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

2 1999

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
UNITED STATES TELEPHONE ASSOCIATION
ON THE
FURTHER NOTICE OF PROPOSED RULEMAKING

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SUMMARY

The Commission reaches several decisions with regard to revising the non-rural universal support mechanism. USTA views several of those determinations as constructive, including the recognition that implicit support must be made explicit, that a hold harmless provision must be included and that support must be portable. However, USTA continues to oppose the use of a forward-looking economic cost model to determine costs for high cost support for non-rural carriers and strongly urges the Commission to abandon its use for that purpose. The input data and results of the model have not been verified, by the Commission's own admission. Furthermore, the model is not designed to measure subsidies, and the costs determined by the model do not reflect economic costs incurred by efficient local exchange carriers (LECs). Because the model is speculative, it cannot legitimately be used to represent real costs for policy-making purposes. Instead, the Commission should adopt the USTA Universal Service plan for non-rural carriers.

The actual level of a benchmark cannot be determined until the Commission decides on a method for sizing the non-rural universal service fund, and it is apparent that the Commission has not done so. The hold harmless provision adopted should assure that individual carriers should be treated the same. USTA proposes that the amount of high cost support a non-rural company currently receives should be frozen at the level received by that carrier in the quarter prior to adoption of the plan and that amount would be multiplied by four to determine the amount of support received at the plan's inception. Also, a carrier-by-carrier approach should be implemented in favor of any state-by-state approach.

The amount of support should be deaveraged at least to the unbundled network element level. It should not be necessary to assess a state's ability to internally support its high-cost areas

if the benchmark is set correctly. The Commission should rely on market forces, rather than impose any restrictions, to make sure that universal service funds are being properly used by carriers. In this regard, carriers receiving universal service support should offer a basic local service package that meets the appropriate definitions of the Commission and the applicable state.

The Commission correctly determines that implicit support must be made explicit and that, as this occurs, price cap local exchange carriers should reduce access charges that provided explicit support. Such reductions must equal the support received, however. This result is accomplished through the USTA Universal Service plan. The mechanism provides that, at a minimum, the current revenues from the carrier common line (CCL) and presubscribed interexchange carrier charges (PICC), as well as revenues ultimately transferred for recovery from the PICC, are to be used to determine the amount of support. Reductions in access should match the amounts collected from end users. The explicit support that is to replace the reductions in implicit support should be collected by all telecommunications carriers through an end-user charge on total retail revenues. Each study area would receive explicit support equal to the amount of access reductions in that study area divided by the number of residential access lines in that study area. This support would be portable. Distribution of the explicit support should be deaveraged, and any reductions in access charges should only be matched by states in a time period sufficient to make similar adjustments in state rate structures.

Deaveraging of the multiline business SLC should be implemented immediately and exogenous adjustments should be used to align the multiline business SLC with costs. USTA offers a proposal to deaverage the SLC.

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COMMENTS OF THE UNITED STATES TELEPHONE ASSOCIATION ON THE FURTHER NOTICE OF PROPOSED RULEMAKING

The United States Telephone Association (USTA) hereby submits its comments on the Commission's Further Notice of Proposed Rulemaking in the above-captioned proceeding (Further Notice).[1] USTA is the principal trade association of the local exchange carrier (LEC) industry. Its members provide over 95 percent of the exchange carrier-provided access lines in the United States. Incumbent LECs traditionally have been the sole providers of universal service.

I. INTRODUCTION

The Commission has made decisions on several issues relating to federal support mechanisms for non-rural carriers that were addressed in the Second Recommended Decision.[2] Particularly, the Commission establishes a methodology for determining support amounts for carriers based on a forward-looking economic cost model and a national cost benchmark. The

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[1] 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, FCC 99-119, released May 28, 1999 (Further Notice).

[2] *Federal-State Joint Board on Universal Service*, Second Recommended Decision, 13 FCC Rcd 24744 (1998) (Second Recommended Decision).

Commission rejects its previous determination that federal support should be limited to 25 percent of the difference between the benchmark and forward-looking cost estimates and replaced it with a method of determining the adequacy of intrastate support. Also, the Commission adopts an initial hold-harmless policy but cautioned against significant increases in current levels of support. The Commission affirms that support would be portable. In addition, the Commission specifically states that the support mechanism adopted should be explicit.

The Commission states that an adequate record does not exist to determine several specific elements of the support methodology. Thus, it seeks further comment on a number of issues, including the level of the benchmark, the amount of the per-line state responsibility estimate, how the hold-harmless mechanism should operate and how to assure that support is used according to the purposes intended. In a separate item, the Commission has recognized that it needed to verify the operation of its current cost model, including the input data elements, and sought comment on a lengthy list of issues.[3]

USTA continues to oppose the use of a forward-looking economic cost model to size the universal service fund for non-rural carriers. The USTA alternative Universal Service Plan for non-rural carriers[4] remains a viable solution to universal service reform for non-rural companies. For the reasons articulated previously in this proceeding[5] and herein, it should be adopted by the Commission. In addition to these general themes, USTA comments on the specific issues raised in the Further Notice below.

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[3] *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, Further Notice of Proposed Rulemaking, CC Docket Nos. 96-45 and 97-160, FCC 99-120, released May 28, 1999 (Inputs Further Notice).

[4] A copy of the plan is attached. It has previously been included in the record of this proceeding. *See Ex parte* letter from John W. Hunter, USTA Senior Counsel, to Magalie Roman Salas, FCC Secretary, in CC Docket No. 96-45, filed September 29, 1998; and USTA Comments on the Second Recommended Decision in CC Docket No. 96-45 and DA 98-2410, filed December 23, 1998 (USTA Comments on Second Recommended Decision).

II. A FORWARD-LOOKING ECONOMIC COST MODEL SHOULD NOT BE USED TO SIZE THE FUND

The Commission has concluded that a national forward-looking economic model should be used to determine costs for high cost support for non-rural carriers.[6] In fact, the Commission specifically states that it is adopting the Joint Board's recommendation in this regard. However, the Second Recommended Decision was rather critical of the fact that the results of the Commission's cost proxy model were not complete and that it is a "work in progress."[7] Individual members of the Joint Board were particularly critical of the model's shortcomings.[8] This is hardly a ringing endorsement of a method that has as its statutory purpose assuring that quality services are available in all regions of the nation at reasonable and affordable rates. The Commission even recognizes that the results of the cost model and certain input data elements have not been verified.[9] In fact, it has issued a 107-page-plus-appendices document seeking further comment on the inputs to its proposed model.[10]

USTA has consistently opposed the Commission's reliance on a forward-looking economic cost model to determine the amount of high cost universal service support.[11] The deficiencies of such a model persist and USTA continues to oppose the Commission's determination. Specifically, the model currently under consideration by the Commission is not designed to measure subsidies. The costs determined using the cost proxy model do not reflect economic costs incurred by efficient incumbent LECs and even the most efficient LEC can expect its actual costs to exceed the costs produced by the engineering "bottoms up" hypothetical

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[5] *See* USTA Comments on Second Recommended Decision.
[6] Further Notice at ¶¶ 50 and 52.
[7] Second Recommended Decision at ¶ 29.
[8] *See* USTA Comments on Second Recommended Decision at 6.
[9] Further Notice at ¶ 52.
[10] Inputs Notice.

model. The implicit message that any cost in excess of the cost calculated by the model is evidence of inefficiency is utterly misleading. Only real costs have consequences. A firm's ability to survive and function in a dynamic, competitive environment depends upon its real costs governed by real market and regulatory circumstances. Because the model is purely speculative, it cannot be used to represent real costs for policy-making purposes.

III. DETERMINATION OF A BENCHMARK METHODOLOGY MUST AWAIT THE COMMISSION'S METHODOLOGY FOR SIZING THE UNIVERSAL SERVICE FUND, BUT A CARRIER-BY-CARRIER HOLD-HARMLESS PROVISION SHOULD BE IMPLEMENTED

The Commission has determined that a national benchmark should be established based on costs, rather than revenues, to determine federal high-cost intrastate support.[12] The Commission seeks comment on the specific benchmark it should adopt and whether it should adopt the Joint Board's recommendation that the mechanism incorporate a hold-harmless provision.

USTA cannot comment on the specific level of the benchmark until the Commission settles on a method for sizing the fund. It is apparent that no one yet knows what that ultimate methodology will be. Until that issue is resolved, it makes no sense to speculate about the actual benchmark level.

On a closely related matter, the Commission agrees with the Joint Board recommendation that a hold-harmless provision should be adopted to prevent immediate and substantial reductions of federal support and potential rate increases.[13] USTA supports this determination that a hold-harmless provision should be included as a part of the federal universal service

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[11] *See* USTA Comments in CC Docket No. 96-45, filed August 9, 1996, Comments filed December 19, 1996, Reply Comments filed January 10, 1997, and Comments on Second Recommended Decision filed December 23, 1998.

[12] Further Notice at ¶ 61.

[13] Further Notice at ¶¶ 100, 117.

program.[14] Implicit in the questions set forth for comment is how individual carriers would be treated. USTA firmly believes that a consistent approach is needed and that all non-rural companies should be treated the same. USTA proposes that the amount of high cost support a non-rural company currently receives should be frozen at the level that carrier received in the quarter prior to adoption of the plan and that that amount would be multiplied by four to determine the amount of support the carrier would receive at inception of the plan.

USTA supports a carrier-by-carrier approach to the hold-harmless policy and opposes adoption of any state-by-state proposal.[15] State block grants should be avoided. The carrier-by-carrier approach would avoid unreasonable shocks to different ratepayers. Initializing a carrier's support at current levels would preclude such shock. In his dissenting statement, Chairman Kennard offers many persuasive reasons for opposing the block grant approach to the hold-harmless policy. Among those reasons are that Section 254 of the Act requires that support must ultimately go to carriers, that federal support has been distributed directly to carriers, that

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[14] The Commission has stated that it intends to also hold rural carriers harmless from reductions in federal support until it adopts and implements a rural alternative to the current federal universal service support program. See Federal-State Joint Board on Universal Service, Report and Order, 12 FCC Rcd 8776, 8889 (1997). "Consistent with the Joint Board's recommendations, until a [rural] carrier begins to receive support based on forward-looking economic costs, the carrier will continue to receive support based on the existing high cost fund, DEM weighting, and LTS programs." Information developed by the National Exchange Carrier Association, Inc., causes USTA to believe that support levels for rural carriers may significantly decline when non-rural carriers move to a new federal support program on January 1, 2000, or some date thereafter. The reductions appear to occur as a result of the mathematical workings of the "cap" on universal service high cost funding, which under current rules will continue to apply to the universal service high cost fund supporting rural carriers after the non-rural carriers move to a new support program, and the higher expense adjustment levels for rural carriers under Commission rule 36.631(c). There may be other causative factors. The exact amount of the reduction has not been determined, but had the non-rural carriers moved to a new support program on July 1, 1999, the reduction in high cost support for rural carriers would have exceeded $30 Million. In order to ensure that rural carriers are not unintentionally harmed by operation of existing rules when non-rural carriers move to a new universal service support program, the Commission should quickly determine the projected universal service funding impacts on rural carriers come January 2000. USTA believes that the quantification and correction of this problem should not delay the adoption and implementation of a non-rural universal service support program.

[15] In order to be a truly hold-harmless approach, the policy should be implemented on a study area-by-study area basis so that a carrier is assured that it receives no less support than it does today in any of its study areas.

additional bureaucracy would be created by block grants resulting in additional costs and inefficiencies, and that the states oppose block grants.

The Commission also raises the portability of federal high-cost support.[16] USTA believes that per-line support should be portable. This means that a carrier would not be guaranteed a certain level of support, particularly in a competitive environment. Portability is part of the USTA Universal Service Plan.

IV. THE AMOUNT OF SUPPORT SHOULD BE DEAVERAGED AT LEAST TO THE UNBUNDLED NETWORK ELEMENT LEVEL

The Commission asks for comment on whether support levels should be calculated on the wire center level, the unbundled network element (UNE) cost zone level, or the study area level.[17] While USTA does not take a position on this particular issue, the amount of support should be deaveraged at least to the UNE zone level.

V. SEPARATE CALCULATIONS TO DETERMINE STATES' ABILITY TO SUPPORT HIGH-COST AREAS ARE NOT NECESSARY

The Commission raises the issue of assessing a state's ability to internally support its high-cost areas and how to determine that amount.[18] If the benchmark is set correctly, this step is not necessary. It would be a duplicative effort. Furthermore, it would be subject to manipulation, since either the benchmark or the determination of state support could be adjusted to achieve the desired level of support. The individual states must assume some responsibility for high cost support.[19] The calculation requested by the Commission is not necessary and should not be added to the calculations for universal service support.

[16] *Id.* at ¶ 122.

[17] *Id.* at ¶ 102.

[18] *Id.* at ¶¶ 110-111.

[19] States must take steps to take care of their high costs problems internally. Nonetheless, carriers in states with a large number of high cost areas and relatively few low cost areas, should receive proportionately more federal support. See USTA proposal for nonrural universal service support, Section IV, attached hereto.

VI. ADDITIONAL MEASURES ARE NOT REQUIRED TO ASSURE THAT UNIVERSAL SERVICE SUPPORT IS USED FOR THE PURPOSES INTENDED

The Commission seeks comment on whether any specific restrictions are necessary to assure compliance with Section 254 requirements for using universal service support.[20] USTA believes that the Commission should rely on market forces to assure that carriers use universal service funding in the high cost areas for which it is intended. Further regulation is not necessary. The fact that funding should be portable and distributed on a geographically disaggregated basis, as proposed by USTA, is sufficient to achieve the statutory objectives. If a carrier were to use universal service funds for purposes other than what is intended, its rates would increase and customers would switch to another carrier, and the original carrier would lose the support. Such a competitive situation assures that carriers will use support received as intended by the statute. Furthermore, the choices of a benchmark, state support, and percentage of federal support are inherently arbitrary given the Commission's determination that the size of the federal fund for non-rural carriers need not be increased significantly. For example, 100 percent federal funding combined with a high benchmark and lower state responsibility will yield roughly the same result as a lower benchmark combined with higher state responsibility.

One area does merit further consideration. USTA advocates that the Commission require carriers receiving universal service support to publicly offer a basic local service package that meets the basic local service definitions of the FCC and the applicable state commission. This is proposed to preclude carriers from creating expensive packages that encompass toll calling and vertical services that could be afforded only by a small group of customers. This could lead to situations where the carrier could use funding to support features of the package other than basic

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[20] *Id.* at ¶113.

service. If a restriction to provide a basic local service is imposed, all customers in a high-cost area would benefit from competition.

VII. ACCESS CHARGES SHOULD BE ADJUSTED TO ACCOUNT FOR EXPLICIT SUPPORT

The Commission has taken a critical step in its development of a mechanism to ensure the continuation of universal service at affordable rates for non rural carriers and their customers by acknowledging the fact that access charges, along with rates for several other services, provide substantial implicit support for universal service. Access charges also allow incumbent LECs to recover their contributions to the schools and libraries, low income, rural health care and high cost universal service mechanisms. The replacement of this implicit support, as required by the Act and acknowledged by the Commission,[21] by explicit support from the universal service mechanism will allow subsidy elements to be removed from current access charges. The Commission requests comment on how interstate access non-rural carriers should adjust charges to reflect explicit recovery of universal service support.

The Commission correctly recognizes that there are many forms of implicit support currently embedded in interstate access charges. As the Commission explains, the separations rules, the rules requiring averaged rates and the rules for recovery of costs are all examples of implicit support. There is a long series of decisions, spanning decades, in which federal and state regulators decided to allocate a large share of costs to the interstate jurisdiction in order to further the promotion of universal service and the maintenance of low local telephone service rates.[22] The allocation of marketing expense adopted by the Commission in its Order in CC Docket No.

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[21] *Id.* at ¶¶43, 123.

[22] James M. Fischer, Albert P. Halprin, Henry M. Rivera and Marvin R. Weatherly, "Implications of the Separations Legacy for Implementation of the Telecommunications Act of 1996", USTA Comments, Attachment 2, CC Docket No. 96-262, filed January 29, 1997.

96-262 is an example of the continuation of the separations legacy.[23] Another recent example is the treatment of switching costs associated with Internet traffic. Despite the Commission's determination that Internet calls are interstate, the associated switching costs are assigned to the intrastate jurisdiction. This results in a form of implicit support from the interstate jurisdiction to the intrastate jurisdiction.

Averaged subscriber line charges (SLCs) result in implicit support. The price cap rules require costs to be averaged across a study area creating implicit support flows from lower cost to higher cost study areas.

Price cap LECs recover a substantial share of their common line costs from interexchange carriers rather than from end users. This constitutes a form of implicit support, which is complicated by the fact that the presubscribed interexchange carrier charges (PICCs) are not the same for all lines. Multi-line business and non-primary lines pay higher PICC charges than primary residential lines again creating implicit support.

USTA agrees with the Commission's tentative conclusion that as implicit support is made explicit, price cap LECs should reduce access charges that provided the implicit support. However, the Commission must be clear in its decision that reductions would be equal to the support received. USTA has submitted such a plan.[24]

USTA's plan for replacing a portion of implicit support for universal service is based on two premises. First, implicit support is an important source of universal service; and, second, the current recovery mechanisms, the carrier common line (CCL) and PICC, are not sustainable in a competitive environment. Moreover, because these cost recovery mechanisms are built into

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[23] Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, FCC 97-158 (rel. May 16, 1997).

[24] *See* n.4, *supra*.

access charges and can be avoided by interexchange carriers which provide their own access or purchase it from competitive LECs, they are not consistent with the 1996 Act's requirement that universal service support be provided on an equitable and nondiscriminatory basis. USTA's proposal is consistent with the Act's requirement in Section 254 that universal service support be specific, predictable and sufficient. In addition, it meets the Joint Board's requirement that universal service support be competitively neutral.

USTA recommended that a new mechanism be established as follows. This mechanism is distinct from the current high cost program. USTA does not support transferring funds from the current high cost universal service program to cover the implicit subsidies in interstate access.

1) Current revenues from the CCL and PICC, as well as revenues that will ultimately be transferred for recovery from the PICC, would be used to determine the amount of support.

2) Reductions in access (the implicit subsidy) should match the amounts collected from end users (the explicit subsidy).

3) The explicit support that will replace the reductions in implicit support should be collected by all telecommunications carriers through an end-user surcharge on total retail revenues.

4) Each study area would receive explicit support equal to the amount of access reduction made by the non-rural LEC in that study area divided by the number of residential access lines in the study area.

5) Explicit support would be portable to any eligible telecommunications carrier that provides universal service in the study area.

6) Distribution of the explicit support throughout the study area should be deaveraged, so that higher cost portions of the study area would receive greater support per-line than would the lower-cost portions of the study area.[25]

7) Any reductions in access charges should only be matched by states in a time period sufficient to make similar adjustments in state rate structures.

[25] This is important since it prevents new entrants from targeting low cost, high volume customers within a study area.

USTA has demonstrated that its plan is manifestly in the public interest. In comments filed last year, USTA provided an analysis of its plan demonstrating that the elimination of the implicit subsidies in the CCL charge would result in a reduction of 1.1 cents per minute in interstate usage charges.[26] The combined effect of all of these changes is an average reduction of 42 cents per month in a customer's average combined local and long distance bill.

USTA concurs with the Commission's tentative conclusion that price cap LECs should make an exogenous adjustment to the common line basket to reflect the reduction in access, with reductions made to the CCL rate first, then the multiline business PICC, followed by the non-primary PICC.[27] Reductions to the primary line SLC would be contrary to the Commission's objective to reduce implicit support. In the rare instance that the primary line cost is below the current cap, USTA's plan would enable targeting support to the high cost areas.

In the Further Notice, the Commission requests comments on a proposal to permit zone deaveraging of the SLC. USTA supports such an alternative. Deaveraging of the multiline business SLC should be implemented immediately. This change would allow the price cap plan to better replicate the competitive environment. USTA proposes the following mechanism to deaverage the SLC:

1) Wire centers or exchanges within a study area would be assigned to a pricing zone based on the cost characteristics of the zone. A study area should generally be divided into a minimum of three zones.

2) The common line costs for each zone within a study area would be determined using either USE rate relationships (loop plus port) to allocate study area common line costs to the zones or by using actual common line costs.

[26] Comments of USTA, CC Docket No. 96-45, DA 98-2410, filed December 23, 1998.

[27] Further Notice at ¶ 130. The Commission has also asked for comment on whether non-rural rate of return LECs should apply additional explicit high-cost support revenues to the CCL element. The Commission should ensure that only the additional, interstate, explicit, high cost support revenues must be offset with reductions in access charges and not current high cost support amounts. Further, given that there are only a few companies that meet this definition, those companies should be permitted to make reductions in CCL or in the SLC for multi-line business as needed to meet competitive circumstances.

3) A zone common line cost per line would be calculated by dividing the zone costs (developed in step 2) by the number of lines in the zone.

4) A zone/study area common line cost ratio would be calculated by dividing each zone's common line costs (developed in step 2) by the study area total.

5) The total reimbursable common line costs would be calculated by summing the interstate SLC, PICC and CCL revenues for the study area. Total reimbursable common line costs should be allocated to each zone by applying the ratio calculated in step 4 for each zone to the study area total reimbursable common line costs.

6) The reimbursable common line costs for a zone would be determined by summing the reimbursable costs for all wire centers assigned to the pricing zone. The deaveraged SLC for the zone would be calculated by dividing the reimbursable common line costs by the number of common lines in the zone.

7) While USTA's proposal is not dependent on increases in the SLC caps, USTA supports increases in SLC caps to reduce implicit support for nonrural LECs. Ideally, the ultimate SLC caps should be set to more closely align with the interstate costs of the end user common line (including Marketing Expense). If necessary, a transition period could be used to arrive at the ultimate amount. End users would pay the lower of the deaveraged SLC or the cap.

8) If the end users' deaveraged SLC is greater than the ultimate SLC cap, the federal universal service fund would pay explicit support equal to the difference between the deaveraged SLC and the ultimate SLC cap to the eligible telecommunications carrier serving the end user. Deaveraging the SLC without raising the SLC cap above the current level will simply inflate the size of the universal service fund.

This mechanism is preferable to the Commission's alternative that price cap LECs reduce the base factor portion.

USTA strongly opposes the use of a cost proxy model to determine the implicit support contained in access charges and has consistently opposed using a model to determine the amount of universal service support, as stated in Section (II), *supra*. The best way for the Commission to target universal service support to high cost areas and to reduce the implicit universal service support contained in access charges is to adopt the USTA proposal described above.

VIII. CONCLUSION

USTA continues to advocate that the Commission adopt the USTA Universal Service Plan for non-rural carriers as a viable solution to universal reform for non-rural carriers. The use of a forward-looking economic cost proxy model to determine the size of the high cost universal service fund is fatally flawed and must be replaced with the elements embodied in the USTA plan. In addition, the plan embodies a mechanism by which implicit support is made explicit and recovered by an end-user charge on total retail revenues collected by all telecommunications carriers.

Determination of a benchmark methodology should await a final determination regarding a methodology to size the fund. A hold-harmless provision should be adopted and should be based on a carrier-by-carrier approach. The Commission should deaverage the amount of support to at least the unbundled network element level. It should not be necessary to assess a state's ability to internally support its high-cost areas. Furthermore, the Commission should rely on market forces to ensure that universal service support is used for the purposes intended.

Respectfully submitted,

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PRESERVING UNIVERSAL SERVICE IN COMPETITIVE MARKETS FOR NON-RURAL CARRIERS

A Plan Proposed by USTA

September 25, 1998

I. Introduction

The Telecommunications Act of 1996 ("1996 Act") charges the Federal Communications Commission ("FCC") working with a special federal-state joint board ("Special Joint Board"), with establishing a new universal service support program based on the principles and requirements set out in the Act. These principles and requirements include the following:

* Quality services should be available at just, reasonable and affordable rates;
* Access to service and rates in rural and high costs areas should be reasonably comparable to that in urban areas;
* The mechanisms used should be specific, predictable and sufficient;
* Every telecommunications carrier shall contribute on an equitable and nondiscriminatory (i.e., competitively neutral) basis;
* Only eligible telecommunications carriers (ETCs) may receive support; and
* Any support must be explicit.

The Commission determined that it would defer any further changes in existing universal service support for rural companies pending further review and at least until January 1, 2001. The Commission has focused its efforts to date on changes affecting non-rural companies. These changes were originally to have been in place by January 1, 1999. In July, following a request by the state members of the Special Joint Board and criticism by key Congressional leaders, the FCC decided to refer a series of issues back to the Special Joint Board and has now committed to implement the revised mechanism for non-rural carriers by July 1, 1999.

USTA has been working to develop a consensus plan for a new program of universal service support for non-rural carriers. That consensus plan is described below. While some non-rural companies have individually proposed similar plans, the consensus plan is the product of extensive discussions and negotiations among many of USTA's non-rural companies and represents USTA's position on these important issues.

II. Description of the Problem for Non-Rural Carriers

Universal service is currently maintained with support from a number of sources. All of these sources relate to the recovery of the fixed costs of the public switched telephone network. Explicit support derives from high cost funds at the federal and state level. In addition to the explicit high cost support, universal service today is maintained by a variety of intra-company support flows. Incumbent local exchange carriers ("ILECs") have developed their rate structures as part of a regulatory process such that a number of services are priced substantially above cost (e.g., access) in order that basic local exchange service remain priced below cost. In other words, affordable service for business and residential customers in high cost areas is made possible by support from other revenue sources. These anomalies in rate structures amount to implicit support and this implicit support acts as a disincentive for residential competition. This is an often overlooked, but vital, aspect of universal service support.

Intra-company support for universal service comes from a variety of sources, such as:

- Interstate access charges;
- Intrastate access charges;
- IntraLATA toll service charges;
- Geographic rate averaging (urban-to-rural subsidies);
- Business-to-residential subsidies; and
- Charges for discretionary services.

The table below briefly describes the various support mechanisms that existed prior to the FCC's universal service order.

Table 1 Support Mechanisms		
Support Mechanism	**Support Source**	**Implicit/Explicit**
Federal High-Cost Fund*	IXCs	Explicit
State High-Cost Fund	Varies: ILECs, IXCs	Explicit
Long-Term Support*	Non-Pooling ILECs	Explicit
DEM Weighting*	Access Customers	Implicit
Carrier Common Line	Access Customers	Implicit
Federal and State Access	Access Customers	Implicit
IntraLATA Toll	IntraLATA Toll Users	Implicit
Business Services	Business Customers	Implicit
Geographic Rate Averaging	Urban Customers	Implicit
Vertical Services	Vertical Service Customers	Implicit

*The FCC has moved these mechanisms to an explicit, competitively neutral fund in CC Docket 96-45, *Federal State Joint Board on Universal Service*, May 8, 1997 at ¶¶ 300-306.

A necessary step (which has been avoided up to now) is for regulators to "size" the implicit support embodied in current rates. This, in turn, will enable regulators to determine the size of the universal service fund that is needed. There have been a number of efforts to measure the amount of this support,[1] but regulators need to reach an agreement quickly if real progress is to be made.

It must be emphasized that this implicit support is derived from revenues earned by telephone companies from both the interstate and intrastate services. Thus, both federal and state regulators share the responsibility for converting this implicit support into the "sufficient" explicit support mechanisms required by the 1996 Act.

The Congressional mandate in the 1996 Act and the introduction of competition require that the various support mechanisms be restructured, that subsidies be made explicit, and that

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[1] Strategic Policy Research estimated in 1993 for USTA that the amount of support contributed from access and toll services was approximately $20 billion annually. That estimate was recently updated to show that the support contributed from these services now amounts to nearly $24 billion annually.

support be assessed and distributed in a competitively neutral manner. Coordinated action on the part of the FCC and state regulators is needed to carry out this mandate. A properly designed federal plan that emerges from the current FCC rulemaking can serve as a model for states in addressing these same issues.

III. Goal of A New Universal Service Policy for Non-Rural LECs

As USTA sees it, the goals of the new universal service policy should be to:

1. Preserve and advance universal service during the transition to competition as mandated by the 1996 Act.
2. Identify and establish universal support mechanisms consistent with terms of the 1996 Act.
3. Creates a competitively neutral fund that removes disincentives for competition.

Two equally important changes are required to achieve these goals. First, a new federal high cost fund must be created for support of high-cost areas of the country with priority given in the distribution of those funds to those geographic areas with highest costs. Second, the implicit intra-company universal service support must be replaced with a more sustainable recovery mechanism.

IV. Support for High-Cost Areas of the Country Served by Non-Rural Carriers

USTA supports the following principles:

1. A federal program to support high-cost areas/states is necessary and mandated by Congress;
2. States, however, must also take steps to address their high-cost problem internally such as through rate rebalancing[2];

[2] Elimination of implicit support, according to the conventions of rate rebalancing, includes increases in below-cost rates in addition to decreases in above-cost rates. Rate rebalancing and establishing explicit intrastate high cost support mechanisms are among the tools available to state commissions to meet the 1996 Act's mandate.

3. While it is appropriate to direct some federal support to any state with high-cost areas, states with a large number of high-cost areas (rural) and relatively few low-cost areas (urban) should receive proportionately more support[3]; and
4. Support should be sufficient to assure affordable service to high-cost customers of non-rural LECs. The fund for non-rural LECs should be sized so that it provides at least the current level of support.
5. Any increase in high cost funding received by a regulated ETC shall be offset with intrastate rate reductions.

V. Collection Mechanism for High Cost Support for Non-Rural Carriers

High cost support should be funded by a surcharge on the total retail bills (combined interstate and intrastate) assessed by every telecommunications carrier. This approach ensures fairness among carriers and competitive neutrality. Basing the surcharge on combined revenue also eliminates opportunity for strategic behavior (*e.g.*, misreporting traffic as intrastate to minimize a surcharge on interstate retail). USTA strongly believes that in order to maintain equity the same basis (*i.e.*, total retail revenue) should be used for both federal and state universal funds. In other words, states which decide to establish their own end-user charges to support universal service should be required to apply the charges to total retail revenue — interstate (originating in the state) and intrastate.

VI. Distribution Mechanism for High Cost Support for Non-Rural Carriers

An equitable mechanism based on a cost benchmark should be developed to identify those states which will need additional support due to significant numbers of high cost customers and relatively few low cost customers over whom to spread these costs. The level of the benchmark, together with the cost estimate, determine the amount of support needed in an area.

[3] USTA policy is that federal support should go to carriers.

For example, if a relatively low (*i.e.*, HAI) cost estimate is used, a lower benchmark should also be used to provide sufficient funding levels. Cost models can properly be used for non-rural carriers to implement the distribution of high cost funds, but should not be used to size the fund itself. Rather, the fund should be sized based on the need to support universal service and on the need to replace other sources of support.

VII. Replacing Intra-Company Universal Service Support for Non-Rural Carriers

USTA's consensus plan for replacing intra-company support for universal service is based on two premises. First, intra-company support (in the federal jurisdiction, the support derived from interstate access rates) is an important source of support for universal service for non-rural companies. Second, the current recovery mechanisms (e.g., CCL and PICC, upon completion of the transition ordered by the FCC) are not sustainable in a competitive environment. Moreover, because these cost recovery mechanisms are built into ILEC access charges and can be avoided by long distance companies which provide their own access or buy it from an ILEC competitor, they are not consistent with the 1996 Act's requirement that universal service support be provided on an equitable and nondiscriminatory basis.

A new collection mechanism for interstate intra-company universal service support should be established along the following lines:

1. Current revenues from the CCL and PICC, plus those revenues that are to be ultimately transferred to the PICC, would be used to determine the amount of support to be collected.
2. Nationwide, reductions in access (implicit subsidy) should match the size of the amounts collected from end users (explicit subsidy).[4]
3. The explicit support that will replace the reductions in implicit support will be collected by all telecommunications carriers through an end-user surcharge on total retail revenues.

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[4] The reductions would be treated as an exogenous cost factor (a "Z" adjustment) for price cap ILECs.

4. Each ILEC study area would receive explicit per-line support equal to the amount of access reduction made by the ILEC in that study area divided by the number of residential access lines in that study area. The amount of per-line support in a study area would remain constant until such time as the FCC acts to adopt an alternative mechanism for distributing explicit support among ETCs.
5. Explicit support to replace intra-company implicit support would be portable among ETCs that provide universal service within a study area. An ETC will receive support on a per-line basis for each residential line it serves.
6. Distribution of the explicit support throughout an ILEC study area may be de-averaged, so that higher cost regions of a study area would receive greater support per-line than would the lower-cost regions of that study area. This feature is important since it eliminates a potential downside to portable support; that is, if the support is distributed on an averaged basis, it makes it even more attractive for new entrants to target lower cost, higher volume customers within a particular study area.
7. The replacement of implicit support is, in effect, a restructuring of interstate access and should not be seen as reducing interstate revenues. Therefore, states which generally mirror interstate access charges should also mirror this restructuring including the development of an end-user surcharge or another compensating action, such as rate rebalancing or another universal service approach. Section 254(f) of the 1996 Act requires that states that develop universal service mechanisms ensure that all telecommunication carriers doing business in that state contribute to preserving and advancing universal service. Additionally, section 254(b)(5) requires that states universal service mechanisms be specific, predictable and sufficient. For example, the replacement of intrastate access implicit support with explicit support recovered through an end-user surcharge on total revenue (interstate and intrastate) assessed by all carriers in the state meets the requirements in the 1996 Act and can be said to mirror the interstate mechanism which the FCC would establish under this proposal. Full mirroring of this restructuring of interstate access, however, requires an action

(*e.g.*, rebalancing) by the state to compensate for the reduction in access revenues resulting from the mirroring. States may also use a combination of several means to meet this mirroring requirement. Thus, states that have rules that require mirroring should review their mirroring rules to ensure that they do not provide results inconsistent with the FCC's universal service policies and that the resulting mechanisms are specific, predictable, and sufficient to meet the requirements of the 1996 Act.

VIII. Conclusion

USTA urges the Special Joint Board, the FCC and state regulators generally to move ahead to fulfill the Congressional mandate and establish new explicit universal service support mechanisms. Perserving universal service as competition expands is a critical part of our new national telecommunications policy.