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Magalie Roman Salas, Esq.
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.,
Washington, D.C. 20554

Re: CC Docket No. 96-45, CC Docket No. 96-262

Dear Ms. Salas:

Transmitted herewith, on behalf of the Rural Telephone Coalition (RTC), are an original and six copies of its comments in response to the Federal-State Joint Board on Universal Service, CC Docket Nos. 96-45 and 96-262.

In the event of any questions concerning this matter, please communicate with this office.

Very Truly Yours,

Margot Smiley Humphrey

Margot Smiley Humphrey

Enclosure

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

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OFFICE OF THE SECRETARY

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 the RURAL TELEPHONE COALITION

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In the Matter of	)	
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	)	
Access Charge Reform	)	CC Docket No. 96-262

COMMENTS of the RURAL TELEPHONE COALITION

The Rural Telephone Coalition (RTC) submits these comments in response to the Further Notice of Proposed Rulemaking (FNPRM) portion of the Commission's decision in the above-captioned proceedings. The RTC is comprised of three associations, the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO). The three associations' members include more than 850 primarily small and rural incumbent local exchange carriers (LECs).

I. INTRODUCTION AND SUMMARY

The RTC urges the Commission not to use the decisions it makes in connection with the methodology for non-rural high cost support as a starting point for any future proceeding on the high cost mechanism for rural LECs. Since, as the Commission has recognized, rural ILECs are fundamentally different from their non-rural counterparts (as well as from each other), rural

ILECs should not be placed in the position of having to prove why the non-rural methodology is inappropriate for them.

In particular, the range and level of a cost benchmark should not be set for rural ILECs based on the analyses and decisions made in this proceeding. The selection of a cost benchmark for rural LECs will require its own separate analysis, in connection with the other elements of the rural high cost plan, to ensure that the mandates of affordability, sufficiency and reasonable comparability are met.

Similarly, no assumptions or decisions made in this proceeding about the sufficiency of support and no principle of minimizing the growth of support should apply to rural ILECs. It cannot be determined whether rural rates would be "reasonably comparable" to those in urban areas until urban rates are first given an opportunity to adjust to changes in the non-rural mechanism. In addition, if objectives for the deployment of advanced services in rural areas are to be achieved, the Commission will not be able to apply its goal of minimizing the growth of the fund to rural carriers.

Particularly in rural areas, adoption of an effective disaggregation methodology is the best way to ensure that carriers will use universal service support in a manner consistent with section 254(e). For rural company study areas, support deaveraging and targeting may need to occur below the wire center level, due to large cost differences attributable to variance in population density and loop lengths within a study area. The Commission can also promote compliance with section 254(e) in rural study areas by reconsidering its requirement that CLEC

support be based on the ILEC's costs during the rural transition. A CLEC that receives support that is greater than its costs because it is averaged at the study area level clearly has a strong incentive to use its windfall to attract lower-cost customers in the ILEC's service area or even in another service area altogether. While the Commission is appropriately committed to maintaining the transition plan for rural LECs until January 1, 2001 at the earliest, this should not prevent it from acting on the RTC's pending petition for reconsideration in 96-45, which addresses these issues.

A "hold harmless" provision at the state level may be more conducive to achieving the FCC's goal of limiting the growth of the fund, but it is certainly less consistent with the universal service principles of the Act. A state hold harmless provision would conflict with the Act's premise of a nationwide support mechanism for consumers. As the Commission acknowledges, a state hold harmless would not prevent carriers from receiving less support than they do presently. This, in turn, threatens customers in the highest cost areas with rate increases, a result that is at odds with the universal service concept. For rural LECs in particular, the difference between a carrier and a state hold harmless provision could be the difference between sufficient and insufficient support. Therefore, at the very least, the Commission should not allow a decision to adopt a state hold harmless provision for non-rural carriers to affect its analysis of the issue in a future rural proceeding.

Regarding the relationship between a hold harmless provision and the portability of support, the Commission is correct to point out that hold harmless support could represent a

windfall to a competitor. A CLEC entering a high cost area would not have received prior support for that area and therefore there is nothing for it to be held harmless from. In addition, the Commission should act before changing the mechanism for non-rural carriers to prevent the unintended drop in rural carrier support caused by removing non-rural carriers from interim cap calculations. Removing the cap in appropriate proceedings will prevent reducing support the Commission has undertaken to maintain during the rural transition.

To correct another portability problem, the Commission should promptly clarify section 54.307 of its rules which could be read to reduce an ILEC's level of support in instances where a CLEC obtains a new subscriber line that was never served by the incumbent. In such instances, the Commission should determine that there is no reduction in ILEC support, since there has been no reduction in the number of lines being served by the ILEC. Indeed, the Commission should quickly respond to this and other portability questions raised by USAC in its February and July letters.

II. THE COMMISSION MUST CONSIDER NON-RURAL ISSUES DECIDED IN THESE BIFURCATED PROCEEDINGS ANEW AND WITHOUT PREJUDGMENT OR PREDISPOSITION IN THE SEPARATE FUTURE PROCEEDINGS TO ADOPT A UNIVERSAL SERVICE MECHANISM FOR RURAL TELEPHONE COMPANIES

The Commission and the Joint Board have "bifurcated" the consideration of universal service reform for non-rural and rural telephone companies (rural ILECs), promising that decisions made about what universal service mechanism to apply to non-rural companies are not

applicable to rural ILECs. Commissioner Ness put it well in her opening statement at the Commission's May 27, 1999 meeting that adopted the FNPRM, stating that rural carrier issues remain "off the table" and that rural companies were "not implicated by what is going on today."

The RTC agrees that universal service issues for rural ILECs need separate exploration and resolution, since rural companies are significantly different from non-rural companies and from each other. Consequently, and in reliance upon the Commission and Joint Board determination to take up rural ILEC issues later and separately, the RTC has not been filing detailed or exhaustive comments in the non-rural phases of these proceedings and does not do so here.

However, the RTC will touch briefly on several of the non-rural issues raised in the FNPRM. The purpose of these comments is primarily to emphasize the importance of avoiding any predeterminations or prejudgments that could confront rural telephone companies later with the task of dissuading the Joint Board and Commission from applying decisions made on the basis of facts and arguments about non-rural companies. Rural ILECs and their associations cannot effectively refute the proposals made for non-rural companies from their rural ILEC perspective at this separate stage of the reform process. The RTC will also flag some issues (a) that are already a cause of concern for rural ILECs owing to their implications and impacts during the rural transition period that will remain in place until 2001, at the earliest, or (b) that the RTC disputes for more fundamental legal or policy reasons, but is in a peculiar posture for

seeking judicial review, for example, in view of the non-applicability of this proceeding to rural ILECs.

III. THE COMMISSION MUST SCRUPULOUSLY AVOID ALLOWING ITS "METHODOLOGY" DECISIONS IN ITS NON-RURAL UNIVERSAL SERVICE REFORM TO PREJUDICE ITS LATER EVALUATION OF REFORM FOR RURAL TELEPHONE COMPANIES

The Commission proposes to decide some important questions with respect to its non-rural universal service mechanism which it characterizes as "methodology issues." If the Commission should later decide that it seemed expedient to propose to adopt large company determinations more broadly -- and even to assume they should apply to rural ILECs unless rural ILECs can prove they should not -- it would not be the first time this has occurred. It would be unfair, however, when rural carriers and others have been repeatedly assured that their cost methodology and mechanism issues have been put off for now. The Commission should make it clear that it will not yield to that temptation, since it has quite properly excluded rural ILEC considerations from consideration at this point and, thus, will not have any basis for such a presumption. The very differences that prompted the Commission and the Joint Board to reserve rural ILEC support issues for later consideration also preclude assuming later that any parts of the non-rural calculus are applicable to rural companies as well.

A. The Range and Precise Level of a Nationwide Cost Benchmark Cannot Be Pre-Determined for Rural Telephone Companies Based on Examination of Non-Rural Companies

The FNPRM, for example, asks about whether the Commission should adopt the range between 115 and 150% of a nationwide cost benchmark recommended by the Joint Board and

what specific cost benchmark level it should prescribe. While the RTC has consistently taken the position that a cost benchmark is more reasonable than a revenue benchmark, the range and level of a cost benchmark should not be set for rural ILECs in a proceeding limited to their non-rural counterparts. It is evident from the FNPRM (paras. 58-70) that the Commission recognizes that it can make adjustments to a non-rural high cost formula in numerous ways (e.g., by changing the benchmark, recovery percentage or range, or adopting some sort of capping mechanism) in order to achieve its stated goals of providing sufficient support and avoiding increases in the size of the resulting federal universal service fund. Therefore, even the non-rural mechanism will have to be evaluated, before adoption, with a cumulative view of all of the relevant plan elements to ensure that the mechanism will provide sufficient support to satisfy the mandates in section 254 with respect to the non-rural ILECs' service areas.

When the time comes for adopting a rural mechanism, the same kind of cumulative effect evaluation will be necessary, but taking account of rural differences. The differences that characterize rural ILECs are such that the effects of each determination, such as the benchmark, the range, or applying a recovery percentage or some cap, and the cumulative effect of the chosen constellation of terms for a non-rural universal service formula, will not achieve the same results for non-rural and rural ILECs. Hence, even the level and range of high cost benchmarks for rural ILECs must be determined de novo in the proceeding that will obtain a record suitable for the task not before the Commission in this phase. That record must be adequate to support findings

that any new rural plan will ensure that the mandates of affordability, sufficiency and reasonable comparability will be met for all rural ILECs, in spite of their widely varied characteristics.

B. Determining the "Area Over Which Costs Should Be Averaged" for Rural Companies Will Require Analysis of Different Factors and Use of Different Standards

The Commission and the Joint Board have decided (see paras. 69-70) that local rates are "largely affordable" and that "any significant increase in the size of federal support for local rates appears unnecessary." From this they have reasoned that it is appropriate to "limit the size of the federal mechanism." This decision has, of course, been reached only in this proceeding dealing with non-rural companies. Limiting the level of the federal support a non-rural mechanism will generate is one of the standards the FNPRM would apply in choosing among proposals for geographic cost and support averaging for the non-rural mechanism.

A similar determination cannot reasonably be made with regard to rural companies. For one thing, "just, reasonable and affordable rates" is not the only statutory standard for rural areas. It is equally or more important that the federal mechanism for the areas served by these rural companies, which lack the lower cost buffer provided by large, dense cities and towns, achieve rates that are "reasonably comparable" with those in urban areas, as section 254(b)(3) requires. Neither the Joint Board nor the Commission has developed or evaluated a record that would support such a conclusion for rural telephone companies' service areas. Indeed, this and other ongoing proceedings dealing with non-rural and price cap ILEC issues will likely redefine the

urban rates to which rural rates must be "reasonably comparable." This alone would make any assumption now based on preventing support growth with regard to rural ILECs arbitrary and irrational.

Moreover, the Commission has not yet decided what lines of a competing Eligible Telecommunications Carrier (CETC) will qualify for support, let alone confirmed that its rules do not mean that CETC lines will come under the current interim cap on transitional rural ILEC support. Even if it is assumed that rural rates are affordable today, current support levels for rural ILECs cannot be assumed to be sufficient if the unlawfully capped transition funding must be divided up among a growing aggregate number of ILEC and CETC lines.

Moreover, central to the determination to control the fund size for non-rural ILECs is the concurrent decision to incorporate a "hold harmless" mechanism into the non-rural plan. The Commission has not yet decided whether the hold harmless will apply by state or by company, but it seems to favor the state approach because that would allow individual companies to receive less support, thus putting less upward pressure on the fund size. The Joint Board and the Commission have both endorsed the objective, which the RTC has shown is totally at odds with the legal premise of a nationwide support mechanism for consumers, of balancing the interests of states with high aggregated support contributions against the interests of states that are less able to contribute to universal service support because they have less low-cost service territory. The RTC does not know how the state or company hold harmless determination will affect non-rural ILECs. However, the RTC will almost certainly support an appropriate "hold harmless"

provision for rural carriers in their future universal service proceeding, regardless of the decision for non-rural ILECs based on their different characteristics. For rural ILECs, which lack a large divergent service area and customer base to dilute the impact of decreased support, the difference between a hold harmless by state or by company could spell the difference between sufficient or insufficient support to achieve the purposes of the federal universal service policy.

In short, no assumptions or decisions about the sufficiency of support for non-rural ILECs and no principle of minimal growth in support should apply to rural ILECs, regardless of what the Commission decides about the non-rural mechanism. Thus, as a driving principle underlying the four combinations of cost averaging, support averaging and support limitation that the FNPRM will evaluate for non-rural ILECs in paragraphs 108-109 is preventing fund growth, these area averaging strategies are not relevant for a rural ILEC universal service mechanism.

In designing a sufficient rural ILEC support mechanism, the Commission will have to take into account the different implications of choosing what areas should be used for several purposes. It must look at geographic areas for cost averaging to calculate total support, to target support, to promote competitive neutrality and avoid windfall support or perverse entry signals, and to prescribe the geographic "service area" throughout which a CETC must provide universal services. The relationships among these averaging areas are different for rural ILECs. The statute already treats them differently in several respects because Congress was aware of the different challenges facing universal service providers in a rural telephone company area. In non-rural ILEC areas, section 214(e) requires the designation of additional requesting ETCs and

leaves the designation of service areas for ETCs up to the states. For non-rural ILEC purposes, disparities between UNE zones and cost averaging areas have been identified as a major potential arbitrage threat.

In contrast, section 214(e) codifies a preference for using a rural ILEC's frozen study area for the area a CLEC would have to serve, absent Joint Board proceedings, and requires a public interest finding by the state as a prerequisite to designating an additional ETC in any such area. Many rural ILECs are still covered by the automatic rural exemption from providing UNEs provided by section 251(f)(1), so that UNE arbitrage is not yet a concern. However, under the rural transition that will apply until 2001 or later, an ILEC's per-line support based on actual costs will be portable to a CETC, and that CETC is currently able to draw study area average support, while directly serving only low cost parts of the ILEC's area. At the same time, ILECs will lose average study area support, but will be left with above-average-cost lines. This situation creates a different set of perverse entry signals and carrier of last resort burdens for rural ILECs and a different set of windfall opportunities for CETCs in their areas. Consequently, the Commission should not only disclaim any precedental value for the non-rural averaging areas it adopts in this proceeding, but also should act on the RTC's pending reconsideration issues that affect the transition period without further delay.

Hence, the RTC opposes any interpretation of the Commission's decisions or rulemaking proposals for non-rural ILECs that might suggest that preventing an increase in universal service funding could be a legitimate goal or assumption with respect to rural companies. Indeed, if

Chairman Kennard and several Senators are to achieve their recently announced objectives for deployment of advanced telecommunications capability in rural areas,[1] the RTC believes that the Commission and the Joint Board will need to look at substantially increased universal service funding for rural telephone company areas in the near future.

While different geographic issues apply for rural ILEC areas, the Commission should recognize the need to match the area over which support is averaged and the area to which a CETC must provide universal service in the event that the incumbent ETC withdraws under section 214(e)(4). Regardless of what area the Commission uses to average its overall cost and overall benchmark comparison, it cannot provide for the legally required "specific" and "predictable" support if a CETC receives portable support averaged over an area including parts it does not serve or serves only by reselling subsidized service provided by the incumbent. Moreover, the deaveraging or disaggregation of support may need to go below the wire center level for rural telephone companies, since even small study areas have higher and lower cost portions, which portable support should track. Disaggregating support is necessary to avoid incentives for CETCs to arbitrage the availability of averaged support and the existence of lower cost lines for which the average support is a windfall. This question is distinct from the Commission's conclusion (e.g., para. 105) that "the level of competition today has not eroded

[1] See, FCC Chairman Kennard Meets with Senators; Maps out Strategy for Rural Access to High-speed Internet Services, FCC News Release (June 11, 1999).

implicit support flows to such an extent as to threaten universal service" because it creates distorted signals for competitive entry and deprives truly high cost customers of necessary support.

IV. THE HOLD-HARMLESS PRINCIPLE SHOULD APPLY TO EACH COMPANY'S SUPPORT AND SHOULD NOT BE PORTABLE

A. Hold-Harmless at the Company Level Benefits Consumers

The RTC is aware that the instant proceeding is aimed at non-rural carriers and that, presumably, if the FCC transitions rural carriers to a new high-cost support mechanism it will employ a transition method that satisfies the goals of the Act as well. In the rural transition, as with the non-rural transition, a carrier-by-carrier "hold-harmless provision" is necessary to prevent immediate and substantial reductions of support and rate increases that will harm consumers.

The hold-harmless provision should be implemented on a carrier-by-carrier basis for a number of reasons. While a state-by-state hold-harmless would work toward one of the Commission's goals in limiting the size of the fund, it would create "winners" and "losers" within a state and, thus, would not actually be a "hold-harmless" provision for customers. This plan would result in some carriers receiving less support, which may result in rate increases for the rural consumers. Whole communities would be cast into the positions of "winners" or "losers".

In addition, section 254 of the Telecommunications Act of 1996 states that "the Commission shall base policies for the preservation and advancement of universal services" on

several principles.[2] One of the principals is that "there should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[3] In its discussion of adopting a state-by-state hold-harmless plan, the Commission acknowledges the possibility that there will not be sufficient funds allocated in a state to prevent carriers from seeing a reduction in the funds needed to support their high-cost customers.

While adopting a carrier-by-carrier hold harmless plan may, depending on other circumstances, increase the size of the fund, there is nothing in the Communications Act which directs the Commission to consider the size of the fund in implementing Congress's universal service policies. The Commission's concern about the size of the fund cannot lawfully take precedence over its obligation to fulfill the terms of the 1996 Act. The Commission's goal should be an efficient, yet sufficient, fund. Only by adopting a carrier-by-carrier approach can the Commission ensure that there will not be a harsh diminution of support for carriers with a concomitant rate increase for consumers.

The Commission should also abandon its proposal to distribute universal service high cost support directly to the state commissions, precisely for the reasons stated by the Joint Board. Federal support has historically been distributed directly to carriers, and the 1996 Act provides for support payments to "only an eligible telecommunications carrier designated under section 214(e) ...." Such an unlawful deviation from the current practice would only disrupt the existing

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[2] 47 U.S.C. section 254.

[3] 47 U.S.C. section 254(b)(5).

support collection mechanism with no real gain for consumers, with the possible exception of gaining yet another bureaucracy.

B. Hold Harmless Support Cannot Rationally Be Portable to New ETCs

The Commission has requested comment on the relationship between hold-harmless and portability of support for non-rural carriers. While RTC is aware that this provision does not apply to rural carriers at this time, there is a clear logical and legal flaw in providing an ILEC's hold-harmless support to another carrier. The RTC believes that a competitor should not be permitted to collect hold-harmless support. The purpose of the hold-harmless provision is to prevent sudden rate increases by carriers that have based their present rate structures and network investments on current support levels, which have enabled them to provide service to all of the customers in their service area. These support amounts, however, are not necessary for new entrants who do not have a historical commitment to providing service to all.

In short, a competing carrier entering a market would not have received support prior to entering the market, and should not be given the hold-harmless amount upon entrance. Since the competitor is a new entrant, there is nothing for it to be held harmless from.

The obligation to serve an entire study area carries with it costs; the ILEC must maintain spare facilities and capacity should it be required to provide service. This burden is not shared by the CLEC. To date, the ILEC has not been compensated for this burden. The Commission should take the opportunity to change the status quo and preserve any difference between the amount which the ILEC would have received had it continued to serve the customer and the

CLEC's cost-based amount of compensation in partial recognition of the differences in carrier responsibilities.

C. The Commission Should Answer Unanswered Portability Questions

The Commission should take this opportunity to address and resolve some uncertainty that revolves around its plan for support portability. Specifically, the Commission should address the question of allocation of support for a new line added by a competing carrier.

In February, the Universal Service Administration Company (USAC) asked the Commission to clarify whether the phrase "captures an incumbent local exchange carrier's subscriber lines" in Commission Rule section 54.307 applies only in instances where the subscriber abandoned the ILEC's service for the CLEC's service, or whether it includes instances where a subscriber adds service from a CLEC in addition to existing ILEC service.

The resolution of this question could have a major adverse impact on the incumbent local exchange carrier. It is the RTC's position that a CLEC's addition of a new subscriber line to its system should not result in a reduction of support to the ILEC. The ILEC was not receiving support for that new subscriber line, so the ILEC should not "lose" support as a result of the addition of the line. The Commission should quickly answer this and several other support portability questions raised in USAC's February and July letters.

V. TO AVOID UNINTENDED ADVERSE IMPACT ON RURAL ILECS AND THEIR CUSTOMERS, THE COMMISSION SHOULD REMOVE THE INTERIM "CAP" ON LOOP SUPPORT FOR RURAL CARRIERS WHEN NON-RURAL CARRIERS SHIFT TO A NEW UNIVERSAL SERVICE PLAN

The Commission has assured rural carriers that "their support systems will not be altered until January 1, 2001, at the earliest, and in no event before the Joint Board has completed further

deliberations on high cost support mechanisms for rural carriers," after receiving recommendations from the Rural Task Force.[4] As Chairman Kennard has put it "...I see no reason why further small company reform must begin in 2001. We should make changes only when it is right to make changes, and not before."[5] Joint Board Chairman Susan Ness recently reiterated that "[t]he Telecommunications Act is clear that we should not hamper the ability of rural telephone companies — some 1300 strong — to serve their communities." The Commission also told Congress in its that "no state should receive less support than it currently receives."[6] However, the Commission cannot keep these promises for rural companies or their states — even though it is considering specific methods of implementing a "hold harmless" approach for non-rural carriers or states in this proceeding — unless it removes (or, at least, remedies) an unintended flaw in the interim cap.

Under section 36.601 of the rules, as soon as a new non-rural methodology takes effect, the associated removal of the current non-rural receivers of high cost loop support from the calculations that now determine the level of the interim cap and the allocation of cap-caused support shortfalls will reduce rural carriers' support. This is because the cap's limit on the annual

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[4] FNPRM, para. 21, citing 11 FCC Rcd at 8910, para. 254, 8917-18, paras. 252-56. Numerous statements confirm that current universal service mechanisms for rural carriers are to remain in place until the year 2001. See, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, and Access Charge Reform, CC Docket No. 96-262, Seventh Report & Order, 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, FCC 99-119 at ¶¶ 117-122 (rel. May 28, 1999) (Order and FNPRM).

[5] Remarks by William Kennard to USTA's Inside Washington Telecom on April 27, 1998.

[6] Federal-State Joint Board, Report to Congress (April, 1998).

increase in funding based on year-to-year loop growth has been spread over all non-rural and rural receivers of high cost loop support and their combined total of about 36 million loops in 1999. Since non-rural carriers as a group have lower high cost support per loop under the expense adjustment in Part 36, but have the majority of the combined loop count (about 28 million of the aggregate 36 million high cost loops), the cap has, in effect, masked or buffered the impact on rural companies, which account for only about 22% of the combined high cost loops, but 87.5% of the costs that exceed the cap. When the non-rural carriers' costs and loops are removed from the cap formula, that part of the support now shared by non-rural carriers is simply eliminated.

Consequently, despite the Commission's assurances, the RTC is concerned that support levels for rural carriers could be *significantly* affected when non-rural carriers move to a "proxy"-based USF support mechanism on January 1, 2000. Based on data submitted in April 1999 by the Universal Service Administrative Company (USAC) in anticipation of a July 1, 1999 proxy implementation date, it has been estimated that rural carriers would have experienced an annual reduction of $36 million in high cost support if non-rural carriers had implemented a new universal service methodology by the Commission's previous deadline.[7] These reductions, fortunately, were averted when the Commission delayed the date for proxy implementation until January 1, 2000.[8]

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[7] *See* Universal Service Administrative Company, Federal Universal Service Programs, Fund Size Projections & Contributions Base for the Third Quarter 1999 at 6, n. 20 (Apr. 30, 1999).

[8] *See Order and FNPRM* at ¶ 19. *See also* 47 C.F.R. § 36.601.

However, rural carriers will also suffer reductions when the non-rural carriers shift to a high cost mechanism based on a cost proxy model on January 1, 2000. The reductions the RTC fears would again occur as a result of the mathematical workings of the interim "cap" on universal service funding specified in Part 36.601(c) of the Commission's rules. The cap, which was intended to moderate growth in the overall size of the universal service fund,[9] was put in place in 1994, supposedly as an "interim" measure pending universal service reform.[10] It works by limiting growth in overall high cost support amounts to the annual rate of growth in nationwide loops.[11] When actual fund requirements (as determined by ILEC cost submissions) exceed the cap on available funds, universal service support amounts are reduced for all companies.[12] Following implementation of proxy-based support payments for non-rural carriers on January 1, 2000, non-rural company cost data will no longer be included in the "cap"

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[9] *See* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Report and Order*, 9 FCC Rcd 303 (1994) (*Interim Cap Order*).

[10] *See Interim Cap Order* at 305 ("Because we shall soon initiate a rulemaking to evaluate the current high cost assistance mechanisms...it is sensible to adopt interim rules to prevent large increases in the USF during the pendency of the permanent rulemaking...[T]he indexed cap represents an effective means of moderating USF growth during the interim period.")

[11] *See* 47 C.F.R. § 36.601(c).

[12] In 1999, for example, the funding requirement for high cost support for the industry is approximately $926.9 million. Under the interim cap rule, available funding based on year-over-year growth in loops equals only $864.1 million. To meet the limitation imposed by the "cap," 1999 federal high cost support was accordingly reduced for all carriers by $62.8 million, an average of $0.14 cents per loop per month for all recipient LECs.

calculation. However, high cost support for rural companies will continue to be capped based on the rate of growth of lines served by rural companies.[13]

The revised rules applying the cap solely to rural companies appear to have been intended to maintain the status quo for these carriers following the implementation of proxy models for non-rural companies (except to the extent that the rate of growth in rural lines might differ from the national average rate of growth). However, there is nothing on the record in this proceeding to quantify the impact of "maintaining the status quo" that would provide quantitative assurance to the rural carriers that they, in fact, will not be harmed by the migration of the non-rural carriers to a different universal service plan.

In short, as long as both rural and non-rural carriers are included in the current cap calculation, effects of cap reductions are "averaged out" between these two groups. When rural companies alone are subject to the cap, however, cap reductions will be applied solely to rural companies, producing a much greater proportionate impact on these carriers' support levels. These are reductions in revenues that are not accompanied by any reduction in the rural carriers' costs, which will need to be recovered through another means, such as increased local rates. Hence, the inadvertent reduction in support is likely to affect the high cost companies and customers that need the most careful attention to universal service safeguards.

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[13] 47 C.F.R. § 36.601(c). The rules require the administrator to implement the cap by calculating a revised nationwide average cost per loop sufficient to produce an overall fund size that does not exceed the cap. 47 C.F.R. § 36.622(c). Since high cost support under current mechanisms is determined by reference to the national average cost per loop, raising the national average has the effect of reducing universal service expense adjustments for all companies. In fact, as the NACPL is increased, some companies fall below the 115% eligibility "threshold" for USF and thereby lose all support.

The Commission should investigate and resolve this problem before it implements a proxy-based high cost mechanism for non-rural carriers. One obvious solution would be to eliminate the "interim" cap on high cost funding for rural companies. This would allow rural carriers to receive the full amount of universal service funding we believe the Commission and Joint Board intended when they designed the current mechanism. If, however, the Commission is unwilling to consider eliminating the cap, it should consider some other adjustment t the rules to assure that both non-rural and rural carriers and their customers are "held harmless" by the introduction of new support mechanisms on January 1, 2000.

VI. AN ACCURATE DISAGGREGATION METHODOLOGY WILL ENSURE COMPLIANCE WITH SECTION 254(E) IN RURAL AREAS

The Commission asks how to enforce section 254(e) for non-rural carriers, but the RTC also urges the Commission to remedy an existing transitional problem for rural carriers in pending reconsideration proceedings. The requirement that transitional support be based on the ILEC's cost defeats the section 254(e) requirement that support must be used "only for the provision, maintenance, and upgrading of facilities for which the support is intended." The RTC petition for reconsideration addressing this issue is still pending before the Commission.[14] The Commission can address this immediate problem with enforcement of section 254(e) by reconsidering this issue and reversing its position on per line support. A carrier that receives support above its costs is obviously unable to comply with the requirement that support be used

[14] Petition for Reconsideration of RTC in CC Docket Nol 96-45, filed July 17, 1997.

for the facilities intended. This problem can be eliminated by limiting support an additional ETC's cost instead of the incumbent's.

In the interim, the Commission need not impose a single rule to ensure compliance with section 254(e). Particularly in rural areas, adoption of an effective disaggregation (i.e. targeting) methodology will be the best way to ensure that support is used for intended facilities and services. As shown above, there is a need for a more discrete level of disaggregation than the wire center in areas served by rural carriers because of a wide variety of factors, the principal one being the tremendous cost differences attributable to wide variations in rural loop lengths. Basing support on the averaged support of the ILEC permits cream-skimming of customers served with lower costs loops. Cream-skimming, in turn, permits competing eligible telecommunications carriers to divert support based on the ILEC's averaged costs to untargeted facilities or services that may be outside the ILEC serving area.

The Commission can also rely on the States to ensure compliance with section 254(e). The states already exercise jurisdiction over service quality of incumbent local exchange carriers and will be in the best position to determine whether support is being used for the facilities and services intended. Since this proceeding does not involve areas served by rural telephone companies, the RTC does not take a position on the proposal to permit states to certify that carriers not subject to their jurisdiction are using the support for the services intended. Instead, it recommends that the Commission address this issue with respect to rural telephone companies when it considers the RTC's petition for reconsideration. However, the experience of the past

suggests that there is no need or requirement that the states impose on rate of return carriers additional conditions or restrictive certification and reporting requirements.

While the issue of how much support is available on a per-line basis has been and continues to be one decided by joint federal and state efforts, prior to 1996 the Commission relied largely on the States to ensure that the federal universal service policies under section 1 of the 1934 Act -- provided by means of cost shifts into the interstate jurisdiction, -- achieved affordable rates and an adequate nationwide system. In this post-1996 Act era, state mechanisms are still effective and can be relied on to ensure that support to ILECs achieves the objectives of section 254. If support is properly targeted, the states will be able to maintain their traditional role and authority over local rates and services, and the Commission will not have to dictate elaborate rules for incumbents' compliance with section 254(e). Even in cases where the states have imposed rate stability, price cap or other forms of regulation that involve forbearance, their authority over ILECs is sufficient to ensure compliance. Furthermore, it should be remembered that the states are the first and most effective forum for consumers. It is pointless for the Commission to require reports that provide subscribers details about how carriers recover the costs of the lines that provide them service. Neither state commissions nor consumers need this information. The states have other ways of finding out what support incumbent carriers receive. Information about how carriers recover their costs is not likely to be of any use to consumers who benefit from support through lower rates.

The situation of competitors that receive support based on the ILEC's cost is different. The Commission's rules on portability defeat its ability to ensure compliance with section 254 (e) by competing ETCs. The rules have no safety mechanism to ensure that a carrier with lower per line costs will not use the higher per line support to subsidize other lines or services. The ability to subsidize in this situation is enhanced if the lower cost carrier is not subject to rate of return or quality of service regulation. Since all carriers are eligible for support, there will undoubtedly be ETCs that are not subject to state commission quality of service regulation. If the Commission does not revise its rule on per line support, the need for regulatory parity and competitive neutrality suggests there may be a need to set up procedures that ensure compliance by competing carriers that might escape oversight completely while the ILEC in the same serving area is subject to compliance.

Moreover, certification with respect to other carriers is not an adequate section 254(e) safeguard because there is no way to tell how they are using support based on another carrier's costs. By the same token, if a competing carrier gets support for providing universal service via a UNE, there is no way to tell whether the carrier is incurring high costs at all — especially since the UNE can be located outside the high cost area.

VI. CONCLUSION

The RTC strongly urges the Commission not to regard its determination on non-rural carrier universal service issues as precedent or even foreshadowing for its later rural carrier determinations. The Commission must abide by the 1996 Act in decisions that shape non-rural universal service reform, and many potential errors here could have drastic effects if carried

forward to rural carriers. Moreover, there remain numerous open issues and unanswered questions about support portability and the impact of shifting non-rural carriers on the interim support cap that the Commission should rectify or answer as soon as possible in appropriate proceedings to prevent adverse consumer impacts during the rural carrier transition.

Respectfully submitted,

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