

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

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

**COMMENTS OF VERIZON**

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**COMMENTS OF VERIZON<sup>1</sup>**

**I. Introduction and Summary**

The 10<sup>th</sup> Circuit Court of Appeals' decision remanding the *Ninth Report and Order*<sup>2</sup> does not require major revisions to the basic structure of the Commission's high cost universal service support mechanism for non-rural carriers. Rates in urban and rural areas are not only already "reasonably comparable" throughout the country, they are almost indistinguishable. Given that fact, the current method of targeting federal fund support to states with above-average costs clearly provides "sufficient" assistance to enable high cost states to maintain rates that are reasonably comparable with those in other states. The benchmark for identifying the states that receive support from the federal fund should take into account a number of factors, including what is a reasonable variation in rates among states and the need to keep the universal service

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<sup>1</sup> The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Inc. These companies are listed in Attachment A.

<sup>2</sup> *Federal-State Joint Board on Universal Service, Ninth Report and Order & Eighteenth Order on Reconsideration*, 14 FCC Rcd 20432 (1999) ("*Ninth Report and Order*").

fund from becoming so large that it detracts from the affordability of service for all customers. To provide an inducement for states to carry out the goals of the Act, the Commission should condition the receipt of universal service support on a state's certification that it maintains reasonably comparable urban and rural rates.

## **II. “Reasonably Comparable” And “Sufficient” Should Be Defined With Reference To Other Principles Listed In Section 254(b) Of The Act.**

It is significant that the 10<sup>th</sup> Circuit Court of Appeals did not find that the Commission's high cost funding mechanism was unlawful – it simply remanded the *Ninth Report and Order* for a better explanation and justification for the Commission's decision that it had met the statutory goals. *See Qwest v. FCC*, 258 F.3d 1191 (10<sup>th</sup> Cir. 2001). The Court required the Commission to provide a more reasoned definition of the principle that consumers in rural areas should have access to telecommunications services at rates that are “reasonably comparable” to rates charged for similar services in urban areas and the principle that the Federal and State mechanisms to preserve and advance universal service should be “sufficient” to achieve the purpose of section 254 of the Act. *See id.*, 1201-02; 47 U.S.C. §§ 254(b)(3) & (5), 254(e). In its *NPRM*, the Commission asks for comments on how to define the statutory terms and whether it should give weight to other statutory principles as well. *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order, FCC 02-41, ¶¶ 16-17 (rel. Feb. 15, 2002) (“*NPRM*”).

In addressing the issues remanded by the Court, the Commission should consider all of the relevant statutory principles in section 254. Section 254(b) states that the Commission “shall base policies for the preservation and advancement of universal service” on all of the listed

principles, not simply those relating to “reasonably comparable” rates and “sufficient” support. The Court itself recognized that these are not the only guiding principles in section 254, and that the Commission may balance these principles against one another as well as against other listed principles in section 254(b) and other obligations or limitations in the Act. *See* 258 F.3d at 1199.

There is an unavoidable tension among the Section 254(b) principles. A universal service fund that is too large will adversely impact the principle that “[q]uality services should be available at just, reasonable, and affordable rates.” 47 U.S.C. § 254(b)(1). Assessments on carriers to support the universal service fund are passed directly to consumers, affecting the affordability of telephone service for customers in all areas. In addition, the funding requirements for high-cost support compete with the funding requirements for schools and libraries under sections 254(b)(6) and 254(h)(1)(B) for a share of the total amount of funding that is compatible with affordable service. The Commission should consider these competing, but equally important principles in defining the goals of “reasonably comparable” urban and rural rates and in deciding what amount of support would be “sufficient” to preserve and advance universal service.

In defining “reasonably comparable” rates, the Commission must first define “urban” and “rural” areas and describe how those areas should be compared. *See NPRM*, ¶ 16. These areas should be defined in terms of population density, since using other measures such as the number of lines in a wire center would incorrectly characterize small wire centers in the middle of large cities as “rural.” *See id.* The Commission has used the concept of “Metropolitan Statistical Areas” (“MSAs”) to distinguish rural from urban areas for several purposes, such as applying the health care provisions of section 254(h), implementing pricing flexibility, and licensing cellular

carriers. *See* 47 C.F.R. §§ 54.5; 69.703, 22.909(a). “Rural” areas should be defined as non-MSAs, similar to the current definition of “rural area” in section 54.5 of the Commission’s rules. Since the normal understanding of the term “urban” would exclude suburban areas within MSAs, the Commission should define “urban” areas as cities or Census Bureau-defined urban areas with populations of at least 50,000 within MSAs. This would be consistent with the Commission’s health care rules, which define the “nearest large city” as a city with a population of at least 50,000. *See* 47 C.F.R. § 54.605(c).

### **III. Urban And Rural Rates Are “Reasonably Comparable” Today.**

In determining the standard for “reasonably comparable” rates between urban and rural areas, the Commission should first examine the rates that are charged for basic telephone service to determine how much variation actually occurs between such areas. The General Accounting Office recently completed a survey of telephone rates throughout the country that identified rates for basic residential and single-line business service for central cities, suburbs, and non-MSAs. *See* General Accounting Office, Telecommunications – Federal and State Universal Service Programs and Challenges to Funding , GAO 02-187 (rel. Feb. 4, 2002) (“GAO Report”). As illustrated in the chart below, the GAO Report shows that, on average, rates between these areas are virtually identical as a result of state regulatory commission policies designed to promote lower rates in rural and high-cost areas. *See id.*, Appendix IV.

Area	Mean Residential Rate	Mean Single-Line Business Rate
Central City	\$14.79	\$33.49
Suburb	\$15.00	\$33.04
Non-MSA (rural)	\$14.76	\$30.66

The state commissions primarily use geographic rate averaging and value-of-service pricing to keep rates for basic telephone service at affordable levels throughout a carrier's service territory. *See id.*, 14. While there are variations from state to state and within states, most states maintain the same basic rates in urban, suburban, and rural areas. In fact, in some states the rates in the rural and less populated areas are lower than the rates in urban areas, despite the fact that per-line costs in rural areas can be three times as high as in urban areas. *See id.*, 15.

Nonetheless, rates vary from state to state, reflecting different cost levels and policy decisions in setting rates for basic services. This can be seen in the table of the standard deviations for rates in each area provided below. Again we see that the standard deviations for rates in urban, suburban, and rural areas are very similar.

Area	Residential Rate Standard Deviation	Business Rate Standard Deviation
Central City	\$5.31	\$8.83
Suburb	\$5.39	\$7.87
Non-MSA (rural)	\$5.40	\$7.93

This range in existing rates is the result of very diverse rate actions that the various state commissions have taken over many years. The data show that the nationwide mean residential rate is approximately \$15.00. Since the vast majority of rates fall within two standard deviations of the mean, the GAO Report implies that most residential customers pay, on the high side, no more than \$26.00, or \$11.00 higher than the mean. Despite this variation in basic service rates,

the nation still has a telephone subscription rate of 95.1 percent.<sup>3</sup> The GAO study shows that the state commissions have adopted pricing policies to keep rates for basic residential service affordable for both urban and rural customers despite large differences in per-line costs between these areas. Because the existing rates have achieved high telephone penetration rates and general comparability among urban, suburban and rural areas, they are consistent with the principles of section 254.

The Commission correctly observed that “reasonably comparable” does not and cannot mean identical. *See Ninth Report and Order*, ¶ 54; *Seventh Report and Order*, 14 FCC Rcd 8078 ¶ 30 (1999). Since the vast majority of rates fall within two standard deviations of the mean, the Commission should adopt a threshold for “reasonably comparable” as rates in urban and rural areas that are within two standard deviations, or approximately \$11.00, of each other or of the national mean.

#### **IV. Current Universal Service Support Is “Sufficient.”**

In defining “sufficient” support for universal service, the Commission should balance the principle of achieving “reasonably comparable” urban and rural rates with the competing principles of funding support to all universal service programs, including schools and libraries, while keeping rates for telephone service “affordable.” The combination of increasing demands on the universal service fund together with changes in demand for retail interstate services has caused a steady increase in the universal service assessment factor that must be paid by providers of interstate telecommunications services. The assessment factor is now 7.2805 percent based on

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<sup>3</sup> *See Telephone Penetration Rate* (rel. Feb. 2002), *available at* [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/subs0701.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/subs0701.pdf).

total program costs of \$5.541 billion on an annual basis. *See* Proposed Second Quarter 2002 Universal Service Contribution Factor, Public Notice DA 02-562 (rel. Mar. 8, 2002). The high cost funds for rural and non-rural carriers are \$2.789 billion of this amount. A substantial increase in the high-cost fund would only drive up the assessment, which would be passed along by the carriers to their end user customers, making telephone service less affordable for all customers. A “sufficient” fund must be one that allows reasonable comparability of rates in urban and rural areas without causing excessive demands on the total universal service assessment and without impairing the amount of funds available for other universal service programs.

Since, as the Court observed, Section 254 contemplates a “partnership” between federal and state jurisdictions to support universal service (see 258 F.3d at 1203), a sufficient federal high cost fund should be defined as one that would provide assistance to states that cannot maintain rates that are “reasonably comparable” to the nationwide average due to high costs within those states. A sufficient fund should not be defined as one which would make all rates identical, or that would seek to bring rates in all states down to the lowest rate in any urban area in the country. This would create a huge demand on the fund and make the universal service assessment that is passed through to customers a significant threat to the affordability of telephone service. In addition, current rates for basic residential service are artificially low in many jurisdictions as a result of state ratemaking policies. Therefore, the federal mechanism should not restrict the ability of states to raise rates while still making them “affordable.” The fund should provide a supplement to already-existing policies and mechanisms in the states that have achieved substantial similarity in urban and rural rates.

## **V. The Benchmark For Identifying States That Need Federal Support Should Be Approximately Two Standard Deviations From The Mean.**

Since the purpose of a benchmark is to identify states that need federal support to achieve reasonably comparable urban and rural rates, the benchmark should reflect the range of “reasonably comparable” rates. As the above discussion demonstrates, rates in urban and rural areas should be considered “reasonably comparable” if they are within two standard deviations as measured by the nationwide data. However, in applying the benchmark, the Commission should retain its existing cost-based approach in identifying states that need support from the federal fund. As the GAO Report shows, rates for basic residential service are not directly related to the cost of service, but rather reflect policy decisions designed to promote universal service. Therefore, a simple comparison of basic residential rates will not be a reliable method of identifying a state that needs support. If a state has above-average per-line costs, it will tend to have more high cost rural areas and less ability to maintain rural rates that are reasonably comparable to the nationwide average than a state with average costs. Providing federal support to above-average cost states will promote their ability to meet the statutory objectives and prevent average or low-cost states from using rate structure changes in rural areas to create an artificial need for more federal support.

Using the rate comparison as a guide, the Commission should establish a cost benchmark based on two standard deviations from the nationwide average cost per-line. This would reflect the range of reasonably comparable rates as well as the fact that the nationwide average rate is already artificially low and could be raised without adversely impacting telephone penetration rates. In the Commission’s proxy model, the nationwide average cost is \$23.35, and the standard

deviation is \$3.75.<sup>4</sup> The average plus two standard deviations would be a cost of \$30.85. This is approximately 132 percent of the average. This is approximately the level of the Commission's current 135 percent benchmark.

For this reason, the Commission should retain the existing benchmark as a method of identifying states with costs that are more than two standard deviations from the mean. This will target support to states that need federal assistance in maintaining rates in rural areas that are within two standard deviations from the rates in urban areas in the same state or in other states. The Commission's high cost support mechanisms have always provided a percentage buffer before states will be eligible for high-cost support.<sup>5</sup> A state with per-line costs that are more than 135 percent of the average will have more difficulty than others in maintaining basic telephone rates in urban and rural areas within two standard deviations of the nationwide average. A 135 percent benchmark also would serve the important policy objective of keeping the fund size close to the current level and avoiding further pressure on the universal service contribution assessment that is passed along to consumers.

While not necessary for this remand, the Commission should initiate a proceeding to revisit its reliance on the flawed proxy cost model in applying this benchmark to target support. Instead, the Commission should consider using a carrier's actual per-line costs from its ARMIS reports, as it did in the previous high cost fund and as it is doing with the rural carrier fund. The

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<sup>4</sup> *See* Updated FCC Cost Spreadsheets, Tab S1 (rel. Jan. 20, 2000), *available at* <http://www.fcc.gov/wcb/tapd/hcpm/wcsupport.xls>.

<sup>5</sup> Prior to the current universal service fund, which has a 135 percent benchmark, the Commission's high cost fund provided support only for carriers that had costs more than 115 percent of the average, with increasing amounts of support for carriers with costs above higher benchmarks. *See NPRM*, n.72.

hypothetical costs in the proxy model do not represent the actual costs of any carrier. The model uses a “scorched node” approach that assumes construction of a brand new network, from scratch, using the most technologically advanced equipment at the lowest current prices for a network that meets the design criteria set by the Commission rather than by the carriers. In other words, it has no relationship at all to the actual costs that the carriers incur to serve customers. The proxy model is inherently incapable of identifying carriers or states that actually have above-average costs or that actually need assistance to achieve the statutory goals. The Commission should ground its policies in the real world of reported costs as it did in the other funding mechanisms.

## **VI. The Commission Should Condition Receipt Of High-Cost Support On A State’s Certification That It Has Reasonably Comparable Urban And Rural Rates.**

The 10<sup>th</sup> Circuit Court also found that the Act contemplates a federal-state “partnership” and that the federal funding mechanism must contain an inducement for the states to provide “a ‘fair range’ of urban and rural rates within their borders.” *See* 258 F.3d at 1203. The Court is correct in observing that “it would be impossible for the FCC alone to ensure reasonably comparable rates in urban and rural areas” without a massive federal fund. The Act clearly establishes that the states have the responsibility to do their part in achieving the goals of section 254. However, the Commission should not dictate to the states how they will carry out that responsibility. The Act states that the states “may” adopt regulations and mechanisms that do not conflict with the Commission’s universal service rules and that do not burden the federal universal service support mechanisms. *See* 47 U.S.C. § 254(f). This clearly allows, but does not require, any specific support mechanisms at the state level.

The Commission should condition the provision of non-rural high-cost support on a certification by a receiving state that it maintains “a ‘fair range’ of urban and rural rates within [its] borders” as noted by the Court. Because current rates are reasonably comparable, a state that falls within today’s variance should not be required to disrupt existing rate relationships. Therefore, a state should be allowed to meet this condition by showing either (1) that its rates in urban and rural areas are within two standard deviations of each other (using the standard deviation for nationwide rates, or \$11); or (2) that its rates in rural areas are within two standard deviations of the nationwide average urban rate. As the GAO Report indicates, almost all states should be able to make such certifications based on their current rate levels. The Commission should define the basic residential telephone services for which a state must certify that it has achieved “reasonably comparable” rates between urban and rural areas as defined in the Commission’s rules.

## VII. Conclusion

For the foregoing reasons, the Commission should maintain the basic structure of its high cost funding mechanism, including the 135 percent benchmark, based on an analysis of the current range of rates between urban and rural areas.

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Respectfully submitted,

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THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States  
GTE Midwest Incorporated d/b/a Verizon Midwest  
GTE Southwest Incorporated d/b/a Verizon Southwest  
The Micronesian Telecommunications Corporation  
Verizon California Inc.  
Verizon Delaware Inc.  
Verizon Florida Inc.  
Verizon Hawaii Inc.  
Verizon Maryland Inc.  
Verizon New England Inc.  
Verizon New Jersey Inc.  
Verizon New York Inc.  
Verizon North Inc.  
Verizon Northwest Inc.  
Verizon Pennsylvania Inc.  
Verizon South Inc.  
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