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

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# JOINT COMMENTS OF

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## EXECUTIVE SUMMARY

The FCC has established sound principles for the estimation, allocation and recovery of costs that faithfully balances the complex goals of the Telecommunications Act of 1996 including: (1) adopting forward-looking economic costs as the basis for establishing prices and universal service support; (2) concluding that the loop is a shared cost; (3) finding that the unit of analysis must be consistent across cost and universal service proceeding; and (4) deciding that actual competition is the trigger for action. However, because the Commission continues to grapple with the details of implementation, consumers have yet to see many of the benefits that would flow from the application of these principles.

Economic analysis based on the FCC's Synthesis Proxy Cost Model demonstrates that the subscriber line charge is too high. For the vast majority of residential loops (approximately 80 percent), current charges imposed by the FCC recover the costs allocated to the federal jurisdiction.

Joint Commenters believe that the SLC should be reduced or eliminated entirely because it was inappropriate in the first place and is inconsistent with a competitive market. Additionally, the SLC could also be eliminated as a mechanism to ensure that reductions in access charges are passed through to consumers. The only rate element that the Commission regulates directly on the consumer bill is the SLC.

The commission cannot rely on IXCs to pass lowered access costs through to residential consumers This approach has been controversial and has denied low volume consumers the benefits of rate reductions. The practical problem that the Commission has in restructuring interstate access charges in this way is that it has no means for ensuring that residential ratepayers see the benefits of these access charge reductions. The Commission's own data shows that low volume customers have done very badly since it began "reforming" access.

Increases in unavoidable end-user charges, mandated by FCC action or tolerated by FCC inaction, are unjustified and run directly contrary to the congressional intention that basic service should bear no more than a reasonable share of joint and common costs. Raising fixed monthly charges on second lines is bad economic and social policy.

The Telecommunications Act of 1996 certainly understood the multi-product economics of the industry and sought efficient entry across a broad range of services, while taking steps to promote and protect universal service. Its goal is deployment of advanced telecommunications services and information technologies based on a sharing of joint and common costs. It repeatedly recognized that advanced services and basic service are linked and that competitive and non-competitive services will be commingled on the network.

The FCC recognizes that the loop is a telecommunications facility used to complete all telephone calls -- local, intraLATA long distance, and interLATA long distance. It is also used to provide enhanced services. When the loop is in use to complete an interLATA long distance call, it cannot be used to complete another call. As a matter of economics, costs for joint and common facilities should be recovered on the basis of the nature and quality of use that each service makes of those facilities. As a matter of public policy from a universal service docket perspective, recovery of joint and common costs should be structured in such a way as to promote universal service by keeping basic service affordable.

The CCL is a charge to cover the use of a joint and common facility, the loop. If the CCL is transformed into either an increase in the SLC or into a draw on the universal service fund, the long distance companies (IXC) will be getting virtually a free ride on the loop. The IXC would be allowed to use a joint and common facility -- the loop – while passing all of the costs through to consumers as fixed per line charges. Eliminating the CCL clearly violates the policy that services included in universal service bear only a reasonable share of joint and common costs.

As the telecommunications market becomes competitive, the commission must move toward the elimination of the subscriber line charge. Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs incurred by the traditional service providers (ILECs and IXCs) who use it.

Joint Commenters also urge the FCC to provide more direction over § 254 implementation issues. The FCC should change its approach to take into account the differences in the ability of the states to achieve rate comparability. Specifically, the FCC should consider (1) placing use restrictions directly on the carrier receiving federal support and (2) adopting an approach that lists multiple options available to the state from which to choose based on its own regulatory environment.

Placing use restrictions directly on the carrier receiving federal support avoids placing the responsibility for achieving rate comparability entirely on the state commissions. Federal support should not be made available to carriers to offset intrastate revenue requirements without some type of check and balance in place. States that have very little ability to reduce basic service rates through any means benefit most from the FCC imposing rate comparability requirements directly on receiving carriers. Adopting an approach that lists multiple options, available to the state to choose, would allow each state to take advantage of the method best suited to its regulatory environment. A state-centered approach would empower regulators to achieve reasonable comparability of rates within their states more quickly than an approach than relies exclusively on federal regulation.

Furthermore, many state commissions have the authority to establish their own universal service fund. The effectiveness of that option depends on the extent to which the services protected under state programs correspond to those services designated as targets for federal support.

## I. INTRODUCTION

The Texas Office of Public Utility Counsel (Texas OPC) represents residential and small business consumers of Texas in telephone proceedings before the Texas Public Utility Commission, the Federal Communications Commission and in various state and federal courts.

The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, founded in 1968. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

The National Association of State Utility Consumer Advocates (NASUCA) is an association of 42 consumer advocate offices in 39 states and the District of Columbia. Our members are designated by laws of their respective states to represent the interests of utility consumers before state and federal regulators and in the courts.

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumer's Union's income is solely derived from sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees.

Joint Commenters submit these comments in response to the Notice of Proposed Rulemaking on Universal Service.[1]

In the three and one-half years since the passage of the Telecommunications Act of 1996 the Commission has articulated a paradigm for the estimation, allocation and recovery of costs that faithfully balances the complex goals of the Act. Through a long series of orders in the universal service, local competition, and access charge reform dockets the Commission's paradigm has identified the following essential principles (in order of their magnitude of importance measured by their impact on rates or the size of the universal service fund):

- Forward-looking economic costs must be the basis for establishing prices and universal service support[2]
- The loop is a shared cost – shared by all of the services that utilize it.[3]

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[1] Federal Communications Commission, In the Matter of Federal-State Joint Board on Universal Service:, CC Docket No. 96-45 and Access Charge Reform, CC Docket No. 96-262, 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, May 28, 1999 (hereafter, " Joint FNPRM").

[2] Joint FNPRM

> We agree with the Joint Board that we should use forward-looking costs as a starting point in determining support amounts. We believe that basing support levels on forward-looking costs will send the correct signals for investment, competitive entry and innovation, and that a single national cost model will be the most efficient way to estimate forward-looking cost levels (¶ 11).
>
> We adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services (¶ 48).

[3] The most explicit statement can be found at Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long distance service

*See below*, section III.B., for a detailed discussion.

- The unit of analysis must be consistent across cost and universal service proceedings.[4]
- Actual competition is the trigger for action, not theory.[5]

Although the fundamental principles have been clearly articulated, the Commission continues to grapple with the details of implementation. As a result, consumers have yet to see many of the benefits that would flow from the application of these principles.

The fact that the instant proceeding combines a Seventh Report and Order and Thirteenth Order on Reconsideration in one docket and a Fourth Report and Order and Further Notice of

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[4] Universal Service Order, (¶ 251).

> We also encourage a state, to the extent possible and consistent with the above criteria, to use its ongoing proceedings to develop permanent unbundled network element prices as a basis for its universal service cost study. This would reduce duplication and diminish arbitrage opportunities that might arise from inconsistencies between the methodologies for setting unbundled network element prices and for determining universal service support levels. In particular, we wish to avoid situations in which, because of different methodologies used for pricing unbundled network elements and determining universal service support, a carrier could receive support for the provision of universal service that differs from the rate it pays to acquire access to unbundled network elements needed to provide universal service. Consequently, to prevent differences between the pricing of unbundled network element and the determination of universal service support, we urge states to coordinate the development of cost studies for the pricing of unbundled network elements and the determination of universal service support.[4]

[5] Joint FNPRM.

> Support based on forward-looking models will ensure that support payments remain specific, predictable, and sufficient, as required by section 254, particularly as competition develops. To achieve universal service in a competitive market, support should be based on costs that drive market decisions, and those costs are forward-looking costs. (¶ 50)
>
> The model currently suggests that, using this methodology, a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals. (¶ 99)
>
> We also seek comment on whether we should calculate costs at the study area level. In recommending that the federal support mechanism calculate costs at the study area level, the Joint Board suggested that the level of competition today has not eroded implicit support flows to an extent as to threaten universal service. (¶ 105).

Proposed Rulemaking in another docket, both dockets having commenced after the passage of the Act, attest to the arduous road the Commission has been forced to follow.

With the development of a cost model and a Supreme Court ruling upholding the concept of forward looking economic costs, the end is in sight. Now is the time to implement the above principles.

Joint Commenters have participated in all of the above proceedings. We have generally supported the principles articulated by the Commission, although we have disagreed with several details of the implementation. These comments use the framework proposed by the Commission to answer the remaining questions and correct some previous errors, all of which play a prominent role in the FNPRM.

Finally, in addition to commenting on the FCC's discussion of the need to adjust *interstate* access charges to account for the removal of implicit support from interstate rates, Joint Commenters comment on the application of explicit federal support to the *intrastate* jurisdiction. Concerning the Commission's discussion on the distribution and application of support (Joint FNPRM at ¶¶ 113-116), Joint Commenters generally urge the FCC to provide more direction over § 254 implementation issues.

## II. REFORM OF COMMON-LINE COST RECOVERY: EMPIRICAL RESULTS

### A. THE RIGHT DIRECTION FOR PUBLIC POLICY

The Commission has based it plan of action on an incorrect premise about the subscriber line charge and its relationship to other rates.

Above all, the Commission assumes, incorrectly, that the subscriber line charge is inadequate to recover the costs properly assigned to it. As a consequence, the Commission is hesitant to reduce the SLC and looks elsewhere for reductions in rates resulting from the creation of a universal service fund or through productivity factors.

Ironically, the Commission acknowledges that the Joint Board has not reached a conclusion about the existence of subsidies in the current recovery of common-line revenues.

> The Joint Board, however, made no finding as to whether implicit support exists in interstate access rates, or whether the Commission should make such support explicit if it does exist. (Joint FNPRM, ¶ 42).

Unfortunately, the FCC leaps to the conclusion that there is such a subsidy.

> Because the SLC for primary residential and single line business lines is capped at $3.50, the SLC does not fully recover the permitted common-line revenues of providing service to the majority of these customers. Consequently, the SLC cap may create implicit support to primary residential lines. Revenues from interstate access charges, such as the CCLC and multi-line PICC, provide support that allows us to maintain the primary residential SLC cap. The PICC for primary residential and single-line business lines has a ceiling that will gradually increase until it reaches a level that allows full recovery of the permitted common line revenues from flat charges assessed to end-users and IXCs. As the primary residential and single-line business PICCs increase, the amount of permitted common-line revenues associated with those lines that the non-primary residential and multi-line business line PICCs recover will fall to zero. (Joint FNPRM, ¶ 127).

This premise influences the Commission's thinking about where rate reductions and rate increases should flow.

> We also seek comment on whether we should reduce the SLC on primary residential and single-line business lines. Although such a reduction is an option, it would not further the goal of reducing implicit interstate support, unless it was targeted to low-cost wire centers within a study area. The current SLC cap of $3.50 per month on primary residential and single-line business lines already creates interstate implicit support for most of those lines. (Joint FNPRM, ¶ 133).

These comments demonstrate that within the context of its own cost/competition paradigm the premise is doubtful at best and the pricing conclusion is wrong and contrary to the intention of the Act. We begin with the empirical discussion, since the concepts are familiar to the Commission. The new ingredient is the cost model[6], which has been developed by the Commission. After the empirical discussion, we review the conceptual issues.

The implication we draw from the empirical and conceptual analysis is straightforward. Economic analysis demonstrates that the subscriber line charge is too high; public policy dictates that it should be reduced. In a world of efficient, multi-product telecommunications companies, claims that current fixed charges do not cover the federal share of loop costs are contradicted by the FCC's own cost analysis. Increases in unavoidable end-user charges, mandated by FCC action and tolerated by FCC inaction, run directly contrary to the congressional intention that basic service should bear no more than a reasonable share of joint and common costs.

[6] The Synthesis Cost Proxy Model, hereafter referred to as the "SCPM".

## B. THE VAST MAJORITY OF LOOPS RECOVER THEIR COSTS

If the Commission implements its decision to utilize forward looking economic costs and treat the loop as a common cost, it must conclude that fixed end-user charges (*i.e.*, the subscriber line charge and the PICC) should not be increased.

- Based up the results of the default runs of the Synthesis Cost Proxy Model for Texas, we conclude that at least 80 percent of residential lines in Texas are covering 100 percent of the forward looking economic costs of loops and ports (*i.e.*, the non-traffic sensitive portion of costs) that are allocated to the Federal jurisdiction.

Based upon this analysis, we conclude that the intention of the FCC to increase the fixed cost recovery, all of which has been loaded onto end users in the form of line items on the bill, is unjustified. The elimination of the CCL, which is the ultimate objective of a policy to increase fixed charges, violates section 254 (k) of the Act. That is, the IXCs would be using a facility that is shared, without paying for it. It is unreasonable to allow the IXCs to have what is essentially a free ride. We arrive at this empirical result in the following fashion. Exhibit 1 is based on the cost of loop and port as calculated by the SCPM at the wire center level. It shows the cumulative percentage of lines falling below a specific dollar figure.

The statewide average for Texas is $18.22 per month. Since 25 percent of these costs have been allocated to the Federal Jurisdiction, the Federal charges should cover $4.55 per month. Similar estimates for over a dozen states that represent almost two-thirds of the lines in the country are presented in Exhibit 3. This analysis shows that Texas is typical of the nation.

Before we estimate how much is collected from residential ratepayers in Texas, there is one observation we would like to make on these results. This data is somewhat old, apparently reflecting

1996 line counts and costs. For example, the data implies that only 4 percent of households had second lines. This would be consistent with 1996 data. By 1997, which is the last point for which the FCC has data, the percentage on a national basis had increased to about 12 percent.[7] In the 18 months since then, the momentum for second lines has increased. SBC is one of the leaders in selling second lines. For the purpose of this analysis, we use a conservative figure of 20 percent[8] for second lines. This is particularly appropriate since the impact of the FCC decisions that would flow from the instant proceeding will be next year and beyond.[9]

The addition of second lines has a dramatic effect on loop costs. The incremental cost of providing the second line is considerably lower than the first, because most of the capital equipment is deployed. This is especially true of loop and port costs. Consider the following example, which we believe is reasonable. Assume that second line penetration has moved from 4 percent to 20 percent. Further assume that the second line costs half as much as the first line. The statewide average cost for loop and port in Texas would decline from $18.20 to $16.60.

Exhibit 2 presents our estimate of the amount collected from Texas residential customers for access in the federal jurisdiction. We assume that 80 percent of the lines in the state are first lines and that 20 percent are additional lines. Based upon charges that will be in place on December 31,

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[7] Federal Communications Commission, Trends in Telephone Service (February, 1999), table 20.4

[8] *See* Application of Southwestern Bell Telephone Company for Rate Group Reclassification Pursuant to Section 58.058 of the Texas Utility Code, (Jan. 26, 1999), General Counsel Exhibit No. 1 at pg. 23. SWBT indicates that improved marketing of additional [second] phone lines resulted in sales which accounted for approximately 14% of new access line in 1993, 18% of new access lines in 1994, 25% of new access lines in 1995, and 29% of new access lines growth in 1996, in Texas.

[9] Trends, Table 20.4, gives year end figures of 114.4 million for residential loops and 17.9 million for additional lines. The figure of 20% for year end 1999 is derived from setting second lines at approximately 25 million and total lines at 123 million. This acceleration of second lines is consistent with the acceleration in Texas as noted in footnote 8.

1999, we estimate that a total of $5.50 per residential account is being collected for access. This total is composed of an average of $4.00 for the federal subscriber line charge, $1.30 for PICCs and $.20 for the CCL.

The fixed charges exceed the costs that should be recovered for the vast majority of residential lines in Texas. The federal charges should cover $4.55 per month. However, the federal jurisdiction is collecting $5.50 per residential account. At $5.50 per month, lines with costs up to almost $22 are covering their federal jurisdiction costs in fixed charges. This is approximately 80 percent of all lines.

Texas is used as an example because it is a large state that is very close to the national average in forward looking costs. We reach similar conclusions for other states as well (see Exhibit 3). For example, in Pennsylvania, at $5.50 per month, 80 percent of the loops cover their costs. These results show that in between three-quarters and nine-tenths of the residential customers cover the loop costs allocated to the federal jurisdiction. There are a few instances of high cost states in which a much smaller percentage of the residential customers cover the costs allocated to the federal jurisdiction. That is an issue to be addressed by high cost fund policy.

## III. THE ECONOMIC AND LEGAL NATURE OF LOOP COSTS

### A. SHARING OF COSTS BETWEEN SERVICES THAT USE JOINT AND COMMON FACILITIES ACROSS JURISDICTIONS REMAINS SOUND ECONOMIC AND PUBLIC POLICY.

Joint Commenters have consistently argued that the loop is a common cost for all telecommunications services that utilize it. In our universal service comments we made the following observations:

> The loop is a telecommunications facility used to complete all telephone calls -- local, intraLATA long distance, and interLATA long distance. It is also used to provide enhanced services. It is impossible to complete an interLATA long distance call without a loop. When the loop is in use to complete an interLATA long distance call, it cannot be used to complete another call.[10]

In its Local Competition comments, Texas OPC defined these costs as follows:

> Joint cost: Costs incurred in the provision of two or more services, that are not captured in the incremental costs of each service individually when the services are produced in fixed proportions
>
> Common cost: Costs, incurred in the provision of two or more services, that are not captured in the incremental costs of each service individually when the services can be produced in variable proportions.
>
> Shared cost: Generic terms for costs that are shared between two or more services that are not captured in the incremental costs of each service individually.[11]

The Commission has adopted a cost and pricing methodology that recognizes the fundamental economics of the modern telecommunications network. This approach involves a number of areas of analysis -- (1) the recognition of the telecommunications network as a multi-

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[10] "Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996, p. 6.

[11] Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, May 16, 1996, pp. 21-22.

product undertaking exhibiting strong economies of scale and scope; (2) the treatment of the loop as a common cost; and (3) the comprehension of competitive market behavior. The economic evidence that the telecommunications network is a multi-product enterprise enjoying economies of scale and scope is overwhelming.

- On the supply-side all long distance calls use the network exactly the same way local calls do. Vertical services (like Call Waiting, Call Forwarding and Caller ID) are supported by all parts of the network. Basic service accounts for about one-quarter of total revenues generated per line.

- On the demand-side, customers expect to receive long distance service when they order telephone service. Vertical services are strong complements of basic service. If a provider sells basic service to a customer, competitors are very unlikely to sell that customer Call Waiting.

- Companies are eager to sell local service and long distance service bundled together.[12] One-stop shopping is an integral part of providers' business plans. In such a bundle, why is local cost the "cost causer", as the LECs claim?

A reasonable basis to determine the allocation of shared costs is to analyze the facilities and functionalities necessary and actually used in the production of goods and services. In order to produce a long distance call one needs distribution plant, as well as switching plant and transport plant. Instead of basing economic analysis on a guess about what consumers really wanted when they purchased a bundle of services, the Commission should rely on a "service pays" principle. That is, services that use facilities should be considered to benefit from the deployment of those facilities and every service that uses a facility should help pay for it.

Historical analysis of why investments were actually made shows that most technologies

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[12] Providers are also intensely interested in bundling many more services, such as Internet and data services, in addition to local and long-distance calling.

were deployed for and used by business customers first. Hence, it is more reasonable to assume that those customers caused the investment. History shows that the integration of the long distance network into the local network (they actually started as two separate networks) raised the cost of the integrated network. Since the integrated network costs more as a result of the addition of long distance, it is reasonable to assume that long distance causes costs in the integrated network. For over half a century the courts, most state commissions, and recently the FCC have all taken this view although most have consistently overallocated shared costs to local service.

Although historical analysis demonstrates the fallacy in attributing loop costs to only basic local service, it is clear that efforts to unraveling the network into cost causation categories are difficult. For that reason, the analysis of costs should be based on the only footing on which sensible economic analysis can be launched -- an assessment of the product, not the psychology of the customer. We must analyze the facilities and functionalities necessary and actually used in the production of goods and services. We rely on a service pays principle. That is, services that use facilities should be considered to cause the deployment of those facilities. Assumptions about prime movers are arbitrary. Every service that uses facilities is a cost causer.

- As a matter of economics, costs for joint and common facilities should be recovered on the basis of the nature and quality of use that each service makes of those facilities.

- As a matter of public policy from a universal service docket perspective, recovery of joint and common costs should be structured in such a way as to promote universal service by keeping basic service affordable.

Now that the companies are intensely competing to sell bundles of services, the fiction that local service causes the loop cost should be put to rest once and for all. In truth, since the first

decade of this century, the network, including the loop, has been consciously designed to serve local and long distance. Long distance was not an afterthought; it was always a forethought, included in the design, development and deployment of the network. Vertical services have been included in economic analyses of network design and architecture for over a decade.

Although some theoretical economists chafe at the thought of recovering shared costs across a range of products, common sense and real world experience demonstrates that this is the way markets work. For example, one of the Regional Bell Operating Companies made this argument in the federal universal service proceeding.

> The Telecommunications Act of 1996 does not require the Commission to replace any, or all, of the contributions to joint and common costs in the interstate access charge system with universal service funding...
>
> They do not require the Commission to eliminate all, or even a major portion, of the contributions to joint and common costs in the interstate access charge system with a universal service funding mechanism, if those contributions do not preserve or advance universal service...
>
> As a practical matter, the Commission must construe Section 254 in this way because it is neither possible, nor desirable, to create a rate structure for telecommunications services that reflects the true economic cost of serving each customer. The costs of service for a particular customer vary by the type of facilities provided, the customers' location, the volume of service, the short run and/or long run effect on capital deployment, and a host of other factors that change constantly. For this reason, a carrier defines a class of customers and develops averaged rates for the entire class. Even if the carrier disaggregates its rates by geography, time of day, or volume, the rate level is the same for the group of customers in the disaggregated category. This means that some customers in the category will pay more than the cost of the service, and the excess revenues from these customers subsidize other customers that are paying rates that do not recover their costs. Moreover, marketing considerations often dictate that rates for some services will directly subsidize rates for other services. For instance, supermarkets do not charge customers for parking, but recover the cost of parking in the price for groceries. They do this because it is a more effective way of encouraging customers to shop...

> Thus, even in a perfectly competitive market, variable amounts of contribution to joint and common costs, and cross-subsidies between services, will always exist. Such pricing practices are not inconsistent with Section 254 unless they represent direct subsidies for universal service. [13]

In a similar proceeding in Texas, one of the potential competitors made exactly the point that a common sense understanding of economic behavior requires the recovery of costs across all services that share facilities.

> In response to comments filed by MCI, Sprint and SWBT, TCG reiterates its strong support of the Commission's recommendation to calculate the subsidy requirements as the difference between total revenue per line and the forward-looking cost of those services rather than the difference between basic service rates and the cost of basic service. Such an approach is simply common sense and recognizes the fact that telephone subscribers buy much more than basic service and generate far more revenue for their local service provider than the rates for basic service and the subscriber line charge. Indeed, to the extent that rates for basic service do not cover the cost of basic service (forward-looking or otherwise), the shortfall may be more than overcome by profits from discretionary services. The basic service rates, therefore, are no more than a loss leader for the provider, used to attract the customer so that the provider can sell him other, more profitable products and services.
>
> It is also important to realize that discretionary services (e.g., call forwarding, call waiting, call answering) and access to a long-distance provider can be provided to that customer only by the customer's basic service provider. That is, once a customer selects a local service provider, that provider captures the *exclusive* right to sell that customer additional services. The Commission has correctly recognized, therefore, that subscribers to basic service are much more valuable to their carriers than the rates for basic service would imply, and that such revenue opportunities should be taken into account when calculating the support requirement.
>
> Including such revenue in the benchmark both prevents a windfall from accruing to the ILECs and allows the marketplace to establish cost-based rates for all services including access. The windfall is prevented because a higher benchmark produces a smaller universal service fund, adjusted automatically for the revenue from access and vertical services. Cost-based rates will result from competition among local service providers for the entire package of services. It is important to realize that the

[13] "NYNEX Comments," before the Federal Communications Commission, In the Matter Of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996, pp. 3,4,5.

> telecommunications industry is extremely dynamic and costs will continue to decline. Competition will only accelerate this trend of declining cost reducing the need for universal service support. Moreover, because a competitive marketplace is the only real guarantor of cost-based prices, there is no need for the commission to intervene to "guess" at what costs ought to be.[14]

To the extent that we propose to recover legitimate joint and common cost from these services, those joint and common costs will not be disappear with the advent of competition. They will not disappear because the competitors must incur such costs if they seek to provide facilities of their own. Competitive markets allow the recovery of efficient joint and common costs.

The Telecommunications Act of 1996 certainly understood the economics of the industry and sought efficient entry across a broad range of services.

- It promotes the deployment of advanced telecommunications services and information technologies and insists on a sharing of joint and common costs.
- It repeatedly recognizes that advanced services and basic service are linked.
- It recognizes that competitive and non-competitive services will be commingled on the network. Its purpose is to advance this multi-product network.

The law directly addresses the revenue responsibility of these various services. Competitive services are not to be cross-subsidized and they are required to make a contribution to joint and common costs. Basic service is to pay no more than a reasonable share of joint and common costs.

> Subsidy of Competitive Service Prohibited – A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and

[14] "Reply Comments of Teleport Communications Houston, Inc. and TCG Dallas Concerning Proposed Rules on Universal Service Fund Issues," before the Public Utility Commission of Texas, Investigation of Universal Service Issues, Project No. 14929, October 10, 1997.

common costs of facilities used to provide those services.

The cross-subsidy and joint cost language of 47 USC 254 (k) addresses this point. It recognizes two distinct steps that are necessary to have fair and efficient pricing in an emerging, partially competitive environment -- a strict prohibition on below cost pricing and a reasonable recovery of joint and common costs across services that share facilities. The Conference Report states this principle more vigorously. The Conference Committee Report clarifies the standard for cost allocation by adopting the Senate report language --

> The Commission and the states are required to establish any necessary cost allocation rules, accounting safeguards, and other guidelines *to ensure that universal service bears no more than a reasonable share (and may bear less than a reasonable share)* of the joint and common facilities used to provide both competitive and noncompetitive services. [15]

In pursuit of universal basic service, this language establishes a reasonable share of joint and common costs allocated to basic service as an *upper* limit.

The failure to take legitimate joint and common costs into account would frustrate the purposes of the 1996 Act. Allowing incumbents to recover joint and common costs excessively from basic service would discourage efficiency and it would frustrate competition, allowing incumbents to price more competitive services at an artificially low level. Allowing incumbents to recover an unreasonable share of joint and common costs from basic service (either directly in the price for basic service through rate rebalancing or indirectly by creating a large universal service fund, which is tied to the provision of basic service) insulates incumbents unfairly from market forces thereby undermining the basic premise of the Act.

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[15] Conference Report, p. 129, *emphasis added.*

## B. THE FCC'S PARADIGM

The FCC, the states, and the courts have found consistently and repeatedly that the loop is a common cost. The courts recognized this almost three quarters of a century ago in Smith v. Illinois.[16] Many of the states have formally recognized this in comments in federal proceedings,[17] and in their own cost dockets.[18]

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[16] 282 U.S. 133 (1930).

[17] Two of the Regional Bell Operating Companies take this point of view (Bell Atlantic and NYNEX), as do a number of state regulators: the Nebraska Public Service Commission, the New Hampshire Public Utilities Commission, the New Mexico State Corporation Commission, the Utah Public Service Commission, the Vermont Department of Public Service and Public Service Board, and the Public Service Commission of West Virginia. In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 p. 18; "Comments of the State of Maine Public Utility Commission, the State of Montana Public Service Commission". Virtually all other Consumer Advocate commenters share this view in their initial comments. "Comments of the Idaho Public Service Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 17; "Comments of the Public Utility Commission of Texas" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. ii; "Initial Comments of the Pennsylvania Public Utility Commission to the Notice of Proposed Rulemaking and Order Establishing Joint Board" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 7.; Florida, p. 22; "Initial Comments of the Virginia Corporation Commission," In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 5; "Comments of the Staff of the Indiana Utility Regulatory Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 9.

[18] "Report of Glenn P. Richardson, Senior Hearing Examiner, Application of GTE South Incorporated For Revisions to Its Local Exchange, Access and IntraLATA Long Distance Rates, Commonwealth of Virginia State Corporation Commission, Case No. PUVC950019, March 14, 1997, p. 84; Application of the Mountain States Telephone and Telegraph Company dong Business as U.S. West Communications, Inc., for Approval of a Five-Year Plan for Rate and Service Regulation and for a Share Earnings Program, Colorado Public Utilities Commission, Docket Nos. 90a-665T, 96A-281T, 96S-257T, Decision No. C97-88, January 5, 1997, pp. 42-43; Decision and Order Rejecting Tariff Revisions, Washington Utilities and Transportation Commission v. U.S. West Communications Inc., Docket No. UT-950200, April 11, 1996 pp. 83-84; Department of Utility Controls' Investigation Into the Southern New England Telephone Company's Cost of Providing Service, Department of Public Utility Control, Docket No. 94-10-01, June 15, 1995, pp. 24-25; Report and Order, In Re: US West Communications, Inc., Utah Public Service Commission, Docket No. 95-049-05, November 6, 1995, p. 95; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-95-10, May 17, 1996, p. 295, 306; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-94-1, November 21, 1994; In the Matter of the Application of GTE Southwest Incorporates and Contel of the West, Incorporated to Restructure Their Respective Rates, New Mexico State Corporation Commission, Docket NO. 94-291-TC, Phase II, December 27, 1995, pp. 11, 14-15; New England Telephone Generic

In a series of recent rulings to implement the 1996 Telecom Act, the FCC has constructed a comprehensive paradigm that starts from the fundamentally correct premise that the loop is a shared cost. There should be no doubt that this is the correct treatment of loop costs and alternatives should be clearly and loudly rejected.

The FCC began in the local competition docket by recognizing that the loop is a common cost of local, long distance and the other services that use the loop.

As discussed above, separate telecommunications services are typically provided over shared network facilities, the cost of which may be joint or common with respect to some services. The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.[19]

The FCC followed that decision with its proposed rulemaking on access charge reform, in which it reaffirmed the observation that the loop is a common cost.

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long distance service.[20]

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Rate Structure Investigation, New Hampshire Public Utilities Commission, March 11, 1991, DR 89010, slip, op., pp. 39-40; Order No. 18598, Re: Investigation into Nontraffic-Sensitive Cost Recovery, Florida Public Service Commission, 1987; Docket No. 860984-TP, pp. 258, 265-266; Order No. U-15955, Ex Parte South Central Bell Telephone Company, Docket No. 1-00940035, Louisiana Public Service Commission, September 5, 1995, p. 12; In Re Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. 1-00940035, September 5, 1995, p. 12; In the Matter of a Summary Investigation into IntraLATA Toll Access Compensation for Local Exchange Carriers Providing Telephone Services Within the State of Minnesota, Minnesota Public utilities Commission, Docket No. P-999/CI-85-582, November 2, 1987, p. 33.

[19] Federal Communications Commission, First Report and Order: Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, ¶678.

[20] Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for

The FCC applied this conclusion in its decision to convert the Common Carrier Line (CCL) charge into a flat rate charge to cover loop costs.

> We reject claims that a flat-rated, per line recovery mechanism assessed on IXCs would be inconsistent with section 254 (b) that requires equitable and nondiscriminatory contribution to universal service by all telecommunications providers. The PICC is not a universal service mechanism, but rather a flat-rated charge that recovers local loop costs in a cost causative manner.[21]

In the reform of the separations process, the FCC has stated the economic reasoning and analysis which underpins this treatment of the loop.

> Nearly all ILEC facilities and operations are used for multiple services. Some portion of costs nonetheless can be attributed to individual services in a manner reflecting cost causation. This is possible when one service, using capacity that would otherwise be used by another service, requires the construction of greater capacity, making capacity cost *incremental* to the service. The service therefore bears a causal responsibility for part of the cost. The cost of some components in local switches, for example, is incremental (i.e. sensitive) to the levels of local and toll traffic engaging the switch. Most ILEC costs, however, cannot be attributed to individual services in this manner because in the case of joint and common costs, cost causation alone does not yield a unique allocation of such costs across those services. The primary reason is that shared facilities and operations are usually capable of providing at least one additional service at no additional cost. In such instances, the cost is *common* to the services. For example, the cost of a residential loop used to provide traditional telephony services usually is common to local, intrastate toll, and interstate toll services. In a typical residence, none of these services individually bears causal responsibility for loop costs because no service places sufficient demands on capacity to warrant installation of a second loop. Another reason why a relationship may not exist between cost and individual services is that some shared facilities or operations provide services in fixed proportion to each other, making the cost *joint* with respect to the services. ILEC billing costs, for

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Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237.

[21] Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: First Report and Order, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 104.

> example, tend to be joint with respect to local, state toll, and interstate toll services. For the majority of bills rendered, billed charges always include all three services. The fixed combination of services makes it impossible for one service to bear responsibility for billing costs...
>
> Both incremental cost and stand-alone cost (which are usually expressed per unit of output) are greatly affected by the way we choose to define the increment and the service class. The incremental cost of carrying an additional call from residences to end offices, for example, is zero if the residences are already connected to end offices, but the incremental cost of establishing such connections is the cost of the loops. [22]

Moreover, the importance of ensuring the correct loop allocation cannot be overemphasized. As the FCC notes, the proper identification of loop costs is critical to telecommunications pricing because loop constitutes almost half of all costs of local exchange carriers.[23] For example, ARMIS data indicates that loop plant investment in 1996 was 49% of total plant investment.

Most importantly, the FCC's methodology for estimating costs of basic service for purposes of identifying high cost areas is consistent with its logic of properly allocating loop costs. Two of the ten criteria it establishes for specification of a cost model require similar treatment of joint and common costs:

> (2) Any network functionality or element, such as loop, switching, transport, or signaling, necessary to produce supported services must have an associated cost...
>
> (7) A reasonable allocation of joint and common costs must be assigned to the cost of supported services. This allocation will ensure that the forward-looking economic cost does not include an unreasonable share of joint and common costs for non-supported services.[24]

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[22] Federal Communications Commission, In the Matter of Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Notice of Proposed Rulemaking, CC Docket No. 80-286, November 10, 1997 (hereafter, Separations NPRM), pp. 14..15.

[23] Separations NPRM, p. 16

[24] FCC, Universal Service Order, ¶ 250.

The FCC has constructed a paradigm that starts from the fundamentally correct premise that the loop is a shared cost. It follows that up with a cost principle that requires costs to be recorded for all facilities used by all services.

## IV. THE COST RECOVERY PARADIGM

### A. THE CCL IS A CHARGE FOR THE USE OF A JOINT AND COMMON FACILITY

Having concluded that the loop is a shared cost, we turn to the question of how the share of those costs that are allocated to uses that fall within the federal jurisdiction should be recovered. The Commission is heading down a path that would eliminate the carrier common line charge.

> Although, at the end of the transition initiated by our *Access Charge Reform Order,* the combination of the SLC and PICC assessed to each line permit carriers to recover the full interstate allocated portion of their common line costs from the line that caused those costs to be incurred, any reduction in the SLC would delay this transitional process and result in a higher PICC on primary residential and single-line business lines. (Joint FNPRM, ¶ 133).

We disagree with this conclusion. The CCL is a charge to cover the use of a joint and common facility, the loop. The loop is a telecommunicationsfacility used to complete all telephone calls -- local, intraLATA long distance, and interLATA long distance. It is also used to provide enhanced services. It is impossible to complete an interLATA long distance call without a loop. When the loop is in use to complete an interLATA long distance call, it cannot be used to complete another call.

If the CCL is transformed into either an increase in the SLC or into a draw on the universal service fund, the long distance companies (IXC) will be getting virtually a free ride on the loop.[25] The IXC would be allowed to use a joint and common facility -- the loop – while passing all of the costs through to consumers as fixed per line charges. Eliminating the CCL clearly violates the policy that services included in universal service bear only a reasonable share of joint and common costs. Given the high levels of usage of interLATA long distance service and the demands placed on the network by these services, the CCL is not too high. InterLATA use of the loop may already exceed the percentage of loop costs recovered through the CCL.

### B. AS THE TELECOMMUNICATIONS MARKET BECOMES COMPETITIVE, THE COMMISSION MUST MOVE TOWARD THE ELIMINATION OF THE SUBSCRIBER LINE CHARGE

As already noted, the implication of targeting the CCL for elimination is to require increases in PICCs for all customers and to diminish or eliminate the potential for reductions in the SLC.

We believe that this policy will be undermined as the market becomes more competitive. The Commission will have to abandon subscriber line charges altogether and allow costs for the provision of loop to be recovered by service providers in the rates they charge each other and their customers. The line item that the Commission has placed on a user's bill for the subscriber line charge cannot be properly placed on the bill if a competitive company provides loop facilities. Because neither the FCC nor the states has or will regulate the rates of these competitive companies,

[25] Notice, ¶ 114, pp. 46-47.

there is no way that the FCC can know whether $3.50 or $6.00 or any other number is just and reasonable.

Moreover, the SLC and other fixed charges make no sense in a competitive market when competitors sell bundled local, toll, and long distance service. The fictions that the FCC has established among these "classes" of service will no longer be relevant and will be unable to exist in a competitive market where the line has been blurred between jurisdictional offerings. Competitors won't be selling "local" service or "long distance", they are and will be selling a bundled package of telephony along with cable, data and internet services.

The FCC has received substantial evidence that rates should be declining because productivity has exceeded the rate of inflation by a substantial margin for the past decade. The most extensive studies of local costs commissioned by Public Counsels across the country show even higher productivity increases than the Commission found in the interstate jurisdiction.[26] The Commission should consider reductions in the SLC and the universal service package, rather than rate increases.

Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and

[26] "Rebuttal Testimony of Dr. Marvin Kahn, on Behalf of the Office of the Attorney General," Before the State Corporation Commission of Virginia, In the Matter of Evaluating Investigating the Telephone Regulatory Case No. PUC930036 Methods Pursuant to Virginia Code S. 56-235.5, Cause No. PUC930036, March 15, 1994 and "Prefiled Testimony of David Gable on Behalf of the Indiana Office of Utility Consumer Counselor," Before the Indiana Utility Regulatory Commission, In the Matter of Petition of Indiana Bell Telephone Company, Incorporated for the Commission to Decline to Exercise in Part Its Jurisdiction Over Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, to Utilize alternative Regulatory Procedures for Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, and to Decline to Exercise in Whole Its Jurisdiction Over all other Aspects of Petitioner and Its Provision of All Other Telecommunications Service and Equipment, Pursuant to IC 8-1-2.6, Cause Number 39705, January 1994, estimate the productivity offset in the rate of 7 percent per year in the late 1980s and early 1990s.

long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs incurred by the traditional service providers (ILECs and IXCs) who use it.

Joint Commenters believe that the SLC should be reduced or eliminated entirely because it was inappropriate in the first place and is inconsistent with a competitive market. Additionally, the SLC could also be eliminated as a mechanism to ensure that reductions in access charges for switching or transport services are passed through to consumers. As described below, Joint Commenters recommend that all charges be moved to efficient levels. This will result in a reduction of the costs that long distance companies bear. The Commission should require that these costs be passed through to ratepayers. However, because the Commission no longer regulates rates, in light of the consistent pattern of price increases for basic long distance service for the past four years, and recognizing the price increases on low -volume long distance users, we believe the Commission must find a mechanism to ensure consumers see the benefits of access charge reductions. The only rate element that the Commission regulates directly on the consumer bill is the SLC. Therefore, the SLC could be lowered by an amount equal to the reduction in switching costs.

## C. THE COMMISSION CANNOT RELY ON IXCS TO PASS LOWERED ACCESS COSTS THROUGH TO RESIDENTIAL CONSUMERS

The Commission contemplates repeating the practice implemented over the past several years of lowering access charges and allowing IXCs to decide whether, and how, to pass those cost reductions through to consumers.

> In the event the Commission determines that implicit support exists in interstate access rates and that it should be removed, the Joint Board recommended several guidelines that the Commission should follow. First, as implicit support in interstate access rates is replaced with explicit support, there should be a corresponding dollar-for-dollar reduction in interstate access charges, such as the carrier common line charge (CCLC), presubscribed interexchange carrier charge (PICC), or subscriber line charge. Second, any reductions in interstate access rates should benefit consumers.[27]

This approach has been controversial and has denied low volume consumers the benefits of rate reductions.

The practical problem that the Commission has in restructuring interstate access charges in this way is that it has no means for ensuring that residential ratepayers see the benefits of these access charge reductions. The Commission has not demonstrated that all of the access charges were passed through and it has certainly not been shown that they were passed through equitably. The Commission's own data (see Exhibit 4) shows that low volume customers have done very badly since it began "reforming" access. Low volume users have experienced dramatic cost increases, while high volume residential and business customers have experienced rate reductions.

[27] Joint FNPRM, ¶ 42.

## D. RAISING FIXED MONTHLY CHARGES ON SECOND LINES IS BAD ECONOMIC AND SOCIAL POLICY

The Commission has already laid the basis for the efficient pricing of loop. With loop set at TELRIC and allocated to IXCs as a cost of business, there is no need or reason to raise the SLC or PICC, yet the Commission continues to allow fixed charges on second lines to rise. The second line SLC has been raised to almost $6 and the PICC to $2.50.

As a matter of economics, second lines are far less costly than first lines. That is, the incremental cost of providing a second line is far less than the cost of the first line, given current technology and deployment. Digital technology allows provision of additional channels at lower costs. As the medium used for loop shifts to coaxial cable and fiber, the cost of additional lines will decline even further. Current pricing practices, which do not discount second lines, means that the price-cost margin on second lines are already much higher than for first lines. Thus, raising the SLC on second lines makes no economic sense.

As a matter of social policy, allowing over-recovery of costs on second lines imposes a severe cost on multi-family households. Two families sharing the same household could well have two lines, each of which is the primary line. Why should one be charged a higher SLC?

Charging more for second lines also creates a potential problem under the reasonably comparable standard of section 254(b)(3) of the Act. To the extent that second lines are found in high cost areas, they should be supported. Second lines are, increasingly used as Internet connections. Failure to support second lines in high cost areas raises the possibility that rural households would be forced to pay much more for their connection to advanced services than urban households. They are not receiving access to reasonably comparable advanced telecommunications

services at reasonably comparable prices.

Even if the statute could be interpreted to suggest that the universal service language in the 1996 Act covers only primary lines, attempting to determine which line is a primary line and which is a secondary line presents an administrative nightmare. Multi-family households would be required to share lines. Large families would be at a disadvantage compared to small. Married couples would pay more than unmarried partners would.[28]

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[28] Recent testimony by GTE in Hawaii makes a number of points similar to these observations (Rebuttal Testimony and Exhibits of Dennis Weller Chief Economist, GTE Hawaiian Telephone Co. Inc. Subject: Universal Service Fund, In the Matter of Public Utilities Commission Instituting a Proceeding on Communications, Including an Investigation of the Communications Infrastructure of the State of Hawaii, Docket No. 7702.)

> Why should second lines be supported?
>
> There are several reasons. First, it maintains a reasonable price relationship between first and second lines. Our customers generally expect that if you buy a second line from us, they will pay no more for the second line then they did for the first. This is a reasonable expectation; in most markets, the per unit price declines if you buy more of something. It also correctly reflects the relative cost of providing first and second line. It will be very difficult for us to explain to our customers why, if the first line costs $19.80, the second line should cost $40. or $100....
>
> Second, there is no good policy reason for distinguishing between primary and additional lines for universal service reasons. Underlying this policy proposal is the implicit assumption that there is a unit, a "household", that has a unique need for basic telephone service. But this is clearly not the case. Different households have different patterns of consumption, for perfectly good reasons. Consider, for example, two different households. They live on the same block, and have similar incomes. One household has a single child; the other household has ten children. If the two families go to the grocery store, we do expect them to buy the same amount of milk?..
>
> Third, in order to limit support to second lines, we would need to define them. Since, as I have already explained, the proposal is not based on any clear concept, there is no clear basis for defining the lines to be included or excluded. In the recent California proceeding, for example, one witness suggested that one line should be supported per household; it was suggested that the company should inquire about the family relationships among the people sharing a living arrangement. Another witness proposed that one line should be provided per dwelling; he suggested that the company should consult the local plant maps in each town to make this determination. Whatever criterion is adopted, the one thing that is clear is that this idea would be difficult to administer...
>
> Fourth, when we attempt to administer a distinction between first and second lines, there will be unintended effects. Some screening procedure will be put in place, and no such procedure is ever perfect. For every wealthy family whose second line is screened out, there'll also be some other

Recognizing these economic and public policy problems, Texas has not discriminated against second lines and includes all residential lines for Texas universal service assistance.[29] We urge the Commission to reconsider its policy of not supporting and charging more for second lines.

### E. THE COMMISSION HAS MISTAKENLY ABANDONED THE REASONABLE COMPROMISE STRUCK BETWEEN END-USER CHARGES AND PER MINUTE CHARGES WHEN THE SLC WAS INITIATED.

The Commission's continuous efforts to shift costs from the CCL to fixed charges is contrary to the compromise that was struck when the subscriber line charge was instituted. At that time, the costs allocated to the federal jurisdiction were shared equally between end-user charges (SLC) and per minute charges (CCL). Over the years, as profits and productivity made rate reductions possible, the FCC reduced the CCL but not the SLC. The share allocated to end-users drifted upward, because the share allocated to per minute charges declined.

Since the passage of the Telecommunications Act, the Commission has begun to increase the fixed charges it imposes on end-users and has allowed the IXCs to do the same. Even looking only at the SLC on primary lines, the burden borne by residential ratepayers is close to seventy percent. Including second lines and the PICC, it is well in excess of ninety percent.

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family who will be denied access to an affordable first line...

Today, customers call us and we provide the services they request. We don't ask whether they deserve the services; we don't ask about their families or their living arrangements. We assume that customers can make their own decisions about where to live and about what services they need.

[29] Tex. Pub. Util. Comm. 16 TEX. ADMIN. CODE s. 23.133(d)(Jan. 10, 1998)(Texas High Cost Universal Service Plan.

Thus, the Commission has abandoned a reasonable compromise that was consistent with the joint cost allocation principles of the Act and prevented the grossly regressive shifting of cost onto those least able to afford the increases in fixed monthly charges.

## V. A CONSISTENT UNIT OF ANALYSIS SHOULD BE USED TO DETERMINE COSTS [30]

> We are also seeking comment in the FNPRM on certain recommendations of the Joint Board, including its recommendation that support be calculated at the study area level and its recommended ranges for a cost-based benchmark.
>
> The Joint Board decided that, although determining costs at the wire center level allows for measurement of support at more granular levels, support calculated at a study area level is more appropriate at this time, because the latter method will properly measure the amount of support that is required of the federal mechanism in light of the current level of competition. (Joint FNPRM, ¶ 101).
>
> We seek 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. (Joint FNPRM, ¶ 106).

Although the FCC seeks a smaller unit of analysis than the current study area and identifies census block groups or wire centers as possible unit of analysis, we believe a much larger unit is required. The census block group or wire centers do not drive the network architecture, nor are telecommunications services marketed at this level. In determining the unit of analysis, the key point is the efficient targeting of support and a reasonable representation of economic behavior in the deployment of facilities and the marketing of services. Choosing an excessively small unit of analysis creates an unnecessarily large universal service fund, since it eliminates the actual averaging

[30] NASUCA takes no position on the issues discussed in this section.

of costs that inevitably goes on in the marketplace. Virtually no producers of goods and services price discriminate down to the census block level, when there are joint and common costs and economies of scale and scope in production.

The issue is not simply one of targeting subsidy payments, but getting the costs right. If a very granular unit of analysis is used, economies of scale and scope are underestimated. As a result, support payments will be overestimated. The unit of analysis should be consistent across analyses. That is, if UNEs are offered over a specific area, *e.g.* urban areas, then the USF should be estimated over the same area. Failure to use a consistent unit of analysis will create opportunities for overrecovery of costs and will impede competition. If the USF is calculated on an exchange-by-exchange basis, but UNE prices are calculated on a larger unit of analysis, companies will receive support for loops whose costs are below the cost-based UNE rate. By using a more disaggregated analysis for universal service than for UNE pricing, companies would virtually ensure that they overrecover by receiving support for high cost lines, keeping the profit on lower costs lines, and charging an averaged UNE cost to competitors.

## VI. DISTRIBUTION AND APPLICATION OF SUPPORT

In the earlier part of its comments, Part II through V, Joint Commenters commented on the FCC's discussion of the need to adjust *interstate* access charges to account for the removal of implicit support from interstate rates. Joint Commenters concentrated on the need to reform the FCC's reliance on the subscriber line charge for common line cost recovery in order to continue federal universal service reform. Part VI of these Joint Comments concerns the application of

explicit federal support to the *intrastate* jurisdiction. Concerning distribution and application of support,[31] Joint Commenters generally urge the FCC to provide more direction over § 254 implementation issues.

The FCC continues in this FNPRM to focus unduly on reducing interstate access rates as one of the principle goals of universal service reform.[32] The FCC's reluctance to state unequivocally that universal service support should be used to keep local rates low has introduced an element of uncertainty, even if not justified, as to the extent of the federal commitment towards state universal service programs. This uncertainty has complicated state efforts at reform. Moreover, the absence of a forthright declaration of support from the principle agency charged with implementing the 1996 Act robs more tentative conclusions about federal USF offsetting intrastate revenue requirements, etc., of some of their effectiveness.

Concerning the distribution and application of support issue, Joint Commenters further believe that the FCC should change its approach to take into account the differences in the ability of the states to achieve rate comparability. Specifically, Joint Commenters recommend that the FCC consider (1) placing use restrictions directly on the carrier receiving federal support and (2) adopting an approach that lists multiple options available to the state from which to choose based on its own regulatory environment.

First, placing use restrictions directly on the carrier receiving federal support avoids placing the responsibility for achieving rate comparability entirely on the state commissions. The FCC seeks

[31] Joint FNPRM at ¶¶113-116.

[32] Joint FNPRM at ¶¶123-135.

comment, among other things, on whether making federal support available as "carrier revenue," to be accounted for by the state in the rate setting process, will sufficiently fulfill the § 254(e) requirement that federal support shall be used "only for the provision, maintenance, or upgrading of facilities and services for which the support was intended."[33] Joint Commenters oppose making federal support available to carriers to offset intrastate revenue requirements without some type of check and balance in place, either through state regulation or federal rule, as to how such revenues will be applied by the recipient carriers.

Section 254(e) indicates that carriers should have principle responsibility in this area, because it focuses entirely on the carrier meeting § 254 requirements, not the state commission. That section provides, "[a] carrier that receives [federal universal service] support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." 47 U.S.C. § 254(e). Ideally, state commissions should report that support has been used by that state to reduce local rates. However, state authority in this area varies widely. Without some direct carrier requirement in place to assure the FCC that the receiving carriers are using federal support for the "provision, maintenance, and upgrading" of universal services, the agency has no way of knowing for certain that federal support was used to achieve the FCC's objectives.

States that have very little ability to reduce basic service rates through any means benefit most from the FCC imposing rate comparability requirements directly on receiving carriers. For example, neither of the two alternatives discussed in the FNPRM–rate of return regulation and an

[33] Joint FNPRM at ¶114.

exogenous price cap adjustment–are readily available in Texas.[34] With the advent of local competition, most states, such as Texas, have moved away from traditional rate of return regulation, particularly for the larger telephone companies, and towards some form of incentive regulation. *See* Texas Utilities Code § 58.025.[35] Therefore, the Texas Commission would have little authority, if any, to lower a receiving carrier's rates for services through rate of return regulation in order to achieve rate comparability.

Moreover, with the recent amendments to the Texas Utilities Code, the Texas Commission has very limited authority to achieve rate comparability through any method over services designated as "non-basic" in the Texas statute, even if that group of "non-basic" services includes services for which the carrier will receive federal support.[36] Although the FCC designated eight services as eligible for federal support,[37] in Texas, the "non-basic" service category now includes some of the very services designated by the FCC as essential to universal service, such as business single-party service and directory assistance. Thus, according to Texas law, an electing company has the ability

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[34] *See*, Joint FNPRM at ¶114.

[35] Texas Utilities Code § 58.025(a) provides, "[a]n electing company is not, under any circumstances, subject to a complaint, hearing, or determination regarding the reasonableness of the company's: (1) rates; (2) overall revenues; (3) return on invested capital; or (4) net income." http://capitol.tlc.state.tx.us/statutes/uttoc.html. Rates are capped under Texas Utilities Code § 58.054. Significantly, the carrier retains the ability to reduce rates on its own initiative at any time. Texas Utilities Code § 58.055(b).

[36] *See* Texas Utilities Code § 58.151 (amended by 1999 changes to the Texas Utilities Code in SB560 at www.capitol.state.tx.us/tlo/billnbr.htm). The statute creates two baskets of services, "basic" and "nonbasic". A company electing into incentive regulation may set the price for any nonbasic service *at any level above* the lesser of the service's LRIC, or the price for the service in effect on Sept. 1, 1999 (§ 58.152).

[37] In re Federal-State Joint Board on Universal Service, Report and Order, CC Docket No. 96-45, FCC 97-157, 62 Fed. Reg. 32862 (June 17, 1997), 12 FCC Rcd 8776 (hereafter, "Universal Service Order").

to set rates for these "non-basic" services as high as it chooses.[38] Such mismatched services (those designated as universal services by the FCC, but not so classified under state law) might never achieve rate comparability under any state method, absent direct carrier requirements. Moreover, as stated earlier, the rates for the "basic" services of an electing company are frozen and not subject to decrease by the Texas Commission, except under certain very limited circumstances.[39]

Second, adopting an approach that lists multiple options, available to the state to choose, would allow each state to take advantage of the method best suited to its regulatory environment. Joint Commenters agree tentatively with the proposition that a state-centered approach would empower regulators to achieve reasonable comparability of rates within their states more quickly than an approach than relies exclusively on federal regulation.[40] The FCC correctly recognizes that states are typically better informed than the FCC as to the cost characteristics of local high-cost wire centers. For example, state regulators have a long history of involvement with costing issues arising within rate of return regulation, as well as the recent arbitration proceedings under § 251. Nevertheless, despite their greater expertise in addressing specific wire center cost issues, reliance on the state commissions works only so long as state commissions have the authority to apply federal support as directed by the FCC.

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[38] *See e.g.*, Texas Utilities Code § 58.152 (amended by 1999 changes to the Texas Utilities Code in SB560 at www.capitol.state.tx.us/tlo/billnbr.htm).The statute creates two baskets of services, "basic" and "nonbasic". A company electing into incentive regulation may set the price for any nonbasic service *at any level above* the lesser of the service's LRIC, or the price for the service in effect on Sept. 1, 1999 (§ 58.152).

[39] Texas Utilities Code § 58.025.

[40] *See* Joint FNPRM, ¶ 34.

While a state may not have the ability to order rates reductions to achieve rate comparability, it may have other means at its disposal to meet the federal universal service objectives. One alternative for the FCC to consider is for it to make use of the separations process to ensure that federal support is distributed properly within the states. Several states have statutory provisions that allow state commissions to adjust rates to reflect changes in FCC separations. The effectiveness of that approach varies, so the FCC should not rely on it exclusively.[41]

Furthermore, many state commissions have the authority to establish their own universal service fund. Texas law already provides for the creation of a state universal service fund.[42] The effectiveness of that option depends on the extent to which the services protected under state programs correspond to those services designated as targets for federal support. A disparity between the services designated by the FCC as targets for federal support and services protected under the state program reduces the ability of the state USF programs to achieve rate comparability for some services.

Joint Commenters suggest that other state commissions may face similar particular limits on their regulatory authority, either now or in the future over local rates. Thus, even if a state commission was fully cognizant of federal support levels, it may not have sufficient authority to insure adequate enforcement of § 254 requirements by the exact method desired by the FCC. Federal regulations should not penalize local ratepayers through having to relinquish federal support

[41] *See e.g.*, Texas Utilities Code § 58.056 and 59.024(c) (no local price adjustment can take place until FCC separation changes affect net intrastate income by at least 10 percent).

[42] Texas Utilities Code § 56.021-56.026.

because of the limited authority of state utility commission over setting local rates.[43] Accordingly, Joint Commenters urge that the FCC not rely exclusively on any single method by which it expects state commissions to meet §254(e) requirements. While the approaches suggested by the FCC have merit, other equally effective alternatives may be available to the states that the FCC has not as of yet anticipated. Letting states explore other methods coupled with direct carrier requirements results in a better fit with that state's regulatory environment. It also demonstrates sensitivity to jurisdictional boundaries.

Dated: July 23, 1999

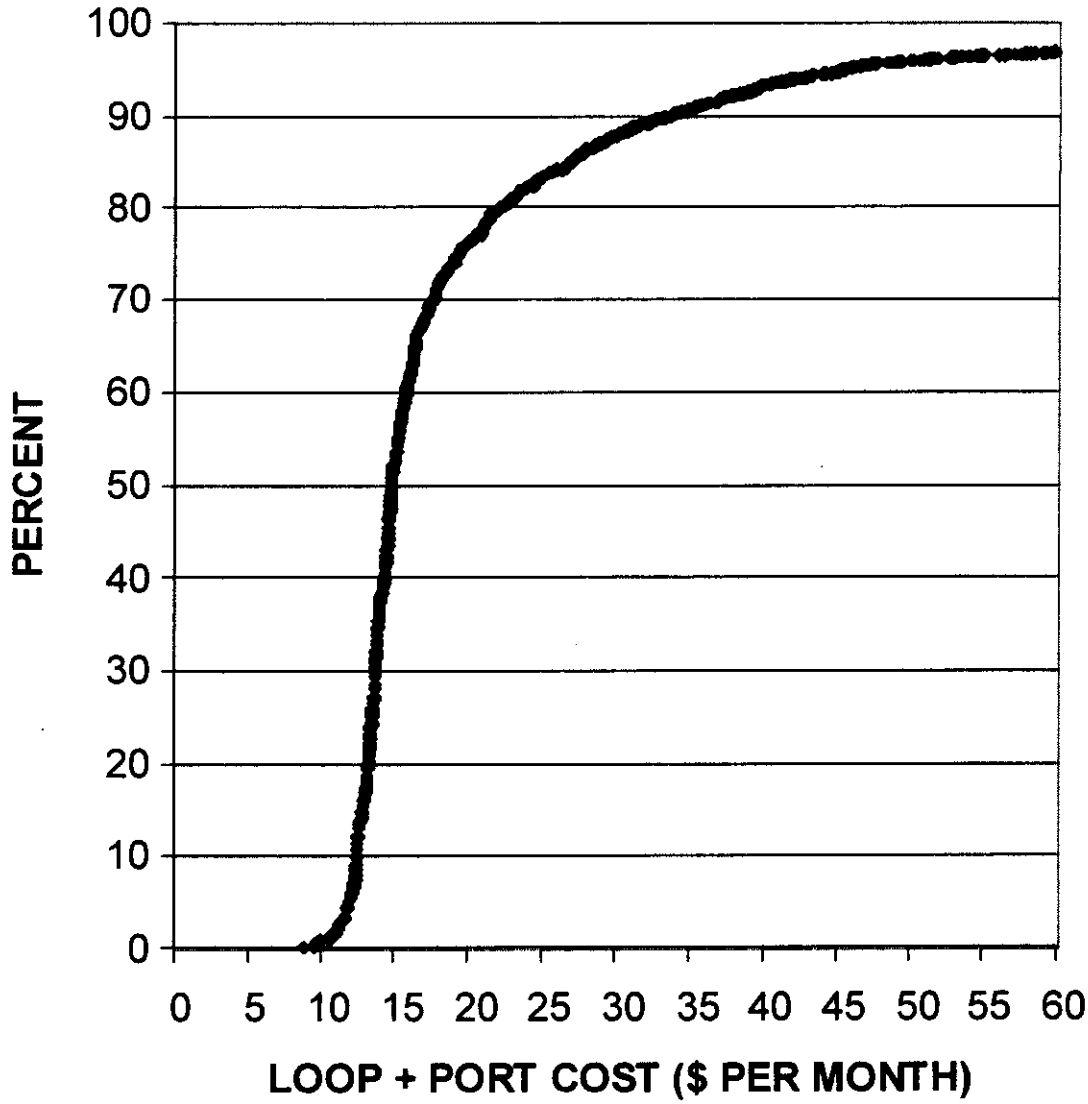
Respectfully submitted,

Texas Office of Public Utility Counsel
Consumer Federation of America
National Association of State Utility Consumer Advocates
Consumers Union (Washington, D.C. Regional Office)

[43] *See* Joint FNPRM, ¶ 115.

*Exhibits*

**EXHIBIT 1**
**TEXAS:**
**CUMULATIVE PERCENTAGE OF LINES**
**BY LOOP + PORT COST**
**(BASED ON WIRE CENTER ANALYSIS)**



## EXHIBIT 2

## ESTIMATED ACCESS COST RECOVERY FOR THE TEXAS RESIDENTIAL MARKET PROJECTED FOR 2000

| | (1) PROPORTION OF LINES | (2) UNIT COST PER LINE | (3=1x2) WEIGTHED COST |
|---|---|---|---|
| **SUBSCRIBER LINE CHARGE** | | | |
| | (a) | (b) | |
| First Line | .8 | $3.50 | $2.80 |
| Second Line | .2 | 5.88 | 1.20 |
| Average Per Line | 1.0 | | $4.00 |
| **PICC** | | | |
| | | (c) | |
| First Line | .8 | 1.00 | .80 |
| Second Line | .2 | 2.50 | .50 |
| Average Per Line | | | $1.30 |
| **FIXED CHARGES PER LINE** | | | $5.30 |
| **USAGE CHARGES** | | | |
| CCL (100 Minutes @.002/Minute) | | | .20 |
| **TOTAL** | | | $5.50 |

(a) Derived from Federal Communications Commission, Trends in Telephone Service, February 1999, Table 20.4, as described in text.

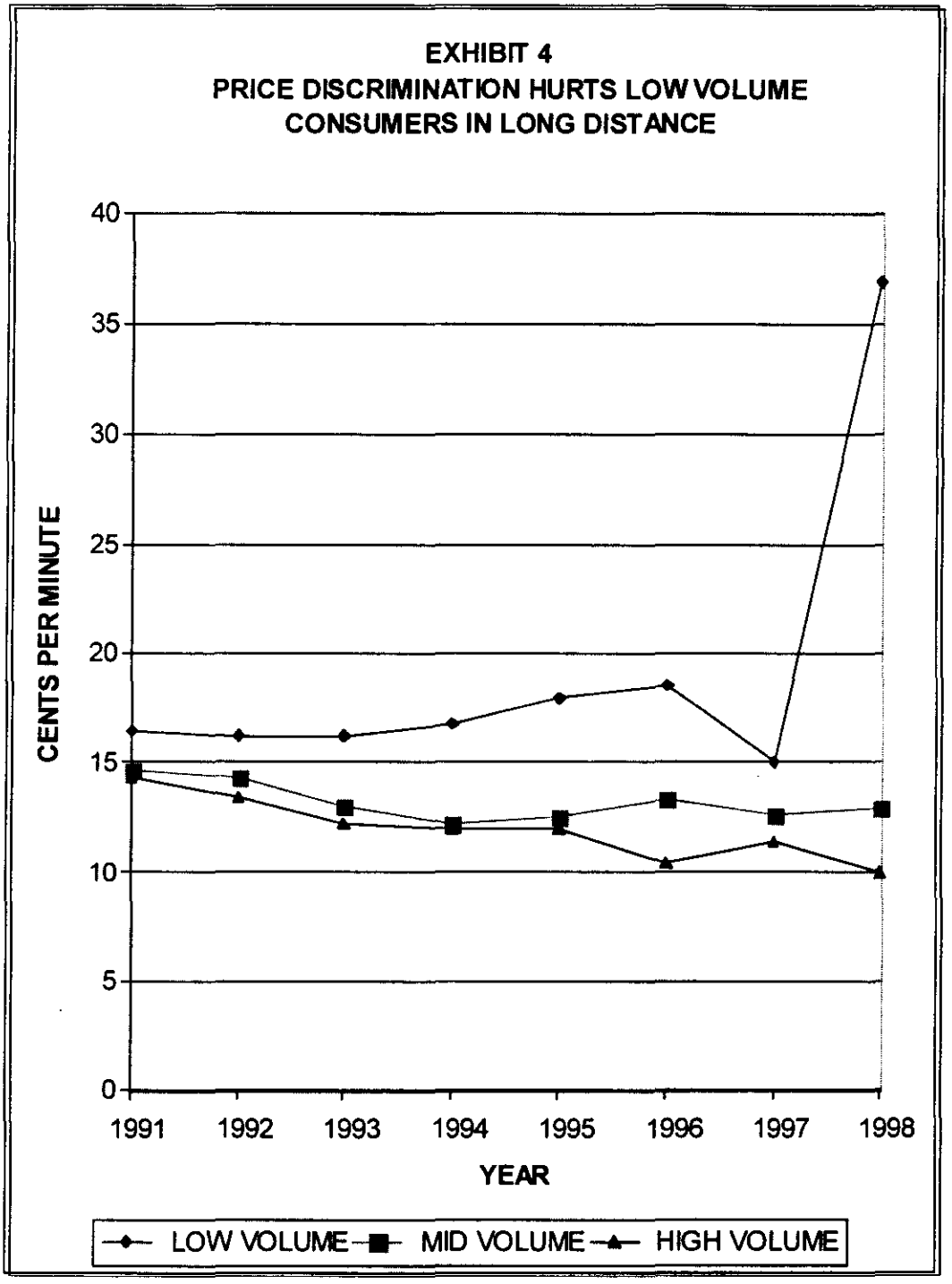
(b) Trends, Table 1.2.

(c) Trends, Table 1.2, adjusted for July 1, 1999 increases.

**EXHIBIT 3**
**ESTIMATES OF COST AND COST RECOVERY**

| STATE | FORWARD LOOKING LOOP + PORT COST (STATE AVERAGE) | PERCENT OF LOOPS COVERING FEDERAL COSTS AT $5.50 |
|---|---|---|
| TX | $18.22 | 81% |
| CA | 14.84 | 94 |
| NY | 14.92 | 91 |
| UT | 16.83 | 90 |
| IL | 17.28 | 87 |
| AZ | 15.67 | 92 |
| MD | 16.55 | 86 |
| FLA | 16.67 | 91 |
| PA | 17.17 | 80 |
| CO | 17.70 | 84 |
| WA | 17.89 | 88 |
| GA | 19.99 | 77 |
| MI | 20.16 | 75 |
| KS | 19.82 | 76 |
| IN | 22.55 | 72 |
| ID | 24.17 | 65 |
| MO | 24.32 | 71 |
| AR | 25.93 | 58 |
| WY | 31.03 | 41 |

SOURCE: Federal Communications Commission, *Synthesis Proxy Cost Model*




SOURCE: Federal Communications Commission, *Reference Book of Rates, Price Indices and Expenditures for Telephone Service*, June 1999.