

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

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

COMMENTS OF AT&T CORP.

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Pursuant to Section 1.415 of the Commission’s Rules, and its Notice of Proposed Rulemaking, FCC 02-41, released February 15, 2002 (“*Notice*”), AT&T Corp. (“AT&T”) submits these comments on the methodology for calculating high-cost universal service support for non-rural carriers. The Commission should readopt the funding methodology that it adopted in the *Ninth Report and Order*.¹

INTRODUCTION AND SUMMARY

The *Notice* seeks comment on how the Commission should proceed following the Tenth Circuit’s remand of the universal service funding methodology adopted in the *Ninth Report and Order*. That methodology provides sufficient support for universal service and appropriately balances the principles that Section 254(b) requires the Commission to consider. As the Commission recognized, state commissions set rates for intrastate services, and each state should first apply the resources available within that state to ensure that rates throughout the state are affordable and reasonably comparable. The Commission properly concluded that it should

¹ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Ninth Report and Order and Eighteenth Order on Reconsideration*, 14 FCC Rcd. 20432 (1999), *remanded sub nom. Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001).

provide support from interstate sources only in instances in which a state does not have sufficient resources within the state to achieve these goals. Accordingly, the Commission decided to fund all costs in excess of 135 percent of the national average forward-looking economic cost of service. *See Ninth Report and Order* ¶¶ 43-63.

The Tenth Circuit’s remand of the *Ninth Report and Order* is very narrow. The court did not find that the Commission’s methodology was necessarily unlawful, but merely that the Commission had not provided an adequate explanation. *Qwest*, 258 F.3d at 1201-03. The court agreed that the statute is ambiguous, and that a court must therefore defer to any reasonable interpretation of the statute’s terms. *See Qwest*, 258 F.3d at 1202; *Chevron U.S.A. v. NRDC*, 467 U.S. 837, 843-44 (1984). The court also acknowledged that the statute requires the Commission to base its universal service policies on several principles that are often in conflict. Thus, “the FCC may balance the principles against one another,” and “any particular principle may be trumped in the appropriate case.” *Qwest*, 258 F.3d at 1199-1200. And the court recognized that any reasoned balancing of these goals would be entitled to deference. *Id.*, 258 F.3d at 1202.

As explained below, the Commission should now readopt the methodology established in the *Ninth Report and Order*, with a fuller explanation as required by the Tenth Circuit. The Commission’s methodology was both workable and fair when it was adopted, and since it went into effect over two years ago, it has proven to be fully sufficient to preserve and advance universal service and to realize the other, often competing goals of the program. Indeed, the General Accounting Office (GAO) recently conducted an exhaustive study of local service rates, and found that there was no material difference between urban and rural rates across the country,

notwithstanding the enormous cost differences that exist. *See* U.S. Government Accounting Office, “Federal and State Universal Service Programs and Challenges to Funding,” GAO-02-187 (February 2002) (“*GAO Report*”). Thus, there is no legal or factual basis for changing or enlarging the fund, and the Commission should therefore readopt its original scheme.

ARGUMENT

1. The Tenth Circuit found that the Commission did not adequately explain why its support methodology, which relies on a 135% cost benchmark, is “sufficient” or ensures “reasonably comparable” urban and rural rates. *Qwest*, 258 F.3d at 1201-02; 47 U.S.C. § 254(b)(3), (d), (e). The Court characterized this as a failure to “define” the statutory terms “sufficient” and “reasonably comparable.” *Qwest*, 258 F.3d at 1201-02. That does not mean, however, that the Commission must establish concrete and fixed outer boundaries on the meaning of “sufficiency” or “reasonable comparability” – *e.g.*, an 80 percent difference between urban and rural rates or a fund designed to ensure that local rates will not exceed \$30. Such an undertaking is neither necessary nor appropriate.

It is not necessary, because the Commission can respond to the court’s remand by recognizing that the statutory term “sufficient” has no fixed meaning in and of itself. Rather, Section 254(e) provides that support must be “sufficient” to “achieve the purposes of this section.” The primary purpose of Section 254 is to “preserve and advance” universal service. *See* 47 U.S.C. § 254(d) & (e); *TOPUC v. FCC*, 183 F.3d 393, 412 (5th Cir. 1999). Congress was legislating against a backdrop of decades of regulatory history, and Section 254’s injunction to establish support that is “sufficient” to preserve “universal service” was intended merely to codify the long-held understanding that the Commission and the states should establish a system

of subsidies that would make it possible to set rates that are low enough so that local service is effectively available to as many citizens as is practical. *See Alenco v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000) (“[s]o long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act”); *see also NARUC v. FCC*, 737 F.2d 1095, 1108 & n.6 (D.C. Cir. 1984); *MCI Telecommunications Corp. v. FCC*, 750 F.2d 135 (D.C. Cir. 1984). Moreover, the Joint Board and the Commission have already found (and no party has disputed) that the wide range of local rates that existed both at the time of the Act and at the time of the *Ninth Report and Order* were “affordable” within the meaning of the Act. *See Federal-State Joint Board on Universal Service*, First Recommended Decision, 12 FCC Rcd. 87, ¶ 133 (Jt. Bd. 1996); *Federal-State Joint Board on Universal Service*, First Report and Order, 12 FCC Rcd. 8776, ¶ 2 (1997); *Federal-State Joint Board on Universal Service*, Second Recommended Decision, 13 FCC Rcd. 24744, ¶ 3 (Jt. Bd. 1998); *Federal-State Joint Board on Universal Service*, Seventh Report and Order, 14 FCC Rcd. 8078, ¶ 30 (1999).

Similarly, the Act codifies and continues the prior practice that the federal and state commissions will act in partnership to provide the subsidies necessary to maintain local rates at “affordable” levels. *TOPUC*, 183 F.3d at 424 (“there is substantial support in the statute for a dual regulatory structure in the administration of the universal service program”); *see also* 47 U.S.C. § 254(d) & (f). To that end, the Commission properly focused in the *Ninth Report and Order* on the states’ *capacity* to provide support from intrastate sources. State commissions regulate and establish rates for local services, and it would be both irrational and unfair to require consumers in other states to provide subsidies when a state has its own resources for achieving the goals of the Act. *See Ninth Report and Order* ¶ 46 (“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” (citation omitted)).

Any attempt to define the outer boundaries of “sufficiency” would also be inappropriate, because “sufficiency” can be assessed only in the context of the circumstances that prevail at any given time. The factors relevant to any sufficiency determination – *e.g.*, services, costs, rates, demand, the nature of competition – can be expected to change over time.

2. The principal question in this remand proceeding, therefore, is whether the Commission’s benchmark of 135 percent of the national average cost provides a “sufficient” supplement to the state’s own capacity to ensure affordable rates. It does, and the Commission should readopt it.

There is obviously no directly observable measure of state capacity to provide universal service subsidies, and thus any predictive judgment will necessarily be subject to uncertainty. The court itself expressly recognized this, however, and noted that “the FCC’s determination of a benchmark will necessarily be somewhat arbitrary,” and that the Commission would be “entitled to deference in its line-drawing when it makes a reasoned decision.” *Qwest*, 258 F.3d at 1202.

The court’s objection to the benchmark was a much narrower one: the court found that the Commission had arbitrarily picked the 135% number from a “wide range” of possible numbers, supported only by “conclusory statements” that such a benchmark would provide sufficient support. *See id.*, 258 F.3d at 1202-03. But the 135% benchmark was justifiable based upon the record evidence at the time it was adopted. Under the old rule, all carriers received 25

percent of their loop costs from the federal jurisdiction, plus 10 percent of loop costs that fell between 115 and 160 percent of the national average.² Under the Commission’s new methodology, carriers receive the 25 percent allocation of all loop costs to the interstate jurisdiction, plus *all* remaining forward-looking costs above 135 percent of the national average. *See Ninth Report and Order* ¶¶ 62-63. This new methodology closely mirrors the old one (and is, if anything, more generous). Since the previous system was “sufficient” to preserve universal service, the new system with increased funding should also be “sufficient.”

The differences between the old and new system in the funding for each state are largely attributable not to the selection of the benchmark, but to the transition from a system based on embedded costs to a system based on forward-looking economic costs. The federal funding, while larger in the aggregate, is redirected under the new system to the states most in need of it as determined by the Commission’s forward-looking cost model. But that is entirely appropriate, and indeed, has already been upheld by the Fifth Circuit. As the Commission has repeatedly found, universal service subsidies based on forward-looking costs are both fully compensatory and more consistent with the development of local competition. *See, e.g., Seventh Report and Order* ¶ 50; *First Report and Order* ¶¶ 224, 273. The Fifth Circuit expressly upheld these determinations. *See TOPUC*, 183 F.3d at 411-13. Indeed, the new system is a substantial improvement over the old, in that federal funding is no longer given to states that do not really need it.

² The old methodology provided increasing percentages of the cost above 160 percent of the national average, but as the Commission noted in the *Ninth Report and Order* (¶ 55 & n.170), in most instances non-rural carriers’ costs do not exceed 160 percent of the national average.

Moreover, the Commission’s methodology is inherently conservative, because formally it accounts only for the states’ capacity to fund universal service from local service revenues. Although non-rural carriers have the wherewithal to fund universal service solely through rate averaging of local services, the states in fact draw on other intrastate sources of subsidy, such as inflated rates for vertical services. *See, e.g., GAO Report* at 17-18.

In any event, experience under the new system confirms that the new federal high cost fund is “sufficient” to preserve and advance universal service. Telephone subscribership has remained at historically high levels under the new system. Indeed, in its most recent report, the Commission found that telephone penetration in the United States in July 2001 was 95.1 percent – the highest rate ever recorded, and a statistically significant increase over the prior period. *See Industry Analysis Division, Common Carrier Bureau, “Telephone Subscribership in the United States”* at 1 (February 2002).³ The Commission’s predictive judgments in 1999 have been proven correct, and there is no demonstrated need to increase the size of the fund.

3. Beyond preserving universal service (through affordable rates), the subsidiary purposes of Section 254 are embodied in the “principles” set out in 254(b), one of which is that urban and rural rates “should” be “reasonably comparable.” 47 U.S.C. § 254(b)(3). Although the Tenth Circuit found that the Commission has a mandatory duty to “base its universal service policies” on these principles, the court recognized that each individual principle is merely “a recommended course of action” rather than an “obligation.” *Qwest*, 258 F.3d at 1200; *see also*

³ Notably, telephone penetration rates in Montana and Vermont, the two state petitioners in the Tenth Circuit, are equally high or higher. Indeed, Vermont’s penetration rate is 97.2 percent – one of the highest penetration rates in the nation (and a substantial increase since 2000). *See id.*, Tables 2 & 3.

TOPUC, 183 F.3d at 421 (Section 254(b)'s list of principles "hardly constitutes a series of specific statutory commands"); *Alenco*, 201 F.3d at 615, 621. These principles are often in conflict, and the court therefore recognized that "any particular principle can be trumped in the appropriate case." *Qwest*, 258 F.3d at 1200.

The Commission should now formally recognize that minimizing the burden on those who contribute to universal service is also a principle under Section 254(b) upon which universal service policies must be based. The Commission has consistently found that "collecting more support than is necessary would increase rates for all subscribers," which would itself threaten universal service. *See, e.g., Federal-State Joint Board on Universal Service, Report to Congress*, 13 FCC Rcd. 11501, ¶ 229 (1998); *Seventh Report and Order* ¶ 69; *Ninth Report and Order* ¶ 54. The Fifth Circuit has also expressly recognized that "excessive funding may itself violate the sufficiency requirements of the Act," and that "excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thus pricing some consumers out of the market." *Alenco*, 201 F.3d at 620. The Tenth Circuit itself acknowledged that the Commission had ample authority to establish this an additional principle pursuant to Section 254(b)(7), *see Qwest*, 258 F.3d at 1200 n.7, and the Commission should now do so.

Thus, even if it could be shown that the Commission's methodology compromises "reasonable comparability" – which it cannot – that alone would not be a basis for abandoning that methodology if, as here, other principles, such as minimizing the burden on net contributors, cut in the other direction. The Commission should not further expand the size of the high cost fund – which is already sufficient to preserve universal service – merely to increase the "comparability" of urban and rural rates. Prior to the *Ninth Report and Order*, the high cost fund

for non-rural carriers was only \$70 million per year; the new fund already represents an increase to \$220 million, even after the hold harmless amounts are eliminated.⁴ Moreover, these increases take place within a larger context of massive increases in overall universal service funding since 1996. As GAO notes, NECA and USAC disbursed \$4.45 billion in subsidies in 2000 (*GAO Report* at 4), which is more than double the amount of federal subsidies prior to the Act. *See also Ninth Report and Order*, Separate Statement of Commissioner Furchtgott-Roth at 1. As former Commissioner Furchtgott-Roth has noted, the primary purpose of Section 254 is to provide funding to rural carriers (*see id.*), not to the large non-rural carriers such as Verizon, BellSouth, and Qwest that have the wherewithal to fund their own universal service needs without any federal subsidies. Consumers who are net contributors to the federal funds have already borne substantial increases since 1996, and further increases would place unreasonable pressures on rates generally – increases which would themselves threaten universal service. *Alenco*, 201 F.3d at 620.

But the *Ninth Report and Order* clearly *does* further reasonable comparability, both as a legal and a factual matter. As to the law, Section 254(b)(3) does not require federal high cost support to ensure that urban and rural rates would be equal, nor does it require or even contemplate that all states would bear equal costs. Rather, that section merely requires the Commission and the states to strive to ensure that rates are “reasonably” comparable – as they were prior to the Act. As the Commission correctly noted in the *Seventh Report and Order* (¶ 30), federal support satisfies the “reasonably comparable” goal so long as it is sufficient to

⁴ *See Qwest Corp. v. FCC*, Nos. 99-9546 *et al.*, Brief of Respondent FCC at 24 (10th Cir., May 26, 2000). Indeed, both of the state petitioners in the Tenth Circuit case (Vermont and Montana) receive increased funding under the new system.

“prevent pressure from high costs and the development of competition from causing *unreasonable* increases in rates above current, affordable levels.” The Commission’s 135% benchmark achieves that goal, by ensuring that no one should have to pay more than 135% of the national average cost. In this way, establishing funding at a level that is an adequate supplement to the states’ capacity to maintain affordable rates, as the *Ninth Report and Order* does, is also reasonably designed to allow the continuation of the reasonable comparability of rates, both between and within states, that existed under the previous system.

Similarly, the Commission was correct to conclude that there is, at present, no undue pressure on implicit subsidies from competition that the state commissions would be unable to replace with explicit subsidies. As the Commission noted in the *Seventh Report and Order* (¶ 69), “current conditions” – *i.e.*, very small levels of competitive pressure – “do not necessitate substantial increases in federal support for local rates,” and that remains true today. Given that pressure from competition is currently weak and unlikely to have any material impact on whatever implicit subsidies (*e.g.*, rate averaging) on which the states may be currently relying, the Commission can fashion federal support based on that reality. *See id.* ¶ 12 (“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”); *see also TOPUC*, 183 F.3d at 436-37 (“the FCC made a reasonable determination that there was little chance of [local] competition’s emerging in the near future”).⁵

⁵ It should be noted that competitive pressures are particularly absent in rural states like Vermont and Montana, where there is virtually no competition. That was true in 1999 and is equally true today. Thus the federal support established in *Ninth Report and Order*, which actually increases the amount of federal support for these states over prior levels, should by definition provide

And as to the facts, experience since the issuance of the *Ninth Report and Order* again confirms that the Commission's predictive judgments were correct. As the *GAO Report* conclusively demonstrates, rates remain reasonably comparable both within and among states, even under the Commission's new methodology. Indeed, the GAO specifically concluded that "[t]here is no statistical difference in residential local telephone rates between central city, suburban, and rural places," notwithstanding the fact that the Commission's forward-looking economic cost model shows wide variations in the costs of serving those locations. See *GAO Report* at 15 & Appendix IV. There is *no* systematic trend under the new system toward higher rates in more rural states or in more rural areas within states. Thus, the Commission's decision to establish funding above a 135% benchmark has proven to be sound. That benchmark may be too low, but the facts demonstrate that it is not too high.

Finally, the alternative methodology advanced by Vermont and Montana before the Tenth Circuit is fundamentally flawed. Those states argued that the Commission should have compared the benchmark with a national average of urban costs (defined as the forward-looking cost in wire centers with at least 50,000 or 100,000 lines) in order to assess "reasonable comparability." See *Qwest Corp. v. FCC*, Nos. 99-9546 et al., Brief of Petitioners Vermont/Montana at 30-32 (10th Cir., April 21, 2000) (asserting that the benchmark was 70-80% higher than urban costs). Isolating costs in urban wire centers, however, is inappropriate and would result in a misleading comparison. For purposes of this methodology, the Commission is entitled to assume that each state will use its resources to equalize rates within the state, and

adequate funding and flexibility to ensure rates that are both affordable and reasonably comparable to rates in other states.

therefore the statewide average cost is the appropriate proxy for both urban and rural rates within each state. Thus, the difference between the benchmark and urban rates would not be as great as Vermont and Montana claimed. *Cf. Qwest*, 258 F.3d at 1201.

Even if on a proper state-to-state comparison the variation turned out to be 70-80 percent, however, the Commission could lawfully deem such variations to be reasonably comparable. Congress did not enact Section 254(b)(3) out of a concern that urban and rural rates were not reasonably comparable at the time of the Act, and variations of that magnitude existed under the previous system. Rather, Congress's concern was that rates might cease to be reasonably comparable if implicit subsidies were eroded away by competition. The Commission's methodology addresses that concern by making all federal subsidies explicit, portable, and based on forward-looking economic cost. *See Seventh Report and Order* ¶ 30 (federal support satisfies the "reasonably comparable" goal so long as it is sufficient to "prevent pressure from high costs and the development of competition from causing *unreasonable* increases in rates above current, affordable levels") (emphasis added).

4. The court also questioned the lack of "inducements" in the Commission's scheme to ensure that the states will do their part to ensure universal service. *See Qwest*, 258 F.3d at 1203-04. As the court noted, however, the Commission has limited authority with respect to intrastate matters, and more importantly, the states have a long history of in fact doing their part to ensure that universal service is preserved and that rates are "affordable" and "reasonably comparable." Based on this history, and in view of the Commission's limited authority, it would be presumptuous for the Commission to base its policies on the assumption that the states will no longer take the necessary steps to ensure that universal service is preserved. It is entirely

appropriate, of course, for the Commission and the Joint Board to monitor state policies, and if a state fails to take action and universal service is threatened as a result, the Commission could consider various actions that might “induce” state funding. It is far from clear, however, that the Commission should act to remedy any state deficiency by supplying more federal funds, because such a policy would merely encourage states to abdicate responsibility in exchange for increased federal funding. *See also* 47 U.S.C. § 254(f) (state universal service policies should not “burden” the federal fund). Nor is it clear that the Commission should withhold funding as a “stick,” because such a policy could perversely do further damage to universal service in that state. Given the states’ unbroken track record of providing sufficient funding from intrastate sources, the Commission should not rush to create new carrots and sticks to “induce” state action.

CONCLUSION

For the foregoing reasons, the Commission should readopt the *Ninth Report and Order* funding methodology.

Respectfully submitted,

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April 10, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of April, 2002, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: April 10, 2002
Washington, D.C.

/s/ Peter M. Andros

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