Before the
Federal Communications Commission
Washington, D.C. 20554

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

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

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I. INTRODUCTION

1. The Telecommunications Act of 1996 (1996 Act) has fostered and accelerated the development of competition in local telecommunications markets across the nation.[1] The 1996 Act also, for the first time, wrote into law the Commission's long-standing policy of supporting universal service. In codifying this federal policy, Congress sought to ensure that universal service remains achievable and sustainable as local competition develops.

[1] The 1996 Act amended the Communications Act of 1934, 47 U.S.C. § 151, *et seq.* *See* Pub. L. No. 104-104, 110 Stat. 56 (1996).

2. In this Order, based on recommendations from the Federal-State Joint Board on Universal Service (Joint Board), we take action to achieve this Congressional goal and to ensure that mechanisms exist so that non-rural carriers' rates for services supported by universal service mechanisms remain affordable in all regions of the nation and reasonably comparable to those prevalent in urban areas.[2] In taking these steps, we are moving closer to bringing to fruition the work of the Joint Board and this Commission to render universal service support mechanisms explicit, sufficient, and sustainable as local competition develops.

3. In this Order, we adopt broad revisions to the federal support mechanisms, in light of the Joint Board's most recent recommendations, to permit rates to remain affordable and reasonably comparable across the nation, consistent with the 1996 Act and the competitive environment that it envisions. To accomplish these goals, as recommended by the Joint Board, we establish a methodology for determining non-rural carriers' support amounts, based on forward-looking costs estimated using a single, national model, and a national cost benchmark.[3] We explicitly reconsider and repudiate any suggestion in the *First Report and Order*[4] that federal support should be limited to 25 percent of the difference between the benchmark and forward-looking cost estimates, in favor of the more nuanced balancing of federal and state responsibilities outlined by the Joint Board. To the extent a state's resources are deemed inadequate to maintain affordable and reasonably comparable rates, the federal mechanism will provide the necessary support. We also adopt today the hold-harmless and portability principles recommended by the Joint Board.

4. Although we are adopting the principles of a federal support mechanism that conform to the *Second Recommended Decision*,[5] we do not believe that an adequate record yet exists to make determinations regarding some of the specific elements of the support methodology. Accordingly, we also adopt the attached Further Notice of Proposed Rulemaking (FNPRM) seeking comment on several specific implementation issues. While we are resolving these implementation issues, we also are continuing to verify the operation of the cost model, including the input data elements. To complete this process, we issue

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[2] 47 U.S.C. §§ 254(b)(1), (3). Although the 1996 Act does not specifically define a non-rural carrier, it does define a rural telephone company as a local exchange carrier that provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines or that serves only very small communities as defined by the Act. 47 U.S.C. § 153(37)(C).

[3] Although we adopt a cost benchmark for purposes of determining federal intrastate high-cost support, differing considerations will inform our selection of a cost-based benchmark, a revenue-based benchmark, or some other method for purposes of identifying universal service support implicit in interstate access charges. Accordingly, we may adopt a different approach in that context.

[4] *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8801 (1997) (*First Report and Order*), as corrected by Errata, CC Docket No. 96-45 (rel. June 4, 1997), *appeal pending sub nom. Texas Office of Pub. Util. Counsel v. FCC*, No. 97-60421 (5th Cir. argued Dec. 1, 1998).

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

separately an additional FNPRM on the model input and operational issues.[6] We encourage commenters to consider both of these FNPRMs together, and frame their comments to recognize the close relationship between the issues discussed in each.

5. We intend to resolve the remaining methodological issues identified in the attached FNPRM and verify the operation of the cost model, including the input data elements, on which comment is being sought in the companion *Inputs FNPRM*. We anticipate adoption this fall of an order resolving these remaining issues, so that support may be based on forward-looking costs of providing supported services beginning January 1, 2000. In conjunction with our actions to implement an explicit high-cost support mechanism based on forward-looking costs, we also take action today and seek comment on additional issues to permit us to identify implicit support remaining in interstate access charges by January 1, 2000.

II. OVERVIEW

6. One primary purpose of universal service support has always been to support telecommunications service in high-cost areas where such service would be relatively expensive. This has been accomplished by subsidizing carriers to enable them to serve high-cost consumers at below-cost rates. Several federal programs have long served this goal by providing explicit support for local loop and switching costs that significantly exceed the national average. State programs and state rate structures also have supported universal service. In the past, in addition to receiving explicit universal service support, monopoly local exchange carriers charged some customers, such as urban businesses and other low-cost customers, rates for local exchange and exchange access services that exceeded the cost of providing those services. Rates paid by these customers implicitly supported the rates for service provided by the same carrier to other, higher cost customers. This implicit support helped keep rates largely affordable by requiring monopoly local exchange carriers to develop rates using costs averaged over large geographic areas, to charge business customers rates that generally exceed those charged to residential customers, and to recover through usage-based charges some non-traffic sensitive costs of the local exchange network. In addition, support implicit in interstate access rates has in some cases inflated per-minute interstate toll charges.

7. Implicit universal service support is becoming less sustainable as competition increases, because a carrier charging rates significantly above cost to a class of customers may lose those customers to a competitor charging cost-based rates. As carriers lower their rates closer to their costs in urban areas, or lose low-cost customers to new entrants, the implicit support for below-cost rates in high-cost areas erodes. In addition, implicit support can promote potentially inefficient competition in low-cost, typically urban areas and for high-revenue, typically business customers. Implicit support can also delay or deny the benefits of

[6] *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, 97-160, FCC 99-120 (rel. May 28, 1999) (*Inputs FNPRM*).

competition to residential and high-cost consumers if a competitor finds that it is unable to compete against an incumbent's artificially low rates. For this reason, in tandem with our shift to explicit support based on forward-looking costs, we have taken steps toward identifying support implicit in interstate access rates.[7]

8. By contrast, explicit support[8] based on contribution and support mechanisms that do not advantage or disadvantage any carrier that may seek to compete in the local market can preserve and protect universal service for all Americans. Efficient competition in local markets is most likely to occur when rates for services, after factoring in explicit universal service contributions or support, reflect the underlying cost of providing service. Accordingly, the 1996 Act requires all providers of interstate telecommunications services to contribute to universal service support mechanisms on an equitable and nondiscriminatory basis,[9] and provides that universal service support should be explicit.[10]

9. Under the current system of federal support, potential new entrants to the local market in high-cost areas are at a competitive disadvantage relative to incumbents, which have access to much greater implicit support than new entrants. Converting such implicit support to explicit support that is portable among all eligible telecommunications carriers will significantly lessen this competitive advantage. Consequently, explicit mechanisms may encourage competitors to expand service beyond urban areas and business centers into all areas of the country and to all Americans, as envisioned by the 1996 Act.

10. The 1996 Act establishes as a principle, on which we must base our universal service policies, that high-quality supported services should be available across the nation at affordable and reasonably comparable rates.[11] In adopting a high-cost support mechanism, we must adhere to the universal service principles and requirements set forth by Congress. The support mechanism we adopt should, as far as possible, be explicit,[12] as well as specific, predictable, and sufficient to preserve and advance universal service.[13] The support mechanism should also require all providers of telecommunications services to make an

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[7] *See* Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing and End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, and 95-72, *First Report and Order*, 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*).

[8] In discussing explicit support, we refer to support that is specifically identified as such in carriers' revenue streams.

[9] 47 U.S.C. § 254(d).

[10] 47 U.S.C. § 254(e).

[11] *See* 47 U.S.C. § 254(b).

[12] 47 U.S.C. § 254(e).

[13] 47 U.S.C. § 254(b)(5).

equitable and nondiscriminatory contribution to the preservation and advancement of universal service.[14] The support mechanism should neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.[15] Any telecommunications carrier, using any technology, including wireless technology, is eligible to receive universal service support if it meets the criteria under section 214(e)(1).[16]

11. 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. A cost model only estimates costs, however; it does not determine support. Therefore, we also adopt today the principles of a methodology for using the model's cost estimates to determine support amounts, as described in the *Second Recommended Decision*. We will use a national, cost-based benchmark set at a percentage of the national average forward-looking cost of providing the supported services as the first step in determining the amount of support to be provided. That is, federal mechanisms will support areas with per-line costs in excess of this benchmark unless, as the Joint Board recommended, an objective indicator of state resources reveals that the state possesses the ability to achieve reasonable rate comparability in the state without federal support.[17] We conclude, consistent with the Joint Board's recommendation, that states should not be required to alter their existing substantial universal service support mechanisms, such as intrastate rate averaging, to receive federal support, but that states' ability to provide for their own universal service needs should be evaluated based upon the assumption that each line within the state is capable of bearing an intrastate support burden equal to a fixed dollar value assessment.[18] The pool of revenue that could be raised from such an assessment is presumed to be available to the state for intrastate support efforts. We emphasize, however, that the use of a fixed per-line dollar value assessment to estimate states' abilities to support their universal service needs internally does not mandate the creation of state universal service funds for this purpose. Federal support will be available if this intrastate support is inadequate to enable reasonable comparability of rates.

12. Preserving and advancing high-cost universal service support, however, is not a task reserved solely to the Commission. On the contrary, consistent with the 1996 Act and the Joint Board's recommendations, and in recognition of the states' long history of acting to ensure universal service, joint federal and state responsibility is the cornerstone of the plan we

[14] 47 U.S.C. § 254(b)(4).

[15] *First Report and Order*, 12 FCC Rcd at 8802, para. 49.

[16] *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

[17] *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 44.

[18] *Second Recommended Decision*, 13 FCC Rcd at 24759-62, paras. 36-46.

adopt today.[19] The federal universal service methodology and principles we adopt today recognize the states' central role in providing intrastate support for high-cost areas, and reaffirm that the primary purpose of the federal support mechanism is to enable federal support to be available to ensure that states have the resources to maintain reasonably comparable rates in all areas of the nation. As competition develops, we agree with the Joint Board that states are likely to come under increasing pressure to render intrastate universal service support explicit. We recognize that the states are best positioned to evaluate their own intrastate needs, however, and we decline at this time to impose any conditions on a state's eligibility to receive federal high-cost support. Also in agreement with the Joint Board, we caution that federal support should not necessarily be available to replace eroding implicit intrastate support, absent a showing that the state is unable to maintain reasonable comparability of rates.

13. We emphasize that the methodology and principles we adopt today do not require any state to impose a per-line charge to support universal service and do not entitle carriers to recover any particular amount of support from new or explicit state mechanisms. As the Joint Board explained, this estimate of the state's ability to achieve reasonably comparable rates on a statewide basis establishes a level above which federal support, consisting of funds transferred from other jurisdictions, should be provided to assist the state in achieving rates that are reasonably comparable to those in other states. States largely are already making use of this ability by providing carriers with substantial universal service support, often through rate averaging and other rate design methodologies, and states are best positioned to determine how and whether these intrastate mechanisms need to be altered to ensure that carriers do not double-recover universal service support. Our estimate of a state's ability to support reasonably comparable rates internally is intended to ensure that federal support for this purpose is no greater than is necessary. In addition, by accounting for state resources that already are largely in use, we minimize the need for significant alterations in local rate structures to reflect federal support payments. We caution, however, that for carriers receiving significant increases in federal support for local rates, carrier and/or state commission action with regard to existing intrastate support, particularly that which is currently embedded in interstate rates, may be necessary to prevent double-recovery of universal service support at both the federal and state level.[20] We therefore seek comment on any actions that may be necessary to prevent such windfalls to carriers.

14. To ensure that our transition to a revised federal support mechanism does not cause sharp or sudden reductions in the level of support any individual carrier receives, we

[19] Congress clearly intended that universal service reform be achieved through a combination of federal and state efforts. 47 U.S.C. § 254(a)(1); *see also* 47 U.S.C. § 254(b)(5) (stating that there "should be specific, predictable and sufficient *Federal and State* mechanisms to preserve and advance universal service") (emphasis added).

[20] *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

also adopt, as the Joint Board recommended, a hold-harmless principle.[21] We agree with the Joint Board that this principle is an important transitional measure that will provide protection as we gain experience with the use of our new support mechanism.[22] We also agree with the Joint Board, however, that we should revisit this issue no later than three years after implementation of the new support mechanism, *i.e.*, January 1, 2003, to reevaluate whether a hold-harmless provision remains necessary.[23]

15. Today, in agreement with the Joint Board, we reaffirm our commitment to the principle that universal service support should be available to all eligible telecommunications carriers on an explicit *and portable* basis.[24] We also reaffirm that all carriers that provide the supported services, regardless of the technology used, are eligible for designation as an eligible telecommunications carrier. We believe that this transition to forward-looking explicit and portable support represents another critical step towards the development of efficient competition in all areas of the nation. As support becomes explicit and portable, we expect that competitors will find that they are increasingly able to compete for customers outside of the urban and business communities where we have seen more extensive competitive entry to date. Support will be available to competitors that win higher cost customers from an incumbent carrier. At the same time, if an incumbent local exchange carrier (LEC) begins to lose customers in high-cost areas, so will it lose the support associated with those customers.

16. While we provide hold-harmless protection in this Order, we are hesitant to provide sharp increases in current support levels, in the absence of clear evidence that, consistent with the development of efficient competition, such increases are necessary to preserve universal service or to protect affordable and reasonably comparable rates. In addition, because this is our first experience with support provided using forward-looking cost models, we conclude that we should implement a support mechanism based on forward-looking costs and gain experience with its operation before determining whether large increases are necessary. Accordingly, at this time we agree with the Joint Board that we should not increase the amount of explicit federal support significantly from current explicit levels.

17. We also agree with the Joint Board that many of the consumer issues raised in the *Second Recommended Decision*, such as how carriers recover their universal service contributions from consumers, are within the scope of the Commission's ongoing *Truth-in-*

[21] *Second Recommended Decision*, 13 FCC Rcd at 24763-64, paras. 51-53.

[22] *Second Recommended Decision*, 13 FCC Rcd at 24763-64, paras. 51-53.

[23] *Second Recommended Decision*, 13 FCC Rcd at 24773, para. 74.

[24] *Second Recommended Decision*, 13 FCC Rcd at 24765, para. 56.

Billing proceeding.[25] We therefore conclude, consistent with the Joint Board's recommendation, that it is more appropriate to address those issues in the *Truth-in-Billing* proceeding, in light of the more complete record developed in that docket. Indeed, several of those issues have been resolved, or are being resolved, in that proceeding.[26]

18. Accordingly, in the attached FNPRM, we seek further comment on certain specific methodological issues, such as the precise level of the benchmark and the precise amount of the per-line state responsibility estimate. The FNPRM also seeks comment on other implementation issues, such as how exactly the hold-harmless mechanism should operate, and how best to ensure that support is used for the purposes for which it is intended, in the areas for which it is intended, as the Act requires,[27] particularly given state jurisdiction over local rate levels.[28]

19. Because we are seeking further comment on implementation issues in the attached FNPRM, and because (as explained in this Order and the *Inputs FNPRM*)[29] further verification of the model's data input elements and results is necessary before its outputs can be used to determine support amounts, we defer implementation of the new forward-looking support mechanism for non-rural carriers until January 1, 2000.[30]

III. BACKGROUND

20. This Order is part of an ongoing process intended to transform universal service mechanisms so that they are both sustainable as competition in local markets develops, and explicit in a manner that promotes the development of efficient competition across the nation. As required by the 1996 Act, the Commission convened the Joint Board,[31] which produced its first set of recommendations to the Commission in November 1996.[32] In light of those recommendations, the Commission, on May 8, 1997, released the *First Report and Order*,

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[25] *See Truth-in-Billing and Billing Format*, First Report and Order and Further Notice of Proposed Rulemaking, FCC 99-72 (rel. May 11, 1999) (*Truth-in-Billing First Report and Order and FNPRM*).

[26] *See Truth-in-Billing First Report and Order and FNPRM*, FCC 99-72.

[27] 47 U.S.C. § 254(e).

[28] 47 U.S.C. § 152(b).

[29] *Inputs FNPRM*, FCC 99-120.

[30] Accordingly, we amend our rules so that the present high-cost support mechanism remains in effect until January 1, 2000. *See* Appendix C.

[31] *Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996).

[32] Federal-State Joint Board on Universal Service, *Recommended Decision*, 12 FCC Rcd 87 (Jt. Bd. 1996) (*First Recommended Decision*).

which, among other things, identified the services included within the definition of universal service and established a specific timetable for implementation of revised universal service support mechanisms.[33]

21. Consistent with the Joint Board's recommendations, the Commission determined that carriers should receive support for serving rural, insular, and high-cost areas based on the forward-looking cost of providing the supported services, because forward-looking costs provide sufficient support while sending the correct signals for efficient entry and investment.[34] The Commission determined that non-rural carriers would begin to receive high-cost support based on forward-looking costs on July 1, 1999, but that the implementation of support based on forward-looking costs for rural carriers would be delayed at least until January 1, 2001, pending further review by the Commission, the Joint Board, and a Joint Board-appointed Rural Task Force.[35] On October 28, 1998, the Commission released an order adopting a platform for a federal mechanism for determining non-rural carriers' forward-looking costs.[36] This platform establishes a framework of fixed assumptions about network design and other basic issues, and will be used, in conjunction with input values for the cost of network components and other parameters, to estimate non-rural carriers' forward-looking costs of providing the supported services.[37] The model is used to estimate the forward-looking cost of providing the supported services, but does not itself determine federal support levels.

22. The Commission concluded in the *First Report and Order* that the share of support provided by the federal mechanism initially should be set at 25 percent, based on the need to avoid double-recovery by carriers pending reform of state rates and support mechanisms.[38] The Commission stated, however, that the federal share of support would be subject to review in light of state proceedings, the development of competition, and other

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[33] *First Report and Order*, 12 FCC Rcd 8776.

[34] *First Report and Order*, 12 FCC Rcd at 8899-8900, paras. 224-26; *Recommended Decision*, 12 FCC Rcd at 232, para. 276.

[35] *First Report and Order*, 12 FCC Rcd at 8910, para. 254; 8917-18, paras. 252-56. The *First Report and Order* determined that non-rural carriers should begin to receive support based on forward-looking costs on January 1, 1999. This implementation date was extended to July 1, 1999, in conjunction with the referral of issues back to the Joint Board. *See Federal-State Joint Board on Universal Service*, Order and Order on Reconsideration, 13 FCC Rcd 13749 (1998) (*Referral Order*). *See also Federal-State Joint Board on Universal Service Announces the Creation of a Rural Task Force; Solicits Nominations for Membership on Rural Task Force*, Public Notice, FCC 97J-1 (rel. Sept. 17, 1997).

[36] *Federal-State Joint Board on Universal Service*, Fifth Report and Order, 13 FCC Rcd 21323 (1998) (*Platform Order*).

[37] The input values will be determined in a separate order. *See* para. 4, *supra*; *Platform Order*, 13 FCC Rcd at 21324-25, para. 2; *Inputs FNPRM*.

[38] *First Report and Order*, 12 FCC Rcd at 8925, para. 269.

relevant factors.[39]

23. The Commission's determination relating to the federal share of support generated several petitions for reconsideration[40] and significant comment.[41] On March 11, 1998, the state members of the Joint Board filed a request that certain issues related to the determination of high-cost support, including issues regarding the share of federal high-cost support, be referred back to the Joint Board.[42] Shortly after a March 1998 *en banc* hearing on these issues convened by the Commission with the participation of the state Joint Board members, the state members filed a letter requesting referral of two additional issues.[43] In April 1998, the Commission committed to completing a proceeding reconsidering the federal share of support before revised support mechanisms are implemented for non-rural carriers,[44] and sought proposals and comments on how to reform high-cost support for non-rural carriers.[45] In response, parties submitted a variety of proposals and comments, and provided input in a number of *en banc* hearings.[46]

24. On July 17, 1998, the Commission referred the following issues to the Joint Board, to obtain its recommendations:[47]

(1) An appropriate methodology for determining support amounts, including a

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[39] *See First Report and Order*, 12 FCC Rcd at 8926, paras. 271-72. *See also Federal-State Joint Board on Universal Service*, Report to Congress, 13 FCC Rcd at 11602-09, paras. 219-234 (1998) (*April 1998 Report to Congress*).

[40] *See, e.g.*, Alaska Commission petition at 5-6; Arkansas Commission petition at 1-3; U S West petition at 6; Western Alliance petition at 18-19; Texas Commission petition at 2; Rural Telephone Coalition petition at 1-6.

[41] *See, e.g.*, *April 1998 Report to Congress*, 13 FCC Rcd at 11603-04, paras. 222-23 and associated notes.

[42] Formal Request for Referral of Designated Items by the State Members of the § 254 Federal-State Joint Board on Universal Service, CC Docket No. 96-45, filed March 11, 1998.

[43] Letter from the State Members of the Joint Board to William Kennard, Chairman, FCC, CC Docket No. 96-45, filed June 18, 1998.

[44] *April 1998 Report to Congress*, 13 FCC Rcd at 11605, para. 224.

[45] *Common Carrier Bureau Seeks Comment on Proposals to Revise the Methodology for Determining Universal Service Support*, Public Notice, 13 FCC Rcd 7341 (Com. Car. Bur. 1998).

[46] In connection with the preparation of the *April 1998 Report to Congress*, the Commission held an *en banc* hearing on March 6, 1998, covering, among other things, revisions to the support methodology for non-rural carriers. On June 8, 1998, the Commission convened an *en banc* hearing, which included the state Joint Board commissioners, to address options for revising the support mechanisms for non-rural carriers. On October 29, 1998, the Commission held an *en banc* hearing, which included the state Joint Board commissioners, to address the consumer billing and information issues that had been referred to the Joint Board.

[47] *Referral Order*, 13 FCC Rcd at 13751-52, para. 6.

method for distributing support among the states and, if applicable, the share of total support to be provided by federal mechanisms. If the Commission were to maintain the current 25/75 division as a baseline, the Commission also requested the Joint Board's recommendation on the circumstances under which a state or carrier would qualify to receive more than 25 percent from federal support mechanisms.

(2) The extent to which federal universal service support should be applied to the intrastate jurisdiction. The Commission specifically requested the Joint Board's recommendation on the following topics:

(a) To the extent that federal universal service reform removes support that [is] currently implicit in interstate access charges, whether interstate access charges should be reduced concomitantly to reflect this transition from implicit to explicit support, and whether other approaches would be consistent with the statutory goal of making federal universal service support explicit. The Commission also requested a recommendation on how it can avoid "windfalls" to carriers if federal funds are applied to the intrastate jurisdiction before states reform intrastate rate structures and support mechanisms.

(b) Whether and to what extent federal universal service policy should support state efforts to make intrastate support mechanisms explicit. The Commission recognized that section 254(k) envisions separate state and federal measures related to the recovery of joint and common costs, but nevertheless indicated that it would welcome the Joint Board's input on how section 254(k) may relate to the Commission's role in making intrastate support systems explicit.

(c) The relationship between the jurisdiction to which funds are applied and the appropriate revenue base upon which the Commission should assess and recover providers' universal service contributions and, if support for federal mechanisms continues to be collected solely in the interstate jurisdiction, whether the application of federal support to costs incurred in the intrastate jurisdiction would create or further implicit subsidies, barriers to entry, a lack of competitive neutrality, or other undesirable economic consequences.

(3) To what extent, and in what manner, it is reasonable for providers to recover universal service contributions through rates, surcharges, or other means.[48]

25. On November 25, 1998, the Joint Board released its recommendations on these

[48] *Referral Order*, 13 FCC Rcd at 13751-52, para. 6.

issues.[49] The Joint Board recommended that the Commission reconsider many aspects of the *First Report and Order's* approach to determining forward-looking support for non-rural carriers. The Joint Board began by considering the potential purposes of high-cost support, and concluded that enabling the reasonable comparability of rates should be a primary purpose. The Joint Board stated that the Commission has the authority to identify and make explicit any support that is currently implicit in interstate rates, but found that making explicit any implicit intrastate support was within the jurisdiction of the individual states.

26. The Joint Board focused its recommendations on a mechanism for enabling the reasonable comparability of intrastate rates. To reach this goal, the Joint Board recommended that the Commission compute federal high-cost support through a two-step process: (1) the Commission should establish a national benchmark to determine the total amount of support needed in areas with costs in excess of that benchmark; and (2) for these high-cost areas, the Commission should consider, in a consistent manner across all states, each state's ability to support its own high-cost areas. The Joint Board recommended that federal support be provided to the extent that a state would be unable to support its high costs areas through its own reasonable efforts. The Joint Board also recommended that the mechanisms it had outlined be reviewed no later than three years from July 1, 1999. Finally, the Joint Board stated that, while it recommended a shared federal-state responsibility, no state can or should be required by the Commission to establish an intrastate universal service fund.

27. The Joint Board also expressed its support for the Commission's commitment to the concept of "hold-harmless" -- in other words, that current support levels should not decrease as part of the transition to support based on forward-looking costs. The Joint Board also made recommendations related to the revenue base on which carriers' universal service contributions are assessed, and how carriers should be permitted to recover those contributions from their customers. In this Order, we largely adopt the recommendations of the Joint Board on these referral issues.

[49] *Second Recommended Decision*, 13 FCC Rcd 24744.

IV. REPORT AND ORDER

A. The Purpose of Support

28. We agree with the Joint Board that a primary focus in reforming the federal high-cost universal service support mechanism is to enable intrastate rates to remain both affordable and reasonably comparable across high-cost and urban areas.[50] We also agree with the Joint Board that the Commission bears the responsibility to ensure that interstate rate structures comply with the Congressional mandates expressed in the Communications Act of 1934, as amended (the Act).[51] In this section, we adopt the majority of the Joint Board's conclusions and recommendations concerning affordability, reasonable comparability, explicit interstate support, and explicit intrastate support. We have determined, however, that further comment is necessary on several implementation issues, as outlined in the FNPRM, and that more thorough verification of the model is necessary before a forward-looking support methodology can be implemented.[52] Pending resolution of these issues, and pursuant to the Joint Board's recommendation, we are leaving the existing support mechanism in place for non-rural carriers for an additional six months. We anticipate adopting the permanent methodology for calculating and distributing support for non-rural carriers, based on forward-looking economic costs, this fall for implementation on January 1, 2000.

1. Enabling Reasonably Comparable Rates

a. Background

29. One of the guiding principles of the 1996 Act is that consumers in all regions of the nation should have access to rates and services that are reasonably comparable to rates and services in urban areas.[53] The 1996 Act does not define the term "reasonably comparable," nor does it specify the means to achieve this goal. In the *Second Recommended Decision*, the Joint Board interpreted the term "reasonably comparable" to refer to "a fair range of urban and rural rates both within a state's borders, and among states nationwide."[54] The Joint Board proposed to achieve reasonable comparability of rates using a two-step methodology that divides responsibility for this goal between the federal and state support mechanisms. In the first step, the federal support mechanism would identify study areas with costs greater than a

[50] *Second Recommended Decision*, 13 FCC Rcd at 24752-53, para. 14.

[51] *Second Recommended Decision*, 13 FCC Rcd at 24752-53, para. 14.

[52] *See* section V, *infra*.

[53] 47 U.S.C. § 254(b)(3).

[54] *Second Recommended Decision*, 13 FCC Rcd at 24753, para. 15.

federally determined national benchmark.[55] The second step would attempt to ensure that support is available where a state would "find it particularly difficult to achieve reasonably comparable rates, absent such federal support."[56] The federal support mechanism would then provide support for intrastate costs that exceed both the national benchmark and the individual state's ability to support those costs.[57]

b. Discussion

30. We agree with the Joint Board that a central purpose of federal universal service support mechanisms is to enable rates in rural areas to remain reasonably comparable to rates in urban areas, and we adopt the Joint Board's interpretation of the reasonable comparability standard to refer to "a fair range of urban/rural rates both within a state's borders, and among states nationwide."[58] This does not mean, of course, that rate levels in all states, or in every area of every state, must be the same. In particular, as the local exchange market becomes more competitive, it would be unreasonable to expect rate levels not to vary to reflect the varying costs of serving different areas. The Joint Board and the Commission have concluded that current rate levels are affordable.[59] Therefore, we interpret the goal of maintaining a "fair range" of rates to mean that support levels must be sufficient to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels. When we use the term "reasonably comparable" throughout this Order and FNPRM, we are referring to this definition of the term.

31. We find that, once we have resolved several implementation issues outlined in the FNPRM, and further verified the forward-looking cost model, the Joint Board's recommended methodology largely will be an appropriate means for the federal mechanism to ensure that states have the ability to achieve reasonable comparability. Specifically, the Joint Board's proposed methodology will ensure that any state with per-line costs substantially above the nationwide average will receive federal support for those intrastate costs, unless the state has the ability to maintain reasonably comparable rates without such support. States, of course, retain primary responsibility for local rate design policy and, as such, bear the responsibility to marshall state and federal support resources to achieve reasonable comparability of rates.

32. This approach does not consider rates directly. Instead, it uses costs as an

[55] *Second Recommended Decision*, 13 FCC Rcd at 24754, 24761-62, paras. 19, 42-44. A study area is a geographical region generally composed of a telephone company's exchanges within a single state. *See* sections IV(B)(3)(1) and V(B)(1), *infra*, for discussion of the benchmark.

[56] *Second Recommended Decision*, 13 FCC Rcd at 24754, 24761-62, paras. 19, 42-44.

[57] *Second Recommended Decision*, 13 FCC Rcd at 24754, 24761-62, paras. 19, 42-44.

[58] *Second Recommended Decision*, 13 FCC Rcd at 24753-54, paras. 18-19.

[59] *First Recommended Decision*, 12 FCC Rcd at 154, para. 133; *First Report and Order*, 12 FCC Rcd at 8780, para. 2; *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3.

indicator of a state's ability to maintain reasonable comparability of rates within the state and relative to other states.[60] We conclude that the underlying assumption in the Joint Board's recommendation -- that a relationship exists between high costs and high rates -- is a sound one, because rates are generally based on costs.[61] We adopt this approach, in part, because states possess broad discretion in developing local rate designs.[62] State rate designs may reflect a broad array of policy choices that affect actual rates for local service, intrastate access, enhanced services, and other intrastate services. A state facing costs substantially in excess of the national average, however, may be unable through any reasonable combination of local rate design policy choices to achieve rates reasonably comparable to those that prevail nationally.[63] Through an examination of the underlying costs, instead of the resulting rates, we can evaluate the cost levels that must be supported in each state in order to develop reasonably comparable rates. Because responsibility for such support is shared at the federal and state levels, determining the federal portion based on costs rather than rates allows the federal jurisdiction to help accomplish the goal of rate comparability without having to evaluate states' policy choices affecting those rates.

33. By providing support for costs in any state that exceed a benchmark level, the Joint Board's recommended methodology ensures that the cost levels net of support that must be recovered through intrastate rates -- and, by analogy, its assumed rate levels -- must substantially exceed the national average. By taking account of the cost levels that must be supported in each state in order to enable reasonable comparability of rates, the Joint Board's methodology ensures that federal support is targeted to areas where it is necessary to achieve its intended purpose -- enabling reasonable comparability of rates -- and also that overall support levels are no higher than necessary to achieve this goal. We agree with the Joint Board that this methodology will result in federal support levels for each state that are appropriate to achieve the statutory principle of reasonable comparability of rates.

34. In the *First Report and Order*, the Commission concluded that the share of support provided by the federal mechanism should initially be set at 25 percent of the difference between the forward-looking cost of providing the supported services and a national benchmark.[64] In adopting the Joint Board's recommended methodology, we reconsider the Commission's conclusions in the *First Report and Order* regarding the federal share of

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[60] *See Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

[61] Even under price cap rate regulation, initial rates generally are based on cost studies or rates prevailing when price caps are initiated.

[62] 47 U.S.C. § 152(b).

[63] Another factor influencing a state's rate design choices, and its ability to achieve reasonably comparable rates, is the extent of cost variations between high-cost and low-cost areas of the state.

[64] *First Report and Order*, 12 FCC Rcd at 8925, para. 269.

support.[65] The Joint Board's recommended methodology for enabling reasonable comparability of rates will define the sharing of responsibility between the federal and state jurisdictions for high-cost intrastate universal service support in a way markedly different from the 25 percent federal share methodology adopted in the *First Report and Order*. Instead of allocating responsibility for universal service support based on fixed percentages, the Joint Board's recommended methodology recognizes the states' primary role in enabling reasonable comparability of rates. Under this recommendation, to the extent a state possesses the ability to support its high-cost areas wholly through internal means, the methodology we adopt recognizes that no federal support is required in that state to enable reasonably comparable local rates. Conversely, to the extent that a state faces larger rate comparability challenges than can be addressed internally, our forward-looking methodology places no artificial limits on the amount of federal support that is available, thus resulting in sufficient support as required by the 1996 Act.[66]

35. We find that section 254(b)(3) supports the use of federal support to enable reasonable rate comparability among states. By specifying that "[c]onsumers in all regions of the Nation" should have rates and services reasonably comparable to rates and services in urban areas, we believe that Congress intended national, as opposed to state-by-state, comparisons. Some commenters dispute the Joint Board's interpretation of reasonable comparability. For example, the California Commission asserts that using federal universal service support to enable rate comparability among states would impermissibly expand the scope of section 254(b)(3), and that support should merely seek to enable the reasonable comparability of rates within each state.[67] Similarly, the Maryland Commission claims that the Joint Board's interpretation would lead to the comparison of rural rates in all states to some fictional national urban rate, with the potentially anomalous result that rural rates in a state could be lower than urban rates in that state.[68] The Joint Board's approach for enabling rate comparability relies not on a national urban rate, as the Maryland Commission asserts, but rather on a methodology that ensures that no state will face per-line costs that substantially exceed the costs faced by other states, taking into account the individual state's ability to support its own universal service needs. In this way, the Joint Board sought to ensure that every state has the means at its disposal to achieve reasonable comparability of rates in that state. We agree that the Joint Board's approach is an appropriate way for federal

[65] *See First Report and Order*, 12 FCC Rcd at 8925, para. 269.

[66] 47 U.S.C. § 254(e). *See also* 47 U.S.C. §§ 254(b)(5), (d).

[67] The California Commission relies in part on language taken out of context from the Commission's brief in a matter pending before the Court of Appeals for the Fifth Circuit. California Commission comments at 4 (quoting Brief of Respondent, *Texas Office of Pub. Util. Counsel v. FCC*, No. 97-60421, *et al.* (5th Cir. argued Dec. 1, 1998) (FCC Brief)). This reliance is misplaced. By stating that "[s]ection 254(b)(3) does not require the Commission to ensure that rural and urban rates in one State are no higher or lower than rural and urban rates in another State," the Commission was simply arguing that section 254(b)(3) allows for a range of comparable rates, rather than a single national rate. *See* FCC Brief at 101-03.

[68] Maryland Commission comments at 9.

support mechanisms to enable "consumers in all regions of the Nation" to have access to "reasonably comparable" rates.[69] We emphasize again, however, that, because states establish local rates, each state's policies will determine the level of urban rates relative to rural rates in that state.

2. Enabling Affordable Rates

a. Background

36. As discussed above, the 1996 Act specifies that telecommunications services should be affordable.[70] In its *First Recommended Decision*, the Joint Board concluded that telephone subscribership levels provide a general measure of affordability.[71] Based on existing subscribership levels, the Joint Board determined that rates were generally affordable.[72] The Joint Board also concluded, however, that additional factors, such as the size of the local calling area, consumer income levels, cost of living, population density, and other socio-economic indicators may affect affordability.[73] The Joint Board further concluded that a variety of factors affecting local rate design, including cost allocations and related charges, should be considered in determining affordability.[74] Because the characteristics of local jurisdictions vary, and because the states possess the expertise to evaluate the various factors affecting affordability, the Joint Board recommended that the states exercise the primary responsibility for determining the affordability of rates.[75] In the *First Report and Order*, the Commission adopted the Joint Board's conclusions regarding affordability, agreed with the Joint Board that the primary responsibility for determining affordability lies with the states, and rejected proposals for establishing a nationwide affordable rate.[76]

37. In its *Second Recommended Decision*, the Joint Board reaffirmed that rates are generally affordable, and focused its efforts instead on the issue of reasonable comparability.[77] The District of Columbia (D.C.) Commission contends, however, that the Joint Board's

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[69] 47 U.S.C. § 254(b)(3).

[70] 47 U.S.C. § 254(b)(1).

[71] *First Recommended Decision*, 12 FCC Rcd at 151-52, para. 127.

[72] *First Recommended Decision*, 12 FCC Rcd at 154, para. 133.

[73] *First Recommended Decision*, 12 FCC Rcd at 151, para. 126.

[74] *First Recommended Decision*, 12 FCC Rcd at 153, para. 129A.

[75] *First Recommended Decision*, 12 FCC Rcd at 153-54, para. 131.

[76] *First Report and Order*, 12 FCC Rcd at 8837-38, paras. 110-11, 8842, para. 118.

[77] *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3.

proposed federal high-cost support mechanism does not meet the affordability requirement of section 254(b)(1) because it fails to inquire whether the beneficiaries of high-cost support actually need the support.[78] According to the D.C. Commission, low-income consumers in low-cost states are required to support telephone service for consumers in high-cost states, regardless of how wealthy those consumers may be.[79] The D.C. Commission suggests that federal high-cost support be conditioned on states certifying that a carrier receiving federal high-cost support has implemented income-based "means testing" and is not earning a higher than average return on equity due to high-cost support.[80] Ad Hoc supports the D.C. Commission's position that high-income consumers in high-cost states should not receive support from the high-cost fund.[81] Ad Hoc maintains that high-cost support should be limited to those areas in which consumers cannot afford to be connected to the network, and advocates a plan developed by Economics and Technology, Inc., under which high-cost support would be available in a particular state only to households with incomes below the 70th percentile of household income for that state.[82]

b. Discussion

38. We decline to adopt the proposals suggested by the D.C. Commission and Ad Hoc. We continue to believe, consistent with the Joint Board's recommendation, that rates for local service are generally affordable.[83] Indeed, since March 1989, at least 93 percent of all households in the United States have had telephone service, and as of November 1998, the subscribership rate was 94.2 percent.[84] While affordability encompasses more than subscribership, the Joint Board and the Commission agree that the states are better equipped to determine which additional factors can and should be used to measure affordability.[85]

39. The principle of ensuring reasonably comparable rates, set forth in section

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[78] D.C. Commission comments at 8-9.

[79] D.C. Commission comments at 8-9.

[80] D.C. Commission comments at 10.

[81] Ad Hoc reply comments at 3.

[82] Ad Hoc reply comments at 3-5 (citing Economics and Technology, Inc., *Defining the Universal Service "Affordability" Requirement, A Proposal for Considering Community Income as a Factor in Universal Service Support*, originally submitted as an attachment to *Proposals to Revise the Methodology for Determining Universal Service Support*, CC Docket Nos. 96-45, 97-160, Comments Regarding Universal Service Methodology, Time Warner Communications Holdings, Inc. (filed April 27, 1998)).

[83] *See also* Bell Atlantic comments at 2.

[84] Report, *Telephone Subscribership in the United States*, Table 1 (Com.Car.Bur., rel. Feb. 18, 1999).

[85] *First Recommended Decision*, 12 FCC Rcd at 153-54, para. 131; *First Report and Order*, 12 FCC Rcd at 8842, para. 118.

254(b)(3), does not specify an income component.[86] To the contrary, although affordability may vary with individual subscriber income, section 254(b)(3)'s statement that consumers in rural and high-cost areas of the country should have access to telecommunications services at rates that are reasonably comparable to rates in urban areas is not qualified. Therefore, we find no congressional mandate for the Commission to implement or to require that states implement means-testing in conjunction with mechanisms designed to provide support to high-cost areas and to enable reasonable comparability of rates nationwide. Affordability problems, as they relate to low-income consumers, raise many issues that are unrelated to the need for support in high-cost areas, and section 254(b)(3) reflects a legislative judgment that all Americans, regardless of income, should have access to the network at reasonably comparable rates. The specific affordability issues unique to low-income consumers, including all factors that may be relevant to means-testing or other need-based inquiries, are best addressed at the federal level through programs specifically designed for this purpose. Indeed, the Commission already has such programs in place, namely, the Lifeline and Link-Up programs, which provide assistance for low-income consumers to get connected and stay connected to the telecommunications network.[87] As discussed in the *First Report and Order*, we believe that the impact of household income on subscribership is more appropriately addressed through programs designed to help low income households obtain and retain telephone service, rather than as part of the federal high-cost support mechanism.[88]

40. Moreover, forcing states to adopt means testing or limits on rates of return in order to receive federal high-cost support would be contrary to the Joint Board's recommendations.[89] Although it may be within the Commission's jurisdiction to condition federal support on specific state action,[90] the Joint Board recommended against our doing so in the high-cost context.[91] Individual state commissions are in a position to evaluate specific affordability issues facing their respective states, and we believe that individual states should retain the primary responsibility to decide questions of affordability and to weigh the relative importance of factors such as consumer income and local rate design. Therefore, we decline to require means testing for federal high-cost support. An individual state, however, could voluntarily adopt an explicit support mechanism using means testing or other cost-of-living data, as suggested by the D.C. Commission and Ad Hoc. Although the states retain discretion to adopt such a mechanism, we will continue to monitor the issue of rate affordability, and we will take remedial action, to the extent we have jurisdiction to do so, if it becomes necessary.

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[86] 47 U.S.C. § 254(b)(1), (3).

[87] For background on the Lifeline and Link-Up programs, *see First Report and Order*, 12 FCC Rcd at 8952-94, paras. 326-409.

[88] *First Report and Order*, 12 FCC Rcd at 8844-45, para. 124.

[89] *See First Recommended Decision*, 12 FCC Rcd at 153-54, para. 131.

[90] GTE comments at 15 n.25.

[91] *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

3. Making Interstate Support Explicit

a. Background

41. In section 254(e), Congress mandated that federal universal service support, as far as possible, "should be explicit."[92] In the *First Report and Order* and the *Access Reform Order*, the Commission began the process of identifying and converting implicit interstate universal service support to explicit support.[93] The Commission determined that implicit support for universal service should be identified and removed from interstate access charges, and should be provided instead through explicit support mechanisms.[94] As initial steps toward achieving this task, the Commission directed that Long Term Support be removed from interstate access charges and be made part of explicit federal support mechanisms, and that incumbent local exchange carriers should use support received from new support mechanisms to reduce implicit support in interstate access charges.[95] The goal of converting support flows that may currently be implicit in interstate rates into explicit support, while also statutorily mandated, is distinct from the goal of assuring that federal support is available to ensure reasonably comparable intrastate rates. Thus, the support that we discuss in this section is different from the support that is described in sections IV(A)(1) and IV(B) of this Order.

42. In the *Second Recommended Decision*, the Joint Board recognized that the Commission has jurisdiction to determine whether interstate access rates contain implicit universal service high-cost support.[96] The Joint Board also recognized that, if implicit support does exist in interstate access rates, then the Commission has the authority to make such support explicit.[97] 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. 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),

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[92] 47 U.S.C. § 254(e). *See* Joint Explanatory Statement of the Committee of the Conference (H.R. Rep. No. 458, 104th Cong., 2d Sess.) at 131.

[93] *First Report and Order*, 12 FCC Rcd at 8782, para. 6; *see generally Access Charge Reform Order*, 12 FCC Rcd 15982.

[94] *First Report and Order*, 12 FCC Rcd at 8786, para. 15; *Access Charge Reform Order*, 12 FCC Rcd at 15986-87, paras. 5-9.

[95] *Access Charge Reform Order*, 12 FCC Rcd at 16148, para. 381

[96] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

[97] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

presubscribed interexchange carrier charge (PICC), or subscriber line charge (SLC).[98] Second, any reductions in interstate access rates should benefit consumers.[99] Third, universal service should bear no more than a reasonable share of joint and common costs.[100] Fourth, reasonable comparability should not be jeopardized, and neither consumers in general nor particular classes of consumers should be harmed.[101] Fifth, the Commission should consult with the Joint Board before taking any final action on removing implicit support from interstate access charges.[102]

b. Discussion

43. We agree with the Joint Board that the Commission has the jurisdiction and responsibility to identify support for universal service that is implicit in interstate access charges. Moreover, we agree with the Joint Board that it is part of our statutory mandate that any such support, to the extent possible, be made explicit. In this proceeding and in our pending *Access Charge Reform* proceeding, we are endeavoring to identify the types of implicit support in interstate access charges and the amount of that support. As we move forward with our efforts to reform interstate access charges, we will develop additional information on the costs of interstate access necessary to evaluate the Joint Board's recommendations in this area and the associated record. The overwhelming majority of commenters addressing the Joint Board's recommendations, however, agree that interstate access rates contain implicit support that should be made explicit.[103] These commenters differ only as to the amount of their estimate of implicit support presently in access rates and the method for making it explicit.[104] We anticipate taking action in the fall of 1999 to resolve the issue of making interstate support explicit, and we will address the Joint Board's recommendations at that time. Although, as explained above, the statutory goal of making explicit the support that is currently implicit in interstate access charges is distinct from the

[98] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

[99] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

[100] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23. *See also* 47 U.S.C. 254(k).

[101] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

[102] *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

[103] BellSouth comments at 3; California Commission comments at 5; Comptel comments at 3; GTE comments at 4-7; MCI WorldCom comments at 3-9; RTC comments at 25; SBC comments at 3; TRA comments at 4; USTA comments at 2-5; US West comments at 10-12; Western Wireless comments at 6. *See also* CWA reply comments at 6. *But see* Colorado Commission comments at 4 (stating that the Colorado Commission "disagrees with any notion that support received from federal high-cost support mechanisms be used to lower interstate access charges").

[104] *See, e.g.*, California Commission comments at 5 (stating that the Commission should proceed cautiously in removing implicit support from interstate access rates); BellSouth comments at 3 (stating that the Commission should move quickly to address implicit support in interstate access rates).

statutory goal of ensuring reasonably comparable intrastate rates,[105] we nevertheless recognize the close relationship between the implementation of the permanent revised support mechanism on January 1, 2000 and the *Access Charge Reform* proceeding. We therefore intend to move ahead with access reform in tandem with the implementation of the revised methodology. In the FNPRM, we seek comment on how, once we determine the amount of implicit support, we should target any reductions in interstate access charges to account for increased high-cost support.[106]

4. Making Intrastate Support Explicit

a. Background

44. As discussed above, Congress envisioned that the Commission and the states would share responsibility for implementing universal service reform, and it gave the states specific authority to create intrastate universal service support mechanisms.[107] In the *Second Recommended Decision*, the Joint Board found that this shared responsibility demonstrated Congress's intent to preserve the states' historical jurisdiction and responsibility to address issues of implicit support through rate design and other state mechanisms.[108] The Joint Board concluded that the federal support mechanism should not be contingent on, nor require, any particular action by the states.[109] Based on this conclusion, the Joint Board determined that the Commission should not require a state to establish an explicit intrastate universal service support mechanism.[110] The Joint Board acknowledged, however, that the competitive forces that prompted Congress to favor explicit interstate support may also lead states to establish explicit intrastate support mechanisms, although the Joint Board found no requirement in the 1996 Act that states do so.[111]

b. Discussion

45. Historically, states have ensured universal service principally through implicit support mechanisms, such as geographic rate averaging and above-cost pricing of vertical

[105] Our approach to making federal support available to help ensure reasonably comparable intrastate rates is discussed in sections IV(A)(1) and IV(B) of this Order.

[106] *See* section V(E), *infra*.

[107] *See* 47 U.S.C. § 254(f).

[108] *Second Recommended Decision*, 13 FCC Rcd at 24755-56, paras. 24-26.

[109] *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

[110] *Second Recommended Decision*, 13 FCC Rcd at 24755-56, para. 24.

[111] *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

services, such as call waiting, voice mail, and caller ID.[112] We agree with the Joint Board that the 1996 Act does not require states to adopt explicit universal service support mechanisms.[113] Section 254(e) does not specifically mention state support mechanisms. Section 254(b)(5) declares that "[t]here *should* be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[114] Section 254(f) provides that states "*may* adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service."[115] The permissive language in both of these sections demonstrates that Congress did not require states to establish explicit universal service support mechanisms. Accordingly, our actions today are consistent with the directives of the 1996 Act.

46. As the Joint Board acknowledged, however, the development of competition in local markets is likely to erode states' ability to support universal service through implicit mechanisms. We agree with the Joint Board that the erosion of intrastate implicit support does not mean that federal support must be provided to replace implicit intrastate support that is eroded by competition. Indeed, it would be unfair to expect the federal support mechanism, which by its very nature operates by transferring funds among jurisdictions, to bear the support burden that has historically been borne within a state by intrastate, implicit support mechanisms. The Joint Board stated that states "possess the jurisdiction and responsibility to address these implicit support issues through appropriate rate design and other mechanisms within a state,"[116] and it concluded that states "should bear the responsibility for the design of intrastate funding mechanisms."[117] The Joint Board's position is consistent with the methodology that it recommended for determining federal support levels. That methodology does not mandate any particular state action, but assumes that states will take some action, whether through rate design or through an explicit support mechanism, to support universal service within the state, and provides for federal support where such state efforts would be insufficient to achieve reasonable comparability of rates.[118] We will continue to monitor state efforts at eliminating implicit support and will consider additional measures should state efforts be insufficient in this regard.

B. Methodology for Estimating Costs and Computing Support

47. We are adopting the majority of the Joint Board's recommendations for a revised

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[112] *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 25.

[113] *See also* GTE comments at 15; New York Commission comments at 4; Sprint comments at 5.

[114] 47 U.S.C. § 254(b)(5) (emphasis added).

[115] 47 U.S.C. § 254(f) (emphasis added).

[116] *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 25.

[117] *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

[118] *Second Recommended Decision*, 13 FCC Rcd at 24760-62, paras. 37, 42-44.

methodology for estimating costs and calculating federal support levels to enable reasonably comparable local rates for non-rural carriers. We are seeking further comment, however, on specific implementation issues in the attached FNPRM.[119] We conclude that the revised universal service high-cost support mechanism shall take effect on January 1, 2000. We anticipate that by January 1, 2000, the Commission will have made final determinations on all outstanding issues raised in the FNPRM, and all verification of the cost model that will be used to estimate the forward-looking costs of providing supported services will have been completed.

48. Specifically, we adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services.[120] We also adopt the Joint Board's general recommendation that the methodology should rely primarily on states to achieve reasonably comparable rates within their borders, while providing support for above-average costs to the extent that such costs prevent the state from enabling reasonable comparability of rates.[121] We further adopt the Joint Board's recommendations that this explicit federal support mechanism should not be significantly larger than the current explicit federal mechanism.[122] Finally, while we endorse the concept of a hold-harmless provision in this Order, we are seeking more specific comment in the FNPRM on how a hold-harmless provision should be implemented.[123] 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.[124]

1. Forward-Looking Economic Costs

a. Background

49. In both *Recommended Decisions*, the Joint Board recommended that the Commission calculate federal high-cost support for non-rural carriers based on forward-looking economic costs, instead of on incumbent carriers' book costs of providing the

[119] *See* section V, *infra*.

[120] *Second Recommended Decision*, 13 FCC Rcd at 24757, para. 28.

[121] *Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 41-46.

[122] *Second Recommended Decision*, 13 FCC Rcd at 24762-64, paras. 47-50.

[123] *See* section V(D), *infra*.

[124] *See* sections (V)(B)(1), (2), *infra*.

supported services.[125] The Joint Board further encouraged the states and the Commission to work with the Joint Board to develop an accurate cost model for estimating forward-looking costs, in recognition of the fact that the cost model was not yet finalized at the time of the *Second Recommended Decision*.[126] The Joint Board also recommended that the Commission reconsider its decision in the *First Report and Order* to allow state cost studies to be used in place of the federal model for non-rural carriers.[127]

b. Discussion

50. We adopt the Joint Board's recommendation that support calculations be based on forward-looking costs, and that those costs be estimated using a single national model. As we stated in the *First Report and Order*, a methodology based on forward-looking economic costs will "send the correct signals for entry, investment, and innovation in the long run."[128] Many commenters support the use of forward-looking economic costs as the basis for estimating the costs of providing the supported services,[129] because the use of forward-looking economic costs will encourage efficient entry and investment. The use of a carrier's book costs, by contrast, would not allocate support in a competitively neutral manner among potentially competing carriers.[130] Instead, such a system would tend to distort support payments because current book costs are influenced by a variety of carrier-specific factors, such as the age of the plant, depreciation rates, efficiency of design, and other factors. 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.[131] To achieve universal service in a competitive market, support should be based on the costs that drive market decisions, and those costs are forward-looking costs.

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[125] *First Recommended Decision*, 12 FCC Rcd at 184, para. 184; *Second Recommended Decision*, 13 FCC Rcd at 24756-58, paras. 27-30. The Joint Board noted, however, that a proxy cost model's determination of forward-looking costs to provide the supported services does not determine the amount of support that will be needed in the aggregate or that any given carrier will receive. *Second Recommended Decision*, 13 FCC Rcd at 24757, para. 28 n.41 (citing *Platform Order*, 13 FCC Rcd at 21324-25, para. 2).

[126] *Second Recommended Decision*, 13 FCC Rcd at 24757-58, para. 29.

[127] *Second Recommended Decision*, 13 FCC Rcd at 24758, para. 31. *See First Report and Order*, 12 FCC Rcd at 8912, para. 248.

[128] *See First Report and Order*, 12 FCC Rcd at 8899, 8927, paras. 224, 273.

[129] AT&T comments at 3; District of Columbia Commission comments at 7; GSA comments at 7; MCI WorldCom comments at 11; Ohio Consumers' Counsel comments at 5; TRA comments at 3-4; Wyoming comments at 3. *But see, e.g.* Bell Atlantic comments at 6; Colorado Commission comments at 1; Harris Skrivan & Associates comments at 1.

[130] *See, e.g.*, AT&T comments at 3.

[131] *See* 47 U.S.C. § 254(b)(5).

51. Although we believe that forward-looking costs will set support levels most efficiently, we decline to adopt a suggestion of the Ohio Consumers' Counsel that carriers should receive the lesser of either current amounts of high-cost support or a forward-looking economic cost model-based amount.[132] The hold-harmless provision set forth in section IV(B)(4) of this Order is intended to prevent dislocation and rate shocks as we make the transition to a support system based on forward-looking costs.[133] As noted below in section IV(F), we intend for the Joint Board and the Commission to re-evaluate non-rural carriers' support mechanisms, including the hold-harmless provision, three years from the date that the revised mechanism is implemented.[134]

52. Although some commenters have expressed concerns about the accuracy of the outputs of the cost model,[135] we agree with the Joint Board that a national forward-looking model will provide a more consistent approach by which to develop a method for measuring rate comparability than would individual state cost studies. We believe state cost studies could rely on differing forward-looking cost methodologies, including differing assumptions or input data elements that would prevent meaningful comparisons of the resulting forward-looking cost estimates, and thus would provide a less accurate and consistent picture by which we could evaluate the cost levels that must be supported in each state to develop reasonably comparable rates. Therefore, we reject the use of state cost studies for the purpose of developing our method for rate comparability. States, of course, retain the flexibility to design state-level support mechanisms using other indicators of cost.

53. At this time, however, there has not been adequate time to verify the results of the cost model and to verify that certain input data elements are accurate. Thus, we cannot implement immediately a revised high-cost support mechanism based on forward-looking economic costs. We anticipate that the model and the input data will be verified and ready for use by January 1, 2000.

54. The Joint Board recommended that, if the Commission did not implement a forward-looking support mechanism on July 1, 1999 to enable the reasonable comparability of non-rural carriers' rates, the Commission should provide interim relief to high-cost states served primarily by non-rural carriers.[136] In formulating this Order, we have continued to consult with the state Joint Board members, and they recently filed a letter stating that the

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[132] Ohio Consumers' Counsel comments at 5.

[133] *See* section IV(B)(4), *infra*.

[134] *See* section IV(F), *infra*.

[135] The Illinois Commission disagrees with the Joint Board's recommendations that a federal proxy model be used, and raises concerns about the accuracy of the proxy models, particularly while the Commission has not yet determined the input values. Illinois Commission comments at 2-3.

[136] *Second Recommended Decision*, 13 FCC Rcd at 24757-58, para. 29.

Commission should not adopt an interim mechanism, given the brevity of the implementation delay that we adopt today.[137] The state Joint Board members state that they have been unable to develop a workable interim solution, and that the administrative complexity of overlaying changes in collection and disbursement onto the existing system for only six months does not appear prudent. In light of the state members' position on this issue, and the reasons they present in their letter, we conclude that we should not adopt an interim support mechanism at this time.

2. Shared Federal-State Responsibility for Reasonably Comparable Rates

a. Background

55. The Joint Board recognized in the *Second Recommended Decision* that states bear part of the responsibility for universal service. The Joint Board further stressed that implicit support in state rates is "intimately related to each state's rate design," and that the Commission may assume that states will address issues regarding implicit intrastate support in an appropriate manner.[138] To the extent that states face great burdens or obstacles in maintaining rates reasonably comparable to those prevalent nationally, the Joint Board explained that federal support could be applied to achieve such reasonable comparability.[139]

56. The Joint Board recommended that federal support should be available where a state cannot meet its own universal service burden to achieve rates that are reasonably comparable, but that federal support should not be conditioned on a state's actions with respect to universal service.[140] Specifically, the Joint Board recommended that federal support should be provided in a manner consistent with each state's ability to use its resources to address its universal service needs.[141]

b. Discussion

57. We agree with the Joint Board that the states share responsibility for universal service, and that states should have "specific, predictable, and sufficient" mechanisms in place to maintain and advance universal service.[142] We further agree with the Joint Board that,

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[137] *See* Letter of State Joint Board Members to William E. Kennard, Chairman, FCC, dated May 14, 1999.

[138] *Second Recommended Decision*, 13 FCC Rcd at 24760, para. 39.

[139] *Second Recommended Decision*, 13 FCC Rcd at 24760-61, para. 40.

[140] *Second Recommended Decision*, 13 FCC Rcd at 24759-60, para. 36.

[141] *Second Recommended Decision*, 13 FCC Rcd at 24759-60, para. 36.

[142] *Second Recommended Decision*, 13 FCC Rcd at 24759-60, paras. 36-38.

because rates are generally affordable, and subscribership is high in most parts of the country, federal involvement may be limited to instances where states face significant obstacles in maintaining reasonably comparable rates.[143] Because affordability is closely tied to local rate levels, established and regulated by the states, we conclude that states are well-positioned to adopt local rate structures and intrastate universal service support mechanisms that maintain affordable and reasonably comparable rates on a statewide basis. Federal mechanisms, in contrast, will assure that these goals are met nationally by providing support to those states where the cost of providing the supported services substantially exceed the national average. We find that the appropriate balance of responsibility for enabling reasonably comparable local rates can be struck through the methodology recommended by the Joint Board. Accordingly, as explained more fully in paragraph 34, above, we reconsider and reject the decision in the *First Report and Order* that the federal share of support should be limited to 25 percent of the difference between the forward-looking cost of providing the supported services and a national benchmark, and directed only to the interstate jurisdiction.[144]

3. Determination of Federal Support Amounts

a. Background

58. The Joint Board recognized that some states may face significant difficulty in maintaining reasonably comparable rates, and therefore indicated that federal support would be necessary to enable states to achieve reasonably comparable rates, as required by section 254(b)(3) of the Act.[145] Accordingly, the Joint Board considered various options and concluded that the methodology for determining federal support should: (1) use a cost-based benchmark; and (2) consider each state's ability to support its universal service needs.[146] Specifically, in the *Second Recommended Decision*, the Joint Board recommended that the support methodology should identify: (1) study areas with average forward-looking per-line costs significantly in excess of the national average forward-looking cost (cost-based benchmark);[147] and (2) a state's ability to support its universal service needs internally.[148] Federal support would then be provided only to the extent that a state could not internally

[143] *Second Recommended Decision*, 13 FCC Rcd at 24760-61, para. 40.

[144] *See First Report and Order*, 12 FCC Rcd at 8925, para. 269.

[145] *Second Recommended Decision*, 13 FCC Rcd at 24760-61, para. 40.

[146] *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 41.

[147] In the *First Report and Order*, the Commission adopted the Joint Board's initial recommendation that, in determining high-cost support for non-rural carriers, the nationwide average revenue per line is a reasonable benchmark to use. *See First Report and Order*, 12 FCC Rcd at 8919-22, paras. 257-64. In this Order, we reconsider the use of a revenue-based benchmark, and decide instead to adopt a cost-based benchmark, consistent with the Joint Board's recommendations. *See Second Recommended Decision*, 13 FCC Rcd at 24761, para. 41.

[148] *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 42.

support its costs exceeding the benchmark.[149]

59. With respect to the first step of the methodology, the Joint Board recommended that the Commission consider setting the national benchmark at a level between 115 and 150 percent of the national average cost per line.[150] The Joint Board supported using a cost-based benchmark, as opposed to one based on revenues, in evaluating rate comparability because state jurisdictions vary in how they set local rates.[151] The Joint Board explained that such a cost benchmark could be used to identify study areas in which costs significantly exceed the national average.[152]

60. In the second step of the methodology, the Joint Board concluded that federal support should be available to the extent that the state is not able to achieve reasonable comparability of rates using its own resources. The Joint Board discussed various potential ways to estimate a state's internal ability to achieve rate comparability, including calculating the ratio of high-cost to low-cost lines, or the ratio of intrastate traffic volume to total traffic volume.[153] In the alternative, the Joint Board stated that the Commission could determine the state's support responsibility as a certain percentage of intrastate revenues, or as a fixed amount per line.[154] Finally, the Joint Board recognized that it could not recommend specific details of the methodology because the model's cost estimates were not yet finalized.[155]

b. Discussion

(1) Determining the National Benchmark

61. We adopt the Joint Board's recommendation that federal high-cost intrastate

[149] *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 42.

[150] *See Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

[151] *See Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

[152] *See Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

[153] *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 44.

[154] *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 44. For example, if the Commission were to determine a limit on a state's presumed responsibility at between three and six percent of intrastate telecommunications revenues, the Joint Board noted that, once the first step in the methodology had estimated the amount by which costs in the study areas in the state exceed the cost benchmark, the percentage of intrastate revenues would be calculated that would be required to meet this high-cost responsibility. *Id.* at para. 45. Federal support would be provided for the amount exceeding the state revenue threshold.

[155] *See Second Recommended Decision*, 13 FCC Rcd at 24762, para. 46. The Joint Board recommended that the Commission continue to consult with it and with Congress in order to specify the parameters of the methodology, as the amount of study area costs is derived from the Commission's model and choice of inputs. *Id.*

support should be determined using a cost-based benchmark and should be provided where states are unable to provide sufficient intrastate universal service support to non-rural carriers with costs that exceed a national benchmark. In so doing, we reconsider and reject the determination in the *First Report and Order* that federal support for rate comparability should be determined using a revenue-based benchmark.[156] Given the focus of the *Second Recommended Decision* on rate comparability, and its recommendation that the Commission should rely on the cost of providing the supported services when determining support amounts, rather than local rates, we believe that a cost-based benchmark is more appropriate.[157] We agree with the Joint Board's re-examination of this issue and its departure in the *Second Recommended Decision* from its original recommendation that a cost-based benchmark should not be used. We have continued to coordinate with the Joint Board in developing specific details of the methodology for determining high-cost support for non-rural carriers.

62. In the first step of the revised support methodology, areas will be identified where the forward-looking cost of providing the supported services exceeds the benchmark amount. We agree with the Joint Board that a cost-based benchmark provides a better gauge with which to identify areas in need of support to enable reasonably comparable rates than would a revenue benchmark. Contrary to the assertions of some commenters,[158] revenues may not accurately reflect the level of need for support to enable reasonably comparable rates because states have varying rate-setting methods and goals.[159] At this time, however, we are seeking further comment in the attached FNPRM on the specific level at which the cost-based benchmark should be set when the revised support mechanism goes into effect on January 1, 2000.[160]

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[156] *First Report and Order*, 12 FCC Rcd at 8919-24, paras. 257-267.

[157] *See Second Recommended Decision*, 13 FCC Rcd at 24754 , para. 19. In the *First Report and Order*, the Commission reasoned that a revenue benchmark was appropriate because, among other things, a revenue benchmark would also include revenues from discretionary (non-supported) services, and these revenues should, and do, contribute to the joint and common costs of providing the supported services. *First Report and Order*, 12 FCC Rcd at 8920-21, paras. 260-262. We now believe, however, that the use of a revenue benchmark is becoming an administratively unworkable approach, given that carriers may now be bundling the supported services with services that are not provided on the supported network, such as long distance services, wireless services, and Internet access services.

[158] *See, e.g.*, BellSouth comments at 7-8 (arguing that use of cost benchmark with analysis of a state's ability to fund its own universal service needs is contrary to intent of Section 254); Kentucky Commission comments at 3 (asserting that the Joint Board has not provided explanations as to why a cost-based benchmark is preferable to a revenue-based benchmark); MCI WorldCom comments at 11-12 (asserting that the only meaningful benchmark to use is the projected revenue that would be generated if rates were set at affordable and reasonably comparable levels).

[159] *See Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19; Bell Atlantic comments at 4; ITCs comments at 3-4; Sprint comments at 11-13.

[160] *See* section V(B)(1), *infra*.

(2) Determining a State's Ability to Support its High-Cost Areas

63. We further agree with the Joint Board that federal support should be available to enable local rate comparability if the state cannot do so on its own, and thus that federal support for this purpose should be determined based, in part, on a state's ability to support its universal service needs internally.[161] Given the difficulties in determining a state's ability to support its high-cost areas, and after extensive consultation with the Joint Board, we have concluded that a set dollar amount per line is an appropriate method by which to ascertain a state's internal ability to achieve rate comparability. We agree with the Maine Commission that a fixed dollar amount per line is a reasonably specific and certain method by which to determine a state's share of responsibility for universal service support.[162] We also believe that using a fixed dollar amount per line is an administratively simple methodology that can be applied in a consistent manner to all states. In this Order, however, we have not set a specific per-line dollar amount. Rather, we seek further comment on the set dollar amount that should be used to define a state's responsibility in the FNPRM.[163]

64. We agree in principle with those commenters that assert that using a fixed percentage of each state's intrastate revenues as the level of the state's responsibility for its universal service needs could unduly burden high-cost states that also have high intrastate revenues because they currently have high rates due to high costs.[164] However a state chooses to bear its universal service burden (*i.e.*, through existing, implicit rate designs or through an explicit support mechanism), the ability to spread the burden over a larger number of lines will make the burden easier for a state to bear. In contrast, using the ratio of high-cost to low-cost lines, one method suggested by the Joint Board, may not be as predictable as using a fixed dollar amount per line, because the number of high-cost to low-cost lines may fluctuate over time. Using the ratio of high-cost to low-cost lines also would be an administratively difficult method of determining a state's internal ability to achieve rate comparability, given the fact that supporting data would need to be obtained from a variety of sources in each state. Finally, the Joint Board's recommendation that intrastate support be calculated as a percentage of intrastate telecommunications revenues was based in part on its judgment that intrastate telecommunications revenues provide a rough measure of the funds available to support intrastate mechanisms. Because we have decided to adopt a cost-based benchmark rather than a benchmark that is based on revenues, we do not believe that a percentage-based cap on intrastate responsibility would in every case provide a meaningful measure of a state's ability to fund intrastate support.

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[161] *See Second Recommended Decision*, 13 FCC Rcd at 24761-62, paras. 42, 44.

[162] *See* Maine Commission *et al.* comments at 6.

[163] *See* section V(B)(3), *infra*.

[164] *See, e.g.*, Iowa Commission comments at 8-9; Maine Commission *et al.* comments at 6.

65. We emphasize that states are not, through the adoption of this approach, required to impose a per-line charge to support universal service, nor are carriers necessarily entitled to recover this amount from new or explicit state mechanisms. As the Joint Board explained, this amount reflects a reasonable estimate of the state's ability to achieve reasonably comparable rates on a statewide basis and establishes a level above which federal support, consisting of funds transferred from other jurisdictions, should be provided to assist the state in achieving rates that are reasonably comparable to those in other states. States largely are already making use of this ability by providing carriers with substantial universal service support, often through rate averaging and other rate design methodologies, and states are best positioned to determine how and whether these mechanisms need to be altered to ensure that carriers do not double-recover universal service support. Given the substantial amounts of universal service support already built into state rate designs, we agree with the Joint Board that providing the full amount of support determined by the federal methodology from federal mechanisms, without any estimate of state support, is likely to lead to carrier double-recovery.[165]

66. Thus, in the second step of the revised support methodology, an assessment will be made as to whether the perceived support need, as established in the first step of the methodology, exceeds the state's ability to achieve reasonable comparability of rates. The state's ability will be estimated by multiplying a dollar figure by the number of lines served by non-rural carriers in the state. Any needed support that exceeds this estimate of the state's ability to support its own high-cost areas will be provided by the federal mechanism. In this way, the mechanism will ensure that every state will have adequate resources to ensure reasonably comparable rates.

4. Size of the Federal Support Mechanism and Hold-Harmless

a. Background

67. The Joint Board concluded in the *Second Recommended Decision* that federal high-cost support mechanisms should be only as large as necessary, consistent with other requirements of the law.[166] Specifically, the Joint Board observed that, although federal support must be sufficient to enable reasonable comparability of rates, it did not believe that current conditions required a significantly larger federal support mechanism than currently exists to meet these ends.[167] The Joint Board recommended that the Commission consider a "phase-in" of any increase in federal support intended to enable reasonable comparability of local rates for non-rural carriers, depending on the final amounts that are estimated on a

[165] *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

[166] *Second Recommended Decision*, 13 FCC Rcd at 24762-63, para. 47.

[167] *Second Recommended Decision*, 13 FCC Rcd at 24763, para. 49.

forward-looking basis.[168] At the same time, the Joint Board expressed in the *Second Recommended Decision* its support for "the Commission's commitment to continue to hold states harmless, so that no non-rural carrier, including the Puerto Rico Telephone Company, will receive less federal high-cost assistance than the amount it currently receives from explicit support mechanisms."[169]

b. Discussion

68. In this Order, we adopt the recommendation of the Joint Board that a hold-harmless provision should be implemented to prevent substantial reductions of federal support and potentially significant rate increases.[170] Adoption of a hold-harmless provision will both serve to avoid any potential rate shock when the new federal support mechanism goes into effect, and to prevent undue disruption of state rate designs that may have been constructed upon, and thus are dependent upon, current federal high-cost support flows. We agree with the Joint Board that the hold-harmless amounts should be provided in lieu of the amounts computed by the two-step forward-looking methodology described in section IV(B)(3), above, whenever the hold-harmless amount exceeds the amount indicated by the forward-looking methodology. While we generally agree that a hold-harmless mechanism should be adopted, we are seeking further comment on specific implementation issues associated with the hold-harmless provisions in the FNPRM, and in particular, whether the hold-harmless mechanism should ensure that states as a whole, or carriers in particular, do not experience reductions in federal support.[171]

69. In determining the size of the new federal mechanism to enable reasonably comparable local rates, we must fulfill our statutory obligation to assure sufficient, specific, and predictable universal service support without imposing an undue burden on carriers and, potentially, consumers to fund any increases in federal support. Because increased federal support would result in increased contributions and could increase rates for some consumers, we are hesitant to mandate large increases in explicit federal support for local rates in the absence of clear evidence that such increases are necessary either to preserve universal

[168] *Second Recommended Decision*, 13 FCC Rcd at 24764, para. 53.

[169] *Second Recommended Decision*, 13 FCC Rcd at 24764, para. 53.

[170] *Second Recommended Decision*, 13 FCC Rcd at 24763, para. 51. Many commenters support the Joint Board's recommendation. *See, e.g.*, GTE comments at 22-23 (supporting hold-harmless and suggesting that a frozen per-line amount of support be the floor for the average per-line support provided in non-rural areas); Puerto Rico Telephone Company comments at 3 (stating that the hold-harmless pledge is particularly important to Puerto Rico, given its low penetration rates); RTC comments at 10 (asserting that hold-harmless will provide a reasonable level of support to states and carriers and will prevent rate shock); SBC comments at 6 (supporting holding states harmless so that no non-rural carrier receives less federal high-cost support than the amount it currently receives from explicit support mechanisms); Vitelco comments at 4 (supporting hold-harmless so that subscribers in the U.S. Virgin Islands will not experience drastic rate increases).

[171] *See* section V(D), *infra*.

service, or to protect affordable and reasonably comparable rates, consistent with the development of efficient competition.[172] Rather, we agree with the Joint Board that current conditions do not necessitate substantial increases in federal support for local rates. We believe that limiting the amount of new support that each state receives under the new mechanism is consistent with the Joint Board's recommendation that the amount of such federal support should not increase significantly.[173]

70. The Joint Board initially recommended that having the federal mechanism calculate support using study-area average costs would be one way roughly to maintain the current size of the federal mechanism.[174] Indeed, the current system calculates costs using study area-averaged costs. While we agree with the Joint Board that there is no current need for large increases in the size of the federal support mechanism for local rates, we are seeking further comment in the FNPRM on whether it is equally important, even at this early stage in the development of local competition, to provide support that is calculated at a more granular level.[175] Given that telephone service currently is largely affordable, and any significant increase in the size of federal support for local rates appears unnecessary,[176] we conclude that we should limit the size of the federal mechanism, as recommended by the Joint Board. We seek further comment in the FNPRM, however, on how we can best achieve this goal.[177]

5. Portability of Support

71. In the *Second Recommended Decision*, the Joint Board recommended that the Commission maintain the policy established in the *First Report and Order* of making high-cost support available to all eligible telecommunications carriers, whether they be incumbent LECs, competitive carriers, or wireless carriers.[178] The Joint Board stated that portable support is consistent with the principle of competitive neutrality, and expressed its continued support for competitive neutrality as a guiding principle of universal service reform.[179] GTE

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[172] *See* D.C. Commission comments at 3-4. *See also* Ameritech comments at 6-7; Maryland Commission *et al.* comments at 5-6; New York Commission comments at 3; Ohio Consumers' Counsel comments at 2-3.

[173] *Second Recommended Decision*, 13 FCC Rcd at 24762-63, para. 47.

[174] *Second Recommended Decision*, 13 FCC Rcd at 24763, para. 50.

[175] *See* section V(B)(2), *infra*.

[176] *See* Maryland Commission *et al.* comments at 5-6.

[177] *See* section V(B)(2), *infra*.

[178] *Second Recommended Decision*, 13 FCC Rcd at 24765-66, para. 56. The Joint Board also reaffirmed the policy that a carrier offering universal service solely through reselling another carrier's universal service package should not be eligible to receive universal service support. *Id.* at 24765, n.60 (citing *First Report and Order*, 12 FCC Rcd at 8861-62, paras. 151-152).

[179] *Second Recommended Decision*, 13 FCC Rcd at 24765-66, para. 56.

and USTA expressed general support for this recommendation.[180]

72. We conclude, consistent with the Joint Board's recommendation, that the policy the Commission established in the *First Report and Order* of making support available to all eligible telecommunications carriers should continue.[181] All carriers, including commercial mobile radio service (CMRS) carriers, that provide the supported services, regardless of the technology used, are eligible for ETC status under section 214(e)(1).[182] We reiterate that the plain language of section 214(e)(1) prohibits the Commission or the states from adopting additional eligibility criteria beyond those enumerated in section 214(e)(1).[183] We also reaffirm that under section 214(e), a state commission must designate a common carrier, including carriers that use wireless technologies, as an eligible carrier if it determines that the carrier has met the requirements of section 214(e)(1).[184] We re-emphasize that the limitation on a state's ability to regulate rates and entry by wireless service carriers under section 332(c)(3) does not allow the states to deny wireless carriers ETC status.[185]

73. We agree with the Joint Board that competitive neutrality is a fundamental principle of universal service reform, and that portability of support is necessary to ensure that universal service support is distributed in a competitively neutral manner. We also agree with US West that "portability" of support should not be used to divert federal funds from high-cost areas to other areas.[186] For this very reason, we conclude in section IV(B)(6), below, that all carriers, both incumbent LECs and competitive LECs, must use high-cost support in a manner consistent with section 254, and we seek comment in the FNPRM on ways in which to target portable support amounts to high-cost wire centers within each incumbent's study area.[187]

74. Although we adopt a hold-harmless provision in section IV(B)(4), above, we do not believe that the Joint Board intended incumbent LECs to be held harmless for federal high-cost support amounts that they lose when a customer elects to switch carriers and begins taking service from a competitive LEC. Such a conclusion would contravene the Joint Board's desire that competitive neutrality be a driving force behind universal service reform.

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[180] GTE comments at 28; USTA comments at 9.

[181] *See First Report and Order*, 12 FCC Rcd at 8861-62, paras. 151-52.

[182] *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

[183] *First Report and Order*, 12 FCC Rcd at 8847, para. 127.

[184] *First Report and Order*, 12 FCC Rcd at 8851-52, para. 135.

[185] *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

[186] US West comments at 12.

[187] *See* section (V)(C), *infra*.

Moreover, it would eviscerate the concept of "portable" support if the loss of customers to a competitor did not change the incumbent's support amounts. We conclude, therefore, that incumbent LECs will not be held harmless for reductions in their federal high-cost support amounts that result from competitive LECs capturing that incumbent LEC's customers. In addition, a competitive LEC or other carrier that gains an incumbent LEC's customers, and hence any high-cost support that the incumbent LEC had received for those customers, may only use that support in a manner consistent with section 254.[188] We seek comment in the FNPRM on how and whether any hold-harmless support should be ported.[189]

6. Use of Support

a. Background

75. Section 254(e) of the 1996 Act requires that carriers receiving universal service support "shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[190] In the *Second Recommended Decision*, the Joint Board recommended that the Commission require carriers to certify that they will apply federal high-cost support in a manner consistent with section 254.[191] The Joint Board also recommended that the Commission should not require states to provide any certification as a "condition" on their carriers' receipt of high-cost support, but that the Commission should permit states to certify that, in order to receive federal universal service support, a carrier must use such funds in a manner consistent with section 254.[192] The Joint Board stated that, to the extent permitted by law, the Commission could reduce or eliminate federal high-cost support if the Commission or a state finds that a carrier has not applied its federal universal service funds in a manner consistent with section 254.[193] The Joint Board also recommended that the Commission clarify the procedures by which a party, including a state, may initiate action against a carrier that fails to apply federal universal service support in an appropriate manner.[194]

76. The Joint Board expressed its belief that conditioning support on a demonstration that funds are being used for the advancement of universal service does not place any

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[188] *See* section IV(B)(6), *infra*, for a discussion of the appropriate use of high-cost support.

[189] *See* section V(D), *infra*.

[190] 47 U.S.C. § 254(e).

[191] *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 57.

[192] *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 58.

[193] *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 59 (citing 47 U.S.C. § 254(e)).

[194] *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 59.

restrictions on the determination of a carrier's status as an eligible telecommunications carrier.[195] Finally, the Joint Board recommended that universal service support should continue to be distributed directly to carriers, rather than to state commissions. The Joint Board arrived at this recommendation based upon: (1) the long-standing policy prior to the 1996 Act of distributing support to carriers providing the supported services; (2) the absence of any affirmative evidence in the statute or legislative history that Congress intended a "fundamental shift" to a mechanism that would distribute funds to state commissions; (3) concerns about imposing substantial administrative burdens on states; and (4) concerns that there is very little time, prior to July 1, 1999, for states to take the steps necessary to administer the support mechanisms.[196]

b. Discussion

77. We conclude that carriers must apply federal high-cost universal service support in a manner consistent with section 254. Specifically, section 254(e) requires carriers to use universal service support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[197] We are seeking further comment in the FNPRM, however, on how, in concrete terms, we can best implement the Joint Board's recommendation that we ensure that carriers will use universal service support in a manner consistent with section 254.

78. We also conclude that, if we find that a carrier has not applied its universal service high-cost support in a manner consistent with section 254, we have the authority to take appropriate enforcement actions. States or other parties may petition the Commission, pursuant to section 208 of the Act, if such parties believe that a common carrier has misapplied its high-cost universal service support.[198] States or other parties should avail themselves of the Commission's formal complaint procedures if they believe that a common carrier is not using its federal universal service high-cost support in accordance with the directions we have set forth in this Order.[199] Because the Commission's statutory authority under section 208 extends to violations of the Act by all common carriers, we conclude that

[195] *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 60.

[196] *Second Recommended Decision*, 13 FCC Rcd at 24767, para. 61.

[197] 47 U.S.C. § 254(e).

[198] 47 U.S.C. § 208. Section 208 provides, *inter alia*, that "any person, any body politic or municipal organization, or State commission, complaining of anything done or omitted to be done by any common carrier subject to this Act, in contravention of the provisions thereof, may apply to said Commission by petition. . . ."

[199] The Commission's procedures for complaints involving common carriers are codified at 47 C.F.R. § 1.720, *et seq.*

all potential recipients of high-cost support would be subject to our enforcement jurisdiction.[200] Depending on the nature of the complaint, furthermore, a complaint filed by a party against a common carrier alleging misapplication of universal service high-cost support could qualify for resolution under the Commission's "accelerated docket" procedures.[201]

C. Carrier Recovery of Universal Service Contributions from Consumers

1. Background

79. In the *First Report and Order*, the Commission concluded that, in a dynamic telecommunications marketplace where pricing flexibility is an important competitive tool, carriers will need the ability to decide how they should recover their contributions to the federal universal service support mechanisms.[202] The Commission found that, as telecommunications carriers and providers begin combining various telecommunications products into single packages, they will be likely to offer bundled services and new pricing options, such as local and long distance service for a package price.[203] Therefore, the Commission decided to permit, but not to require, incumbent LECs whose interstate rates are under the Commission's jurisdiction to recover their contributions to the universal service support mechanisms from their interstate access and interexchange customers.[204] In doing so, the Commission declined to require that carriers recover their contributions from consumers through a mandatory end-user surcharge.[205] Instead, consistent with the Joint Board's recommendations, the Commission allowed interexchange carriers, wireless carriers, and competitive LECs to decide for themselves whether, and how, to recover their contributions from their customers.[206]

80. In the event that carriers decided to recover their contributions from their customers, the Commission required carriers to provide complete and truthful information on

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[200] *See generally Implementation of the Telecommunications Act of 1996, Amendment of Rules Governing Procedures to Be Followed When Formal Complaints Are Filed Against Common Carriers*, Report & Order, CC Dkt. No. 96-238, 12 FCC Rcd 22497 (1997). Standing is not an issue for parties seeking redress for violations of the Act.

[201] *See Implementation of the Telecommunications Act of 1996, Amendment of Rules Governing Procedures to be Followed when Formal Complaints are Filed against Common Carriers*, Second Report and Order, CC Docket No.96-238, 13 FCC Rcd 17018 (1998).

[202] *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

[203] *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

[204] *First Report and Order*, 12 FCC Rcd at 9199, para. 829.

[205] *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

[206] *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.