’s response is based on two points discussed above: federal support, for the purpose of reasonable comparability, should be calculated on the basis of UNE zones, and the calculation should be neutral with respect to company or study area size.

In the second option suggested by the Commission, the support would be calculated on a UNE zone basis, an approach that GTE supports. The plan would then provide a “uniform percentage” of the support so indicated. The Joint Board’s recommendation makes no mention of supporting anything less than 100 percent of the difference between the benchmark and the area average cost. However, the current high-cost mechanism supports, in study areas smaller than 200,000 lines, 65 percent of the cost above 115 percent of the nationwide average, and 75 percent of the cost above 150 percent of the nationwide average. This structure corresponds to the fourth alternative set forth in the FNPRM (at ¶ 109), which would calculate support on a zone

⁴⁴ Order and FNPRM, ¶¶ 108-109.

basis, but would then determine the actual amount of funding based on a sliding scale of benchmarks and percentages.⁴⁵

GTE believes that this fourth alternative provides the most promising framework for the new high-cost algorithm. Further, the support schedule used for smaller study areas today provides the most reasonable starting point for the sliding scale that would apply to larger companies. For reasons discussed above, the support schedule should be the same for both large and small study areas, and the Commission has not indicated any plans to reduce the current level of support it provides in smaller study areas.

Based on the cost estimates and spreadsheets provided by the Commission, if the federal fund were to compensate all non-rural study areas on the basis of the current support schedule for small study areas (those under 200,000 lines), the resulting non-rural federal high-cost fund would be \$1,693 million per year.⁴⁶ GTE

⁴⁵ In previous comments to the Commission, GTE has suggested the use of a sliding scale with multiple benchmarks and percentages. Proposal of GTE, CC Dockets 96-45 and 97-60, at 21 (filed April 27, 1998). The third alternative set forth in the Order and FNPRM would arbitrarily cap the amount that the plan would make available to any state. Order and FNPRM, ¶ 109. GTE does not support this proposal. The cap might prevent a high-cost state from receiving the support it needs, and there does not appear to be any reasonable basis for determining the cap.

⁴⁶ The figures used in this section are based on calculations at the study area level using Commission provided cost estimates and spreadsheets (hereinafter referred to as "based on Commission data"). The preliminary input values in the spreadsheets were made available by the Commission on June 16, 1999. Common Carrier Bureau Releases Preliminary Results Using Proposed Input Values in the Forward-Looking Cost Model For Universal Service, CC Docket Nos. 96-45, 97-160, DA 99-1165 (rel. June 16, 1999) (Public Notice). GTE recommends that support be calculated at the zone level, but cannot estimate the resulting fund size accurately because it does not have access to UNE zone information for other companies.

submits that if the current level of federal high-cost funding is reasonable for smaller study areas, then this is also a reasonable size for the non-rural high-cost fund; this would represent a large increase compared with the current fund.

For an option that would avoid resorting to the “state effort” calculation (which will be discussed below), the Commission could adopt a “middle ground” payout schedule which produces results between the schedules currently used for small and large companies. For example, the plan might provide 15 percent of the cost above 115 percent of the nationwide average cost, 60 percent of the amount above 160 percent, and 75 percent of the amount above 200 percent. With a “state effort” contribution of zero, this would yield a federal non-rural fund of \$713 million, based on Commission data.

V. THE COMMISSION’S FORMULA TO CALCULATE THE STATES’ ABILITY TO GENERATE HIGH COST SUPPORT IS ARBITRARY.

The Order concluded that “a fixed dollar amount per line is a reasonably certain and specific means of assessing a state’s ability to enable reasonable comparability of rates using its own resources.”⁴⁷ The Commission now seeks comment on the level at which this dollar amount should be set.⁴⁸

⁴⁷ Order and FNPRM, ¶ 110.

⁴⁸ *Id.*, ¶ 111. The FNPRM suggests that the “state’s ability to enable reasonably comparable rates . . . would . . . be estimated by multiplying the per-line figure by the total number of non-rural carrier lines in the state,” and that federal support would make up the difference between “this estimate of the state’s own resources” and the cost benchmark.

The “state effort” criterion represents an effort by the Commission to limit the size of the fund and to take into account states’ ability to fund their own universal service needs. Unfortunately, the proposed calculation produces results which are arbitrary and implausible, especially when the dollar amount of “state effort” is set too high. Further, the “state effort” calculation has the effect of exacerbating the discrimination between large and small study areas.

An obvious question that might be asked is: What is the difference between \$2 of “state effort” and simply raising the benchmark by two dollars? The answer is that there is no difference – if the plan supports 100 percent of the difference between the benchmark and the study area average cost. In that case, the second criterion is redundant, and can be duplicated simply by adjusting the parameters of the first criterion. The “state effort” calculation only produces a different result if the support is less than 100 percent. Put another way, the effect of the “state effort” calculation is to magnify the effect of the arbitrary difference in support in the current plan between large, non-rural study areas and smaller areas. A plan which provides different percentages, and which also includes a significant “state effort” amount, thus applies a “double whammy” to larger study areas. Not only does the support schedule arbitrarily discriminate against customers in large study areas, but the “state effort” calculation then exacerbates the effect of this discrimination.

The results of this process can be capricious and unreasonable. Based on Commission data, if a substantial per-line amount of “state effort” (such as two dollars per line) is used to constrain the fund to approximately its current size, then the effect is to deprive most states of any federal support at all. Two states, Mississippi and

Alabama, receive the lion's share of the support. Most states that would appear to be logical candidates for high-cost support, such as Nevada, New Mexico, and North Dakota, would receive no support. These haphazard results cannot be represented as a reasonable implementation of Section 254. The only rationale offered in the FNPRM for the choice of a particular level of state effort, such as \$2 per line, is to represent it as a percentage of a nationwide revenue benchmark that the Commission has finally decided to jettison from its federal plan. Other than the fact that any number is a percentage of some other number, this hardly serves as a basis for reasoned decision-making by the Commission. The simple fact is that the basis for choosing any level of state effort boils down to whether the result of that choice is reasonable, and as shown above, the results generated by the Commission's proposal are not reasonable.

If the Commission wants to utilize the "state effort" criterion at all, there are two steps which would minimize these unfortunate effects. First, the plan should adopt the same support schedule for larger, non-rural study areas that is currently used for smaller areas. This would limit the leverage the "state effort" calculation has when applied to payout schedules that support only a small proportion of the difference between the benchmark and the area average cost; it would also prevent the "state effort" contribution from magnifying the disparity between large and small area support. Second, the magnitude of the "state effort" contribution should be limited.

For example, if the plan were to provide support on the basis of the current small company schedule – 65 percent of the amount above 115 percent of the nationwide average, and 75 percent of the amount above 150 percent – and if the "state effort" amount per line were set at \$1.25, the resulting non-rural federal fund would be \$713

million. This is the same size as the option discussed above, in which the “state effort” is set at zero and the federal support amount is a variation of both the large and small companies’ algorithms. However, the distribution of funds across states is different between the two options. Fewer states would receive support under the “state effort” option, and a larger share of the fund would go to Mississippi and Alabama. Nonetheless, if the Commission wants to implement the “state effort” criterion as described in the FNPRM, the parameters suggested here would mitigate the more extreme effects: the support would be distributed in a more reasonable manner across states, and most of the states that would appear to need high-cost support would receive at least some federal funds.

VI. THE COMMISSION SHOULD RELY ON MARKET FORCES TO ENSURE THAT SUPPORT IS USED IN HIGH-COST AREAS AND SHOULD REQUIRE ALL ETCS TO OFFER AT LEAST ONE AFFORDABLE PACKAGE OF BASIC LOCAL SERVICE.

The Commission asks what restrictions should be imposed to ensure that federal support is used consistent with Section 254.⁴⁹ GTE believes that detailed accounting or certification requirements are unnecessary. As long as universal service funding is both portable and distributed on a geographically disaggregated basis, carriers receiving high-cost funding will have a strong incentive to use the funds only in high-cost areas. If they do not, customers in those areas will switch to a competing carrier, since the original carrier will not be able to maintain competitive rates. Once the customer leaves, of course, the carrier loses the support. As discussed above,

⁴⁹ Order and FNPRM, ¶ 113.

portable support in a sufficient amount, targeted to specific areas, will provide firms with the same incentives to enter and invest as they would face in a competitive market. Consequently, competition alone, without new accounting or certification rules, will assure that support is used only in high-cost wire centers, as long as support is distributed to those areas rather than on a study area-wide basis.

Modest regulatory intervention is needed, however, to assure that recipients of support do not reap the benefits of federal funding yet effectively serve only high-revenue customers within the high-cost areas. In particular, as GTE has explained in several filings in this docket,⁵⁰ the Commission must require that any carrier receiving support offer an affordable basic local service package in addition to any other service bundles it may choose to provide. That is, the carrier should have at least one service offering that meets the definition of basic local service and is priced no higher than the rate found by the state commission to be “affordable” in that area. Absent such a requirement, carriers could create expensive packages including toll calling and vertical services that would be affordable only to a small group of customers. If a carrier limits its offerings to such packages, there is no way to ensure that funding is being used for supported services rather than the other elements of the package. In contrast, requiring a basic service option will enable all customers in a high-cost area, regardless of income level, to benefit from competition and would assure that funding is used in a manner consistent with Section 254.

⁵⁰ See, e.g., Comments of GTE, CC Docket No. 96-45, at 26-29 (filed Dec. 23, 1998); Reply Comments of GTE, CC Docket No. 96-45, at 11-19 (filed Jan. 25, 1999).

The FNPRM discusses the structure of the mechanism through which states would assure that support is used in a manner consistent with Section 254. Specifically, the Commission seeks comment on whether “to condition the receipt of federal universal service support on any state action.”⁵¹ The FNPRM expresses concern that such a requirement could penalize states that lack regulatory authority over some carriers’ local rates. GTE agrees with the Commission’s tentative conclusion that even states that lack this authority would be able to certify to the Commission that a carrier within the state had met the required conditions.⁵² GTE suggests that the Commission should require each state to determine the rate it considers to be “affordable” for any given area within that state. The state would then certify to the federal fund administrator that each carrier seeking funding for areas within that state provides at least one service package that: (1) meets the Commission’s definition of the supported service and (2) is offered at a price no higher than the state-established “affordable” rate. This would not require the state actually to regulate the carrier’s rates if it chooses not to, or lacks the necessary authority. As the Commission notes, if a state were unwilling to take these actions to achieve the goals of Section 254, the Commission could allow that state to refuse federal high-cost support.

⁵¹ Order and FNPRM, ¶ 115.

⁵² *Id.*

VII. THE HOLD-HARMLESS PRINCIPLE SHOULD APPLY ON A CARRIER-BY-CARRIER BASIS AND IS ENTIRELY CONSISTENT WITH PORTABLE SUPPORT.

The Commission asks whether the hold-harmless principle should be implemented on a carrier-by-carrier basis or on a state-by-state approach.⁵³ GTE strongly urges use of the carrier-by-carrier approach. The retail rates charged today by each ILEC are based on calculations taking into account support received from the existing high-cost fund. This is done on a study area basis, and the amount of support built into current rates may vary significantly across different study areas within a given state. Applying the hold-harmless principle on a carrier-specific basis is necessary in order to avoid an unwarranted decrease in support for consumers in a given study area. Any such decrease would place upward pressure on rates, giving rise to the very rate shock concerns that the hold-harmless principle is intended to ameliorate.

In almost all study areas, at the support levels provided by the options GTE has reviewed here, the support amount calculated based on Commission data is greater than the hold harmless amount produced by the existing fund. However, if the option using the “state effort” amount is adopted, this relationship changes dramatically. Because of the extreme effect of the “state effort” calculation, the support amount under the model approach is reduced to zero in many states. The hold harmless feature comes into play in those states.

Since applying the hold harmless principle on a state-by-state basis is not reasonable, it follows that funds should not be provided to the states through “block

⁵³ *Id.*, ¶ 117.

grants.” As the Commission notes, both the Joint Board and commenters that have addressed this issue strongly oppose routing support through the state commissions.⁵⁴ If states are given block grants, they may not distribute the funds as needed to ensure a continuous level of funding. Similarly, there are often significant political pressures placed on state commissions which could make it difficult to use the funds as the Commission and Joint Board intend. States also would need considerable (and potentially unavailable) resources to manage the block grants.

As Chairman Kennard has stated:

the block grant idea amounts to a proposal to add an additional layer of administration, which is bound to increase costs and reduce efficiency. The states themselves are generally opposed to the idea as evidenced by the rejection of this idea by the Joint Board. Similarly a majority of the commenters in this proceeding, including many of the recipients of high-cost support are also opposed to the idea. In sum, block grants are not a good idea for high-cost support.⁵⁵

For these reasons, the Commission should continue to distribute high-cost support to individual carriers, thereby avoiding the substantial problems inherent in the block grant approach.

The Commission also seeks comment on the relationship between the hold-harmless principle and the portability of high-cost support.⁵⁶ There is no inherent tension between the hold harmless principle and portability; hold harmless does not

⁵⁴ *Id.*, ¶ 121.

⁵⁵ *Id.*, Statement and Dissent in Part of Chairman William E. Kennard.

⁵⁶ *Id.*, ¶ 122.

mean that the carrier receives the same amount of support regardless of the number of customers it has. Rather, the hold harmless funding level should take into account the loss of customers to competition, so that support “moves” with the customer if the customer changes carriers. This can be achieved by taking the hold-harmless level of support on a particular date, such as the last quarter before the implementation of the new plan, and calculating a per-line support amount that would then be portable. Such portability will encourage competition for high-cost customers, and as explained above, will ensure that support is used for eligible services.

Finally, the FNPRM asks whether a CLEC that wins a customer from the incumbent should receive the incumbent’s hold harmless support or the amount of support determined on a forward-looking basis.⁵⁷ GTE believes that, in the interest of competitive neutrality, each carrier that takes on an equivalent universal service obligation in a given area should receive the same level of support per customer. It doesn’t matter whether that amount is based on a model, a hold harmless amount, an auction, or some other mechanism.

In any event, GTE does not believe that the model provides an accurate measure of the overall level of a carrier’s cost. It is used here simply as an indicator of the relative levels of cost in different areas, for the purpose of assessing reasonable comparability. There is therefore no meaning that can be read into the difference between support determined on the current basis versus support determined using the

⁵⁷ *Id.*

calculation proposed in the FNPRM. Each is simply a comparison of the means of two distributions.

VIII. IF THE COMMISSION CHOOSES NOT TO USE ITS COST MODEL, IT SHOULD IMPLEMENT ITS HIGH COST PLAN ON THE BASIS OF AVERAGE REVENUE PER LINE.

In both the FNPRM and the concurrent Further Notice on cost model issues, the Commission seeks comment on whether any alternative should be adopted in the event that the Commission's cost model is not ready in time for implementation of the plan on January 1, 2000.⁵⁸ GTE suggests that an alternative is available for high-cost support.

The alternative is simply to compare the level of revenue across study areas. Variation in revenue across states should be closely correlated with variations in cost. GTE therefore proposes that the Commission construct a measure of the average revenue per line for each ILEC serving area, based on appropriate state and interstate, access, basic local, toll, and vertical services. This measure will roll up the sources of implicit support which have been used at both the state and federal level.

The resulting measure would not necessarily represent either "forward-looking" or "embedded" cost. Rather, it would reflect the level of recovery that has been permitted by the relevant state authority or by the Commission, using whatever method of regulation that agency has found to be most reasonable. In the case of the Commission, with respect to interstate access revenues, the method of regulation has been price caps for nearly a decade. Similarly, a majority of states have adopted some

⁵⁸ *Id.*, ¶ 129; Further Notice of Proposed Rulemaking, CC Docket Nos. 96-45, 97-160, ¶ 243 (rel. May 28, 1999).

form of incentive regulation. It is reasonable that the measure of cost used for determining the support mechanism for telecom rates should be consistent with the level of cost recovered by the rates themselves, taken in aggregate for a given area. Further, the surrogate measure of cost derived in this way is much less likely to exhibit arbitrary swings from one area to the next than numbers produced by either the allocation of embedded cost or the vagaries of the cost model. Finally, this measure could readily be constructed using currently available data. Once this measure has been developed for each study area, the comparison to the nationwide mean could proceed, exactly as set forth in the FNPRM, for the purpose of determining support necessary to maintain reasonable comparability.

GTE has argued above that support should be determined on a deaveraged basis. For the purpose of assessing the federal funding that should be provided to maintain reasonable comparability, GTE has suggested that the UNE zones established by the states, which will generally be aggregations of homogeneous wire centers, would be reasonable geographic areas. The relative levels of the UNE rates in each zone could be used for this disaggregation. Until the appropriate UNE zones have been set by the state, the study area can be used in the interim. The result would be a set of geographic zones in which the total revenue, across all zones, would be the same as the study area revenue, while the relative level of the average revenue per line for high-cost support determination between any two zones would be the same as the ratio of the UNE rates in those zones. This approach would allow the Commission to develop a consistent, reasonable surrogate measure of cost at the zone level for purposes of the USF calculations proposed in the FNPRM.

IX. THE COMMISSION SHOULD ADOPT AN EXPLICIT, COMPETITIVELY NEUTRAL FUNDING MECHANISM TO REPLACE IMPLICIT SUPPORT IN INTERSTATE ACCESS RATES.

The FNPRM tentatively concludes that price cap LECs should reduce access charges to reflect any increased explicit federal high-cost support they receive. Specifically, the Commission seeks comment on the best means to adjust rates for such support, including changes to the common line basket price cap index, deaveraging of some or all common line rate elements, and reducing the base factor portion. The Commission also asks how access reform can be used to direct more high-cost support to high-cost areas.⁵⁹

When it first developed its access charge plan, the Commission determined that a flat, monthly Subscriber Line Charge (“SLC”) was the most efficient method for recovering interstate revenues associated with common lines. However, out of concern for the effect of increases in the SLCs on the affordability of local service, the Commission has maintained caps on the levels of SLCs.⁶⁰ The FNPRM notes that the current cap on SLC rates, in particular the \$3.50 cap on the SLC for primary residential and single-line business lines, prevents the SLC from fully recovering the permitted interstate common line revenue, and that this limit represents an implicit support flow to lines whose SLCs have been capped.⁶¹ Further, because both the SLCs and other common line charges are geographically averaged, there is an implicit flow of support

⁵⁹ See generally Order and FNPRM, ¶¶ 123-135.

⁶⁰ Notice of Inquiry, CC Docket No. 99-249, ¶ 3 (rel. July 20, 1999).

⁶¹ *Id.*, ¶ 127.

“from areas where the cost of service is less than the averaged rate, to areas where the cost of service is more than the averaged rate.”⁶²

The Commission should move promptly to eliminate these implicit subsidy flows. This can be accomplished through a combination of rate restructuring, access reform, and explicit funding from a competitively neutral federal universal service fund. First, the Commission should eliminate the current requirement that SLCs be averaged across each study area. SLC deaveraging could proceed along the lines of the zones established for UNE rates in each state. The overall level of SLC rates across the zones in an area should be set to recover the revenues that are allowed under the Commission’s price cap rates, while the relative relationships between the SLCs in any two zones should reflect the relative levels of the UNE rates for the loop and port elements established by the state. Second, the Commission should determine an “affordable” level for the SLC rate. Where a deaveraged SLC would exceed the level consistent with affordable local service, a new federal universal service mechanism should fund the difference. The support should be portable and specific to each zone.

GTE agrees with the Commission that any new federal funding to replace implicit support in interstate access should be offset by reductions in interstate access rates.⁶³ If universal service funding is sufficient, it should be possible for the CCL and PICC charges to be eliminated and for SLC rates to be deaveraged by zone as discussed above. This will ensure that customers in lower cost zones will no longer be asked to

⁶² *Id.*, ¶ 125.

⁶³ *Id.*, ¶ 130.

subsidize affordable SLCs for customers in higher cost zones through the implicit mechanism of averaged SLCs. At the same time, the usage rates charged to interexchange carriers should also fall dramatically, making possible significant reductions in long distance rates. Customers in high-cost zones will be protected by the explicit universal service funding against SLC increases that might make their local service unaffordable.

Whatever else the Commission does, however, it should not reduce the SLC cap for primary residential and single-line business customers.⁶⁴ As the FNPRM acknowledges, such action “would not further the goal of reducing implicit interstate support”; indeed, lowering the SLC cap would create additional implicit support (contrary to Congress’s express direction) and would expand the need for universal service funding. As noted above, GTE believes that common line rate elements, including the SLC, should be deaveraged to reflect underlying costs. If such deaveraging produced a residential or single-line SLC below the current cap for some carriers in some areas, then the SLC should be reduced accordingly. In all other cases, however, the cap must not be lowered.

X. CONCLUSION

The FNPRM addresses a number of important mechanical issues regarding the federal high-cost support mechanism, but it is based on several untenable premises and fails to move toward true universal service reform. Most notably, it appears to accept as a given the Joint Board’s view that support mechanisms need only be

⁶⁴ See *Id.*, ¶ 133.

tweaked, given the relatively small level of residential competition. Residential competition will not develop, however, particularly in high-cost areas, unless federal and state high-cost support mechanisms provide sufficient explicit and portable funding to rationalize ILEC retail pricing and therefore provide incentives for efficient competitive entry. True universal service reform is the chicken and competition the egg, not vice versa.

The Commission violates its statutory obligations by failing to provide strong incentives for states to replace implicit intrastate support mechanisms with explicit arrangements. States have an undeniable mandate to do so under Section 254, and the Commission, as it has previously acknowledged, bears “ultimate responsibility” for assuring compliance with the statute for both interstate and intrastate services. By providing federal support at a level that assumes the discontinuance of all implicit support, the Commission will enable the states to rebalance and deaverage local rates, which in turn will stimulate residential competition in all areas of the country.

The framework established by the Commission only serves to calculate a level of support to achieve reasonably comparable rates. The support benchmark and payout schedule must not be designed to preserve the status quo, which is inefficient and anticompetitive. Instead, the Commission must first determine the total amount of explicit funding necessary for reasonably comparable rates in a competitive market without implicit support. High cost support should be calculated and distributed on a deaveraged basis, using zones comprised of homogeneous geographic units in order to minimize implicit support and encourage competitive entry. The “state effort” calculation proposed by the Commission is arbitrary and will deprive states of needed

support. If the Commission insists on using a "state effort" criterion, it should adopt the same support schedule for larger areas as is currently used for small areas and should limit the size of the state contribution.

Furthermore, there is no need for a regulatory mechanism to assure support is used only in high-cost areas, as long as support is portable and is distributed on a deaveraged basis. Under such circumstances, competition will assure that carriers spend their support dollars only in high-cost areas. To assure that those dollars are used only for eligible services, however, the Commission should require each ETC to offer an affordable package of basic services.

The hold-harmless principle should apply on a carrier-by-carrier rather than a state-by-state basis and, in any event, support should go directly to carriers rather than as block grants to state commissions. When a CLEC wins a customer away from an ILEC, the portable support amount should be the amount as the ILEC would receive. Finally, the Commission must eliminate the implicit support in interstate access rates through a combination of rate restructuring and explicit universal service funding. SLC rates should be deaveraged and the remaining implicit subsidy should be replaced by an explicit universal service funding mechanism.

Respectfully submitted,

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