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Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45

AT&T REPLY TO OPPOSITIONS TO AND COMMENTS ON ITS PETITION FOR RECONSIDERATION

Pursuant to Section 1.429 of the Commission's Rules, 47 C.F.R. § 1.429, and the Commission's Public Notice (Report No. 2397), published in 65 Fed. Reg. 17879 (April 5, 2000), AT&T Corp. ("AT&T") submits this reply to oppositions to and comments on its petition for reconsideration of the Commission's Memorandum Opinion & Order and Seventeenth Order on Reconsideration, FCC 99-280, released October 13, 1999 ("*Seventeenth Reconsideration Order*") in its *Universal Service* proceedings.[1] In that order, the Commission reaffirmed its prior-year assessment methodology for universal service fund ("USF") contributions. As AT&T showed in its petition, that methodology systematically disadvantages certain carriers, violates statutory requirements, discourages local competition, and should be promptly reconsidered.

Bell Atlantic, BellSouth and U S WEST oppose AT&Ts' Petition primarily on procedural grounds, alleging that AT&T's filing is an untimely petition for

[1] Bell Atlantic, BellSouth Corporation ("BellSouth"), and U S WEST Communications, Inc. ("U S WEST") filed oppositions, while Hertz Technologies, Inc. ("Hertz"), Operator Communications, Inc. d/b/a Oncor Communications, Inc. ("Oncor") and the Telecommunications Resellers Association ("TRA") filed supporting comments.

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reconsideration of rulings issued at much earlier phases of this proceeding. AT&T anticipated this argument and addressed it in its petition (at n.1). AT&T candidly admitted that its petition addresses issues that were determined initially in the *Universal Service Order*.[2] Nonetheless, as AT&T demonstrated, because petitions for reconsideration of the *Universal Service Order* still remain pending, "the Commission retains jurisdiction to reconsider its own rules on its own motion."[3] Bell Atlantic (at 2), however, contends that this "procedural fig leaf" is unavailable because AT&T is itself pressing for reconsideration. The fact that AT&T has petitioned for reconsideration cannot and does not undermine the FCC's authority to act "on its own motion."[4] Indeed, if it did, it would mean that although the Commission recognized the need for and retains jurisdiction to modify an inequitable rule, it would be precluded from taking corrective action simply because a party also identified the problem and petitioned for relief.

As AT&T showed (at 2-3), Section 254(d) of the Telecommunications Act of 1996 requires that all interstate telecommunications service providers make an equitable and nondiscriminatory contribution to universal service support. The Commission's existing USF recovery mechanism – which assesses carriers' USF contribution obligation based on prior-year revenues – is profoundly anticompetitive and does not comply with this

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2 *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776 (1997) ("*Universal Service Order*").

3 *Changes to the Board of Directors of the National Exchange Carrier Association, Inc.; Federal-State Joint Board on Universal Service,* CC Docket Nos. 97-21 and 96-45, Second Order on Reconsideration in CC Docket No. 97-21, FCC 97-400, ¶ 3, n.8 (Nov. 26, 1998) (citations omitted).

4 *Central Florida Enterprises, Inc. v. FCC*, 598 F2d 37, 48, n.51 (D.C. Cir. 1978), *cert. dismissed,* 441 U.S. 957 (1979).

statutory directive because it means that carriers with declining interstate revenues will be systematically disadvantaged as compared to carriers with increasing interstate revenues. Specifically, it will put interexchange carriers ("IXCs"), who must compete with Regional Bell Operating Companies ("RBOCs") as they gain entry into the long distance market, at a severe and untenable competitive disadvantage because, under the Commission's prior-year assessment and contribution methodology, the RBOCs will escape contributions for one year on their increasing retail interstate long distance revenues after in-region entry.[5] In addition, in subsequent years of their ramp-up in the long distance market, their USF assessments, and corresponding contributions, will be based on their lower prior-year interstate revenues. To the extent the RBOCs increase market share following in-region entry, the revenue base for recovery of their USF obligations will always be greater than the revenue base on which their USF obligations were assessed. In fact, the RBOCs will be able to use this discrepancy to finance their market share growth. By contrast, IXCs will be in precisely the reverse situation: they will be forced to recover the USF assessments made against a larger prior-year revenue base from a diminishing long distance customer base.

Consequently, as AT&T showed (at 3-4), the RBOCs would enjoy an extraordinary cost and pricing advantage for long distance or an all-distance bundle. Given that the RBOCs would not have any incremental USF costs for the first year after they gain in-region entry into the interLATA market, an RBOC could, for example, offer a customer a long distance service or an all-distance bundle waiving USF charges for 12 months,

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[5] Instead, the RBOCs will make their USF contributions for the first year after in-region entry based exclusively on their prior-year revenues from the subscriber line charge ("SLC"), special access and such limited corridor service that an RBOC was previously permitted to provide.

effectively giving the customer a substantial discount off of an IXC's rate which includes the recovery of USF obligations. That in itself is a powerful offer subsidized by the IXC who lost the business. It would not be possible for AT&T to match this offer except by absorbing its own real USF costs, a tactic that could not last long in a competitive market.[6] Predictably, customers will select those carriers that can offer the most attractive package to meet their overall telecommunications service needs. Not only do IXCs have to make substantial investments to enter local markets, but they will be handicapped in their ability to price favorably compared to the incumbent, if they are disparately burdened with USF assessments, as they are under the Commission's current scheme. Such an assessment is not competitively neutral and is totally at odds with both the requirements of Section 254 and the fundamental objective of the 1996 Telecommunications Act to open all markets, and most particularly *local* markets, to competition.

Bell Atlantic (at 1), one of the would-be beneficiaries of this rule, nonetheless attacks AT&T's petition as an "unsupportable effort by AT&T to complicate universal service assessments and insulate itself from competitive losses." To the contrary, neither AT&T nor any other carrier operating in a competitive market can insulate itself from competitive losses so the very premise of Bell Atlantic's assertion is false. Bell Atlantic (at 3) then cites to the Commission's ruling in the *Seventeenth Reconsideration Order* (¶ 21) that the "fact that some carriers may have difficulty recovering their contributions from a declining customer base is the product of a

[6] Alternatively, an RBOC could opt to assess a USF charge against its end-user long distance customers (as Bell Atlantic has done in New York) even before it has a contribution obligation on its long distance revenues and thereby increase its profits and ability to cross-subsidize other offerings.

competitive marketplace, not an inequitable, discriminatory, or competitively-biased Commission rule." This finding is incorrect and must be reconsidered. As Hertz (at 6) explains correctly, the fact that "some carriers are experiencing declines in market share and revenues is undoubtedly attributable to market forces that are independent of the Commission's rules. *It does not follow, however, that the Commission's rules, when applied to these pre-existing market conditions, have no separate or distinct competitive effect.*" (emphasis added).

Oncor (at 2) demonstrates that the "economic effect of the current system of universal service funding on carriers whose revenues are declining is to increase the percentage of a carrier's current year revenues which must be paid to support universal service." *Accord* Hertz (at 2-3). This creates a distinct advantage to each RBOC after it gains in-region entry, an advantage that cannot be explained away by the fact that other long distance carriers will likely rapidly lose market share to these new entrants. The FCC rule itself necessarily "punishes carriers with declining revenues and rewards those with increasing revenues." Hertz at 5. The Commission did not consider these particular impacts in establishing the rule. Oncor at 4. Moreover, as TRA (at 4-5) points out, this anticompetitive effect is further exacerbated by the Fifth Circuit ruling excluding intrastate revenues from the federal USF assessment base.[7] Had the Court affirmed the Commission's authority to assess interstate carriers based on their combined interstate and intrastate revenues and had the Commission adopted the Joint Board's *Second Recommended*

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[7] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir.1999), *petitions for rehearing and rehearing en banc denied* (Sept. 28, 1999), *petitions for certiorari pending sub nom AT&T Corp. and MCI WorldCom Corp. v. Cincinnati Bell Telephone Company,* No. 99-1249 (January 26, 2000).

Decision[8] to assess the high-cost and low-income programs based on carriers' combined revenues, at least there would have been some parity by the fact that the RBOCs would be losing local retail customers to IXCs entering local markets. Yet, given the Fifth Circuit's ruling, that symmetry is now totally lacking and the prior-year assessment and contribution mechanism is skewed to favor solely carriers entering the interstate long distance market.

Under the FCC's prior-year assessment mechanism, carriers with declining revenues have no viable options. They can either: 1) pass-through a higher percentage for USF recovery, or 2) absorb the difference (although the latter is not a realistic option given narrow margins that are subject to intense competition). Hertz at 3-4. Either approach has a pernicious spiraling effect. At bottom, "when a carrier with declining revenues loses customers either because the customer perceives that the carrier is passing on too much of the USF contribution to the customer, or because the carrier cannot compete on price after absorbing the contribution, the carrier's revenues will decline still further. Such declines lead to ever greater gaps between prior-year and current-year revenues, and the need to pass on or absorb an even greater sum the following year." Hertz at 4.

All of the parties supporting AT&T's petition recognize this fundamental problem with the Commission's current rule. As TRA (at 6) points out, the "prior-year assessment mechanism when applied to BOC provision of in-region, interLATA services is a far cry from the competitive neutrality demanded by Section 254. . . . "

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[8] 13 FCC Rcd 24744, ¶¶ 62-63 (Jt. Bd. 1998). From the inception of the schools, libraries and rural health care universal service support programs until it was forced to revise the assessment base by the Fifth Circuit's ruling, the Commission had assessed interstate carriers' combined revenues for these new USF programs.

Although the RBOCs now defend the prior-year assessment methodology, which would uniquely advantage their operations, their current self-serving support is, at best, disingenuous. In earlier phases of this proceeding, *all* carriers had supported a mandatory end user surcharge, which would have assured that both assessment and recovery of USF obligations would be based on current revenues.[9] Indeed, GTE and Southwestern Bell appealed the Commission's failure to adopt such a recovery mechanism to the Fifth Circuit.[10]

Stripped of its rhetoric, what the RBOC opposition boils down to is the notion that AT&T's proposed mechanism would be complicated or would involve using historical data as a forecast to be later trued up to fix any overbilling and underbilling that would occur. U S WEST at 4, n.11; Bell Atlantic at 1. However, as Oncor (at 5) shows, "basing contribution requirements on current earnings subject to true-up or reconciliation is neither unusual nor unduly cumbersome." In fact, it is the precise model used by the income tax system, where payments are made periodically during the tax year via payroll deductions or estimated taxes, subject to true-up (either a refund of an overpayment or an

[9] In the proceedings leading up to the *Universal Service Order*, AT&T had urged the Joint Board and the Commission to recover universal service costs through a retail surcharge on end-users' bills, applied to customer-specific retail revenues. AT&T's petition for reconsideration of the *Universal Service Order*, filed July 11, 1997, which remains pending, asked the Commission to adopt a mandatory end-user surcharge as the most competitively neutral USF recovery mechanism. Such a mechanism was broadly supported by all carriers. Such a contribution mechanism, had it been adopted, would have been based on current-year revenues and would ameliorate the effects on a carrier of a reduction in year-to-year revenues, as is bound to occur as the RBOCs enter the long distance market.

[10] *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421, Brief of GTE and Southwestern Bell Tel. Co. at 96-99 (Feb. 20, 1998).

additional payment) based on the information shown on the tax return that is filed several months after the close of the tax year.

AT&T strongly urges the Commission to immediately revise its USF assessment methodology and adopt a contribution mechanism based on current-year revenues which would operate in a competitively neutral manner. Specifically, the Commission should require the Universal Service Administrative Company ("USAC") to set the USF contribution factor assessed against carriers (as it does today) but require carriers to contribute to the USF based on the application of the factor to their *current* retail revenues.[11] Such a carrier assessment would be competitively neutral and would avoid several problems, including, most fundamentally, the discriminatory impact of the current mechanism given carrier revenue fluctuations.

To implement this approach, the Commission should require each interstate telecommunications carrier to submit twice each year to USAC a verified accounting of its retail revenues on the Form 499 Worksheet. USAC would then estimate the total federal support that will be needed for the following quarter, as it does currently. Based on this estimate, USAC would then develop a factor that is equal to the ratio of the federal support requirement to total retail revenues for the period. Each telecommunications service

[11] This is the method used by Texas and Colorado for their state universal service funds. In Texas the factor is applied to monthly retail revenues, whereas Colorado applies the factor quarterly.

provider would then be assessed an amount equal to the application of the USAC factor to its current retail revenues. Thus, even if an RBOC had no long distance revenues when it submitted its Form 499, it will be assessed by the application of the USAC factor to its current period revenues. Competitive neutrality would thus be assured.

In its *Seventeenth Reconsideration Order* (¶ 23), the Commission expressed concern that relying on a forecast of total industry revenues to set the USF contribution factor would increase the likelihood that universal service contributors would be overbilled in some periods and underbilled in others. One of the benefits of the AT&T-proposed plan is that it does *not* require reliance on revenue forecasting. Indeed, the AT&T proposal has the same indicia of reliability as the FCC's current mechanism because industry aggregate historical revenues are used to calculate the uniform assessment rate that would be applied by all carriers to their current retail revenues. Further, to guard against a shortfall, AT&T's proposal includes a quarterly true-up mechanism which would allow USAC to adjust the prospective assessment rate.

Moreover, under AT&T's proposal, as end-user revenues shift among carriers, so would their USF contribution obligation. In other words, the carrier contribution obligation would be portable, just as USF support distribution is, under the Commission's program. Although this would not insulate any carrier from competitive loses, it would ensure that no carrier is competitively disadvantaged by the USF program and that customers are free to select carriers based on the quality and price of their services, as contemplated by the Act.

CONCLUSION

To the extent and for the reasons stated above, the Commission should reconsider its prior-year assessment methodology.

Respectfully submitted,

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May 1, 2000

CERTIFICATE OF SERVICE

I, Laura V. Nigro, do hereby certify that on this 1st day of May, 2000, a copy of the foregoing "AT&T Reply to Oppositions to and Comments on its Petition for Reconsideration" was served by U.S. first class mail, postage prepaid, on the parties named on the attached Service List.

/s/ Laura V. Nigro

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