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

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Federal-State Joint Board on Universal Service	))))	CC Docket No. 96-45 FCC 00J-1

AT&T REPLY COMMENTS ON JOINT BOARD RECOMMENDED DECISION ON PHASING DOWN INTERIM HOLD-HARMLESS SUPPORT

Pursuant to the Commission's Public Notice, DA 00-1536, released July 11, 2000, AT&T Corp. ("AT&T") submits this reply in response to other parties' comments on the Joint Board's Recommended Decision, FCC 00J-1, released June 30, 2000 ("*Recommended Decision*"), concerning schedules and procedures for phasing out or eliminating the interim hold-harmless provision of the Commission's new forward-looking high-cost support mechanism for non-rural carriers.

In the *Methodology Order*[1] (¶¶ 78-88), the Commission established an interim hold-harmless provision under which non-rural carriers would receive the greater of either their pre-existing universal service support amount or the support to which they would be entitled under the new forward-looking cost-based mechanism. The Commission emphasized that the interim hold-harmless provision is a *transitional*

[1] Federal-State Joint Board on Universal Service Reform, CC Docket No. 96-45, Ninth Report & Order and Eighteenth Order on Reconsideration, FCC 99-306, released November 2, 1999 ("*Methodology Order*").

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measure that is intended to protect consumers in high-cost areas from potential rate shock during the shift to the forward-looking mechanism. Accordingly, the Commission asked the Joint Board to provide a recommendation on or before July 1, 2000 concerning how the interim hold-harmless provision can be phased out or eliminated without causing undue disruption to consumer rates in high-cost areas. *Id.* ¶ 88.

Verizon (at 3) now contends that the Commission should not even begin to phase-down interim hold-harmless support because the Supreme Court is currently reviewing the *Universal Service Order* to determine whether support based on forward-looking economic cost ("FLEC") is "sufficient" within the meaning of Section 254 of the Communications Act.[2] Sprint (at 3) refers to the Eighth Circuit's decision in *Iowa Utilities Bd. II,*[3] and also claims that use of forward-looking economic cost for determining UNE and interconnection rates is overly speculative. Notwithstanding Supreme Court review of the *Universal Service Order*, the Commission's USF rules remain in full force and effect. Indeed, the Fifth Circuit had affirmed the use of forward-looking costs in the decision now before the Supreme Court and no party has sought a stay of that aspect of the ruling.[4] When (and if) the Eighth

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[2] Texas Office of Public Utility Counsel v. FCC, 183 F.3d 393, 411-12 (5th Cir.1999), *cert. granted sub nom. GTE Service Corporation v. FCC*, 120 S. Ct. 2214 (June 5, 2000).

[3] Iowa Utilities Bd. v. FCC, No. 96-3221 (8th Cir. July 18, 2000).

[4] The Commission first adopted FLEC as the basis for determining universal service support in Federal-State Joint Board on Universal Service Reform, CC Docket No. 96-45, Report and Order, FCC 97-157, ¶¶ 199-201, 206, 224-226, released May 8, 1997 ("*Universal Service Order*"), which has already been the subject of review by

(footnote continued on following page)

Circuit's mandate in *Iowa Utilities Bd. II* issues and even if it is not stayed, that decision would have no direct effect on the Commission's universal service scheme. Thus, neither appellate case presents any occasion whatsoever for delaying the phase-down of interim hold-harmless support. Indeed, because the phase-down would not begin until January 1, 2001, in the unlikely event that the Supreme Court finds FLEC-based support to be inadequate when it rules next spring, the Commission could still make support recipients "whole" during calendar year 2001. Thus, there is absolutely no reason for delaying the phase-down.

AT&T generally supports the Joint Board's recommendations with the exception of that relating to suggested modifications of Section 54.305 when exchanges are transferred from rural to non-rural carriers.[5] The Associations (namely, NECA, NRTA and OPASTCO, at 6-7) and the NTCA (at 3-5) all urge the Commission to adopt the Joint Board's recommendation (at ¶ 21) that interim hold-harmless support for exchanges transferred to rural carriers should *not* be phased down following the transfer until the Commission reexamines the operation of Section 54.305 of its rules or reforms

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(footnote continued from previous page)

the Fifth Circuit. That Court expressly upheld the use of FLEC as the basis for determining the need for high-cost support. Texas Office of Public Utility Counsel v. FCC, 183 F.3d 393, 411-12 (5th Cir.1999), *cert. granted sub nom. GTE Service Corporation v. FCC*, 120 S. Ct. 2214 (June 5, 2000); *see also* Alenco Communications Inc. v. FCC, 201 F.3d 608, 622 (5th Cir. 2000).

5 AT&T agrees with the Florida PSC (at 1-2) and WorldCom (at 2) that the phase-down for PRTC should be much more expeditious than the recommended 12 years.

the high-cost mechanism for rural carriers, so that replacement support for the transferred exchanges is available.[6] However, these commenters misconstrue the purpose of the Commission's high-cost program in pointing to the fact that, in a given transaction, the carrier acquiring the exchange may not be entitled to the full measure of FLEC-based support shown by the Commission's cost model at the wire center level. As the Commission explained in the *Methodology Order* (¶ 7), "the primary role of federal high-cost support is to enable reasonable comparability of rates *among* states, while the primary role of state high-cost support is to ensure reasonable comparability of rates *within* states."[7] (*emphasis in original*). Accordingly, the Commission decided to determine "federal support amounts by considering the average cost of providing the supported services in the entire area of the state served by non-rural carriers" and to provide support based "solely on the extent to which the costs of providing supported services in high-cost areas exceed the national benchmark." *Methodology Order*, ¶ 8. Given that, under the Commission's FLEC-based support mechanism for non-rural carriers, costs are averaged at the statewide level and the state is entitled to support only to extent that intrastate forward-looking costs per line exceed the benchmark, naturally,

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6 In addition, the Associations (at 7-8) and NTCA (at 9-10) parties request the Commission to eliminate the individual high-cost caps and the overall indexed cap on the universal service fund for rural carriers. These requests are outside the scope of this proceeding, which relates the phase-down of interim hold-harmless high-cost support for non-rural carriers.

7 *Citing* Second Recommended Decision, 13 FCC Rcd at 24760, ¶¶ 37-39; Seventh Report and Order, 14 FCC Rcd at 8094, ¶ 35, 8101, ¶ 46, 8102, ¶ 48, 8128, ¶ 105.

some high-cost wire centers will not receive federal support. There is no reason why this should change just because a rural telephone company acquires such an exchange.

As the Accounting Policy Division recently reiterated, "Section 54.305 of the Commission's rules provides that a carrier acquiring exchanges from an unaffiliated carrier shall receive the same per-line levels of high-cost universal service support for which the acquired exchanges were eligible prior to their transfer. For example, if a rural carrier purchases an exchange from a non-rural carrier that receives support based on the Commission's new universal service support mechanism for non-rural carriers, the loops of the acquired exchange shall receive the same per-line support as calculated under the new non-rural mechanism, regardless of the support the rural carrier purchasing the exchange may receive for any other exchanges. Section 54.305 is meant to discourage carriers from transferring exchanges merely to increase their share of high-cost universal service support, especially during the Commission's transition to universal service support mechanisms that provide support to carriers based on the forward-looking economic cost of operating a given exchange."[8]

More fundamentally, adoption of the Joint Board's suggestion would undermine the Commission's sound reasons for adopting Section 54.305 in the first instance. The Commission expressly adopted Rule 54.305 to avoid skewing carriers'

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[8] Citizens Telecommunications Company of North Dakota and U S WEST Communications, Inc. Joint Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, CC Docket No. 96-45, Memorandum Opinion and Order, DA 00-1548, ¶ 3, released July 12, 2000 (citations omitted).

decisions regarding the purchase of exchanges. As the Commission stated in the *Universal Service Order* (¶ 308), "[u]ntil support for all carriers is based on a forward-looking economic cost methodology, . . potential universal service support payments may influence unduly a carrier's decision to purchase exchanges from other carriers. In order to discourage carriers from placing unreasonable reliance upon universal service support in deciding whether to purchase exchanges from other carriers, we conclude that a carrier making a binding commitment on or after May 7, 1997 to purchase a high cost exchange should receive the same level of support per line as the seller received prior to the sale." *Id.*

By contrast, "[a]fter support for all carriers is based on the forward-looking economic cost methodology, carriers shall receive support for all exchanges, including exchanges acquired from other carriers, based on the forward-looking economic cost methodology." Once that occurs, "the level of support will not be a primary factor in a carrier's decision to purchase exchanges because the carrier's support will not be based on the size of the study area nor embedded costs." *Universal Service Order,* ¶ 308. Neither the Joint Board nor any commenter has advanced a valid basis for reversing these findings.

Indeed, if for any reason the Commission decides not to adopt a FLEC-based support mechanism for rural carriers, retaining current Section 54.305 would become even more imperative because of the incentive that the dichotomy in the basis of high-cost support between rural and non-rural carriers would create to transfer non-rural carriers' high-cost exchanges to rural carriers. Moreover, if the phase-down of hold-harmless support were frozen at the time the exchange is transferred to the rural

carrier, not only would it serve only to increase the sales price, *i.e.*, create windfall profits for the non-rural carrier, rather than serving any legitimate universal service support objective, but it would also drive up the cost of high-cost support to the purchasing carrier. The ratepayer would be charged for all of this unnecessary inflation in both the sales price and subsequent USF support.

CONCLUSION

For the reasons stated above and in AT&T's Comments, the Commission should *not* adopt the Joint Board's recommendation that exchanges transferred from non-rural to rural carriers should not be subject to the phase-down of the seller's interim hold-harmless support.

Respectfully submitted,

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August 28, 2000

CERTIFICATE OF SERVICE

I, Kelly Hannigan, do hereby certify that on this 28th day of August, 2000, a copy of the foregoing "AT&T Reply Comments on Joint Board Recommended Decision on Phasing Down Interim Hold-Harmless Support" was served by U.S. first class mail, postage prepaid, on the parties named on the attached Service List.

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