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

APR 25 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)
Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-45

**REPLY COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC.
IN RESPONSE TO THE TENTH CIRCUIT REMAND**

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TABLE OF CONTENTS

INTRODUCTION AND SUMMARY..... 1

DISCUSSION..... 4

 I. The Tenth Circuit’s Decision Precludes Retention of a High-Cost Funding Regime
 Based Solely on Statewide Averages. 4

 II. The Commission Should Take Affirmative Measures to Protect Universal Service from
 the Inexorable Erosion of Implicit Cross-Subsidies. 7

 III. The Tenth Circuit’s Order Requires a Somewhat Larger Federal Fund..... 9

 IV. The Commission Should Not Conflate the Goal of “Reasonable Comparability” with
 the Separate Goal of Need-Based Funding for Indigent Subscribers. 12

CONCLUSION..... 13

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Qwest Communications International, Inc. ("Qwest") respectfully submits these reply comments on remand from the Tenth Circuit's decision in *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001).

INTRODUCTION AND SUMMARY

Qwest's universal service proposal consists of three basic elements: two "tiers" of funding — which would provide support to, respectively, high-cost *wire centers* and high-cost *states* — plus a set of conditions that states must meet before receiving any such funding. Working in tandem, the three component parts of this proposal would enable the Commission to meet its legal obligations on remand, ensure reasonable comparability of rates on a nationwide scale, and keep the federal fund size manageable. The same cannot be said of the majority of comments submitted by the other parties to this proceeding, most notably those that encourage the Commission to retain the status quo on the mistaken premise that the Tenth Circuit expects nothing different or better.

Before addressing the merits of these other comments, however, Qwest first offers the following brief synopsis of its own proposal for purposes of comparison. As elaborated in

Qwest's opening comments, Tier 1 funds would provide federal subsidies for all costs above a dollar benchmark for the costliest wire centers in the United States, *irrespective of state boundaries*. Tier 1 would thus give the vast majority of states federal support for what is (after all) a *federal* "comparability" mandate, and it would thereby enable the Commission, as the Tenth Circuit required, to exercise influence over virtually all states through reasonable conditions on the disbursement of these funds. Tier 1 would also correct the basic legal problem that caused the Tenth Circuit to invalidate the *Ninth Report and Order*: a single-minded focus on statewide average costs that impermissibly "substituted a comparison of national and statewide averages for the statutory comparison of urban and rural rates."¹ At the same time, however, "Tier 2" of Qwest's proposal would provide supplemental federal funding to states with unusually high average costs, and it would thereby ensure that all states have the resources needed to keep all of their rates, including rural rates, below a designated multiple (such as 1.5) of the average urban cost, \$18.80.

These two tiers of funding are defined flexibly. Their primary variables include (a) the dollar benchmarks that trigger Tier 1 funding for given wire centers and (b) the definitions of "urban" and "reasonably comparable" that, taken together, define the federal obligation for supplemental funding under Tier 2. As discussed at length in Qwest's opening comments (and in the supporting declaration), these variables can be adjusted to strike different balances among the Commission's various objectives in this proceeding.

Third, Qwest proposes conditioning federal high-cost funding not just on a state's certification that its rural rates are "reasonably comparable" to its urban rates, but also, over time, on the state's progress in making the transition from implicit subsidies to explicit funding

¹ *Qwest*, 258 F.3d at 1202.

mechanisms. Just as section 254 calls for reasonable comparability of rural and urban rates, so too does it call for explicit, competitively neutral funding mechanisms on both the state and federal levels.² Congress has directed the Commission to play a leadership role in ensuring state compliance not just with the “reasonable comparability” objective (as the Tenth Circuit has already ruled), but also with the imperative to move to explicit funding mechanisms. (See Qwest Comments 20-24.) Indeed, the two issues are intimately related. Explicit, competitively neutral funds are the *only* support mechanisms that can survive as competition intensifies for business customers, which are the primary source of today’s implicit funds. Although various apologists for the regulatory status quo continue to deny that such business-sector competition exists, the facts tell otherwise, as discussed below.

Although Qwest’s approach would somewhat increase the total amount of federal high-cost support, it would increase that support only to the extent necessary to fulfill the Commission’s statutory duty on remand to play the leadership role that Congress has assigned it and the Tenth Circuit has now enforced. Significantly, enlargement of the federal responsibility for universal service vis-à-vis the states would neither disserve consumers nor impair any principle of competitive neutrality among carriers. Instead, it would simply shift from the states to the federal government a small additional share of that responsibility. From the perspective of end users taken as a whole, the result would be a virtual wash: over the long term, any increases in line item charges attributable to an increased federal fund size would be largely offset in the aggregate by commensurate rate decreases (or line item decreases) attributable to reduced state responsibilities. Of course, shifting any portion of the support obligation from the states to the federal government would slightly *reallocate* the contribution burden *among* end users in

² See 47 U.S.C. § 254(e) and (f).

different states, but that is a routine and unobjectionable consequence of having a national government with national statutory objectives, such as “reasonable comparability” on a nationwide basis.

DISCUSSION

I. The Tenth Circuit’s Decision Precludes Retention of a High-Cost Funding Regime Based Solely on Statewide Averages.

Most parties to this proceeding, and indeed the Commission itself, recognize the need to reform high-cost universal service funding in light of the Tenth Circuit’s decision. AT&T and a few other parties with vested financial interests in the regulatory status quo, however, urge the Commission to adhere to the same funding regime established in the *Ninth Report and Order* and dress it up with “a fuller explanation.” (AT&T Comments 2.) But the problems with the *Ninth Report and Order*³ are deeply substantive as well as explanatory. In this and several other respects, AT&T’s arguments presuppose that AT&T prevailed on many of the issues on which it in fact lost in the Tenth Circuit.

First, despite AT&T’s contrary suggestion, the Tenth Circuit in fact held that the Commission *must* take positive action to induce (by “carrot” or “stick”) state compliance with the reasonable comparability mandate of section 254. (See AT&T Comments 12-13.) This is not a discretionary choice. As the court explained, because the Act requires reasonably comparable rates, and because state mechanisms are necessary to achieve such comparability, the Commission is “obligated to create some inducement . . . to ensure that the states act.”⁴ To leave

³ Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 20432 (1999) (“*Ninth Report and Order*”), *rev’d sub. nom. Qwest Corp. v. FCC, supra*.

⁴ 258 F.3d at 1204.

no doubt about the exact nature of the Commission's obligations, the court added: "On remand, the FCC *is required to develop mechanisms* to induce adequate state action."⁵

Because the Tenth Amendment precludes the Commission from commandeering state resources to advance this federal objective,⁶ the Tenth Circuit's decision effectively requires the Commission to "induce" the states to cooperate by placing conditions on federal high-cost funds. The regime of the *Ninth Report and Order*, however, is not up to that task, because it provides funding to only a handful of states – and thus effectively precludes the Commission from meeting its "obligation to create some inducement" for all the remaining states. The only conditional funding system that could comply with the Tenth Circuit's order is one that, like Qwest's, provides some funding to the overwhelming majority of states. Indeed, such a system would be the right approach even if it were not compelled by the Tenth Circuit's order. "Reasonable comparability" is a new requirement of *federal* law. If the federal government expects the states to do their part to meet this new *federal* objective, a basic respect for state sovereignty suggests that the federal government should also help the states, whatever "resources" they may harbor on their own, to shoulder the burden of funding the very highest cost areas within their borders.

Second, quite apart from those considerations, the existing scheme would remain unlawful no matter what "fuller explanation" the Commission might try to concoct for it, because that scheme would not ensure "reasonable comparability" — within the outer bounds that the Tenth Circuit is prepared to recognize — between urban and rural rates across the United States. As that court has explained, the *Ninth Report and Order* is invalid because, among its

⁵ *Id.* at 1204 (emphasis added).

⁶ *See Printz v. United States*, 521 U.S. 898 (1997).

other defects, it contains no “explicit empirical findings” demonstrating that it would or even could ensure rural-urban rate discrepancies of less than 70-80%.⁷ Although AT&T pretends otherwise (AT&T Comments 3), the Tenth Circuit plainly indicated that discrepancies of that magnitude would violate section 254’s reasonable comparability mandate,⁸ a fact that the Commission itself appears to acknowledge.⁹ Significantly, however, none of the supporters of proposals to maintain the basic approach of the *Ninth Report and Order* even attempts to provide empirical data showing that retention of the 135% benchmark would in fact ensure smaller discrepancies. For its part, AT&T effectively concedes that it would not; indeed, AT&T argues, in the teeth of the Tenth Circuit’s decision, that the Commission need not even establish “concrete and fixed outer boundaries on the meaning of ‘sufficiency’ or ‘reasonably comparability,’” such as an 80% difference. (AT&T Comments 3.)

Third, and just as important, basing federal subsidies only on statewide averages would impermissibly “substitute[] a comparison of national and statewide averages for the statutory comparison of urban and rural rates.”¹⁰ Qwest’s proposal would approach the statutory task as Congress intended: by focusing first on actual high-cost areas, wherever located; earmarking most federal support to those areas; and only then supplying additional funding to states with unusually high statewide average costs.

In contrast, an approach based solely on statewide averages would approach the problem of high-cost rates only from the back end and would do little to help the majority of states to

⁷ 258 F.3d at 1202.

⁸ *Id.* at 1201 (“Does the FCC contend, for example, that a 70-80% discrepancy is within a ‘fair range’ of rates? We doubt that the statutory principle of ‘reasonable comparability’ can be stretched that far.”).

⁹ Notice of Proposed Rulemaking and Order, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, FCC 02-41 ¶ 16 (rel. Feb. 15, 2002) (“NPRM”).

¹⁰ 258 F.3d at 1202.

shoulder a fair share for achieving the new federal “reasonable comparability” objective. Such an approach could achieve true national comparability only by lowering the benchmark far below 135%, as explained above. That approach would be less efficient than Qwest’s, because it would result in a considerably larger federal fund than would be achieved by simply focusing on rural wire centers as a starting point. Indeed, even lowering the benchmark to 100% of the national average, while costing more than \$2 billion, would still allocate federal funds only to about half of the states. Because the remaining states would receive no such funding, the Commission would take no responsibility for any of their costs – and would have no basis on which to induce those states to do their part to ensure reasonable comparability. Qwest’s proposal, by contrast, would entitle between 47 and 49 states to federal funding and thus would give each of them a concrete stake in helping realize section 254’s objectives. At the same time, Qwest’s proposal could cost one-half (or less) of the \$2.1 billion price tag for the more state-oriented alternative discussed above. *See* Qwest Comments at 20 and Appx. A at 3, 5.

II. The Commission Should Take Affirmative Measures to Protect Universal Service from the Inexorable Erosion of Implicit Cross-Subsidies.

Several parties to this proceeding have noted that the states have been able to keep differences in urban and rural rates within their borders in check through traditional implicit cross-subsidy schemes such as geographic rate averaging and above-cost business rates. That is true, but also irrelevant. The precarious survival of such schemes to date does not free the Commission from its affirmative “responsibility” under the Tenth Circuit’s decision to induce the states, through “carrot” or “stick,” to ensure reasonable comparability over the long term.¹¹ In particular, the Commission “may not simply assume that the states will act on their own to

¹¹ *Id.* at 1204.

preserve and advance universal service.”¹² As this Commission has repeatedly recognized, the implicit subsidies on which today’s geographic rate averaging schemes rest are inherently unstable,¹³ and as the Tenth Circuit made clear, the Commission does not have the discretion simply to “wait and see” how long these schemes can survive the inexorable erosion of the implicit subsidy base before the subsidies cease to “preserve and advance” universal service.

AT&T contends, however, that competition is weak and “unlikely to have any material impact” on the implicit subsidies employed by states. (AT&T Comments 10.) That is wrong. First, as AT&T points out in other contexts when in its interest to do so, local competition is fiercest for business customers, the very lifeblood of the existing cross-subsidy scheme. Indeed, in part because the traditional cross-subsidy scheme has kept business rates artificially high, CLEC business plans have targeted these business customers in particular.¹⁴ CLECs’ share of BOCs’ business lines is at least 26%, and likely closer to 33%.¹⁵ The above-cost rates those customers have traditionally paid – but can no longer be expected to pay – have underwritten much of the existing universal service regime in this country.¹⁶

¹² *Id.*

¹³ *See Ninth Report and Order* at 20490 ¶ 16.

¹⁴ For example, about 55% of CLEC local telephone lines provide service to medium and large business and institutional customers, compared to 23% of ILEC lines for the same category of customers. *Local Telephone Competition: Status as of June 30, 2001*, FCC, Industry Analysis Division, Feb. 2002, at Table 2.

¹⁵ 2002 UNE Fact Report, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, filed with Qwest Comments in CC Docket No. 01-338 Apr. 5, 2002, at I-6.

¹⁶ For example, a recent GAO Report found that local telephone rates for single-line business customers are almost uniformly higher than residential rates, and that, for every type of geographic environment, business rates are approximately twice as high as residential rates, while the cost of serving business customers is not likely to be significantly different. Report to the Ranking Minority Member, Subcommittee on Telecommunications and the Internet, Committee on Energy and Commerce, House of Representatives, *TELECOMMUNICATIONS Federal and State Universal Service Programs and Challenges to Funding*, GAO-02-187, Feb.

For these reasons, the Commission can and should use funding conditions to induce states to move towards explicit funding mechanisms, if only to protect the goal of “reasonable comparability” over the long term. That role is perfectly consistent with the Tenth Circuit’s determination that the Commission must develop affirmative mechanisms to “induce *adequate* state action.”¹⁷ Moreover, the policy merits of letting implicit cross-subsidies persist into the future is not subject to debate. Congress has spoken on this issue in the text of section 254 itself, and it has mandated a prompt transition to “explicit,” competitively neutral state and federal funds.¹⁸ The Commission has also recognized that, because the development of competition will erode implicit support mechanisms at the state level, the states can and must continue to pursue universal service objectives through explicit support mechanisms.¹⁹ To assure adequate universal service funding at the state level, the Commission should take this unique opportunity to induce the states, through funding conditions on federal universal service support, to rebalance retail rates and require explicit, competitively neutral funding schemes and avoid the erosion of universal service at the state level.

III. The Tenth Circuit’s Order Requires a Somewhat Larger Federal Fund.

As noted in Qwest’s opening comments, the Tenth Circuit’s decision requires the Commission to play a somewhat larger role – though still smaller than that of the states – in ensuring rate comparability throughout the United States. This larger funding obligation is an unavoidable consequence of the court’s core holdings (1) that the Commission may not “substitute[] a comparison of national and statewide averages for the statutory comparison of

2002, at 16. Even anemic competition will make such price discrepancies wholly unsustainable over the mid- to long-term.

¹⁷ 258 F.3d at 1204 (emphasis added).

¹⁸ See 47 U.S.C. § 254(a), (e) & (f).

¹⁹ *Ninth Report and Order* at 20465 ¶ 57.

urban and rural rates”;²⁰ (2) that a 70-80% discrepancy between rural and urban rates would likely fail the reasonable comparability test;²¹ and (3) that “[o]n remand, the FCC is required to develop mechanisms” – most likely in the form of funding conditions – “to induce adequate state action.”²² Mechanisms “to induce adequate state action” must be sizable enough to give states a meaningful stake in adopting universal service reform within their borders. In other words, the federal pie must grow to accommodate more slices and to ensure that the size of each slice is adequate for the statutory purposes. At the same time, as Qwest has explained in its opening comments, the Commission can meet these various obligations while still keeping the fund size manageable.²³

AT&T resists any enlargement of the federal fund on the ground that ensuring the statutory command of reasonable comparability between urban and rural rates must give way to the objective of lower long-distance rates. (AT&T Comments 8-9.) Here again, AT&T fails to come fully to grips with the Tenth Circuit’s decision. The court found that two principles under section 254(b) were relevant to Qwest’s challenge to the *Ninth Report and Order*: (1) reasonable comparability between rates in rural and urban areas, and (2) the need for “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.”²⁴ The court noted that section 254(b)(1) “arguably” encompasses the price of long distance services (“as well as universal services”), but that “at most” would mean taking those costs into account

²⁰ 258 F.3d at 1202.

²¹ *Id.* at 1201.

²² *Id.* at 1204.

²³ *See* Declaration of Byron Watson, filed with Qwest’s Comments, at 3 and 5.

²⁴ 258 F.3d at 1199.

as part of the overall balance in determining an appropriate plan for implementing section 254.²⁵ AT&T makes no serious effort to conduct that balancing exercise: it presents no empirical evidence suggesting that increasing the size of the fund would place an additional “burden” on customers that would outweigh the benefits of ensuring reasonable comparability.

Indeed, so long as the Commission places appropriate conditions on a state’s receipt of federal support, *see* Qwest Comments at 21-23, any increase in the size of the federal fund would be offset, over the long term, by a commensurate decrease in the size of the corresponding state funds. From the aggregate perspective of consumers nationwide, the net result would be a virtual wash: line-item increases caused by higher federal contribution obligations would be largely offset by rate (or line-item) decreases attributable to smaller state-level funding needs. There is thus no merit to AT&T’s contention (Comments at 8) that the Commission should read into section 254 an objective that Congress did not place there: a limit on the size of the federal portion of this zero sum equation between the federal government and the states. Of course, *any* adjustment in the respective roles of the federal government and the states has the effect of slightly *reallocating* the contribution burdens *among* end users in different states. Again, however, “reasonable comparability” is a *federal* statutory mandate, and it is both routine and unobjectionable for the federal government to subsidize its own statutory programs through assessments on individuals nationwide – whether through taxes or, as here, line item charges. In any event, *Qwest’s* proposal would produce only a modest increase in the size of the federal program. *See* Qwest Comments at 20 and Appx. A at 3, 5.

Finally, there is no merit to AT&T’s suggestion that the size of the old federal high cost fund should serve as the measure of “sufficiency” (much less “reasonable comparability”) under

²⁵ *Id.* at 1200.

section 254. Congress adopted section 254 precisely because (1) it had just enacted sections 251, 252 and 253 to make competition possible, (2) competition will inevitably erode traditional implicit subsidies, and (3) what was sufficient in 1995 will not necessarily be sufficient after years of competition have washed away the existing monopoly-based funding schemes. Put differently, there is no reason to suppose that, at the same time it unleashed the forces of competition and added a new federal requirement of rate comparability, Congress wished the Commission simply to grandfather in the details of the old regime. In any event, the Tenth Circuit has invalidated precisely this mode of reasoning, holding that the Commission's prior argument (that 135% "is 'near the midpoint' of the current range") is flatly "insufficient to support the benchmark."²⁶

IV. The Commission Should Not Conflate the Goal of "Reasonable Comparability" with the Separate Goal of Need-Based Funding for Indigent Subscribers.

There is no merit to various proposals (such as those presented by SBC and, to a lesser extent, BellSouth) to blur the distinction between the high-cost fund, which focuses on rate comparability irrespective of subscriber income, and various need-based funding mechanisms such as Lifeline. (See SBC Comments 12-24; BellSouth Comments 12.) Each of these programs addresses a distinct federal objective. As stated in the *Ninth Report and Order*, the purpose of high-cost support is "to enable access to telecommunications service in areas where the cost of such service otherwise would be prohibitively high."²⁷ The Tenth Circuit likewise recognized that comparability between rural and urban *areas* is the focus of section 254, and it held that the Commission cannot ignore that objective altogether to achieve some other goal.²⁸ Here, the

²⁶ 258 F.3d at 1202.

²⁷ *Ninth Report and Order* at 20441 ¶ 16.

²⁸ 258 F.3d at 1204.

Commission should not – and, under the Tenth Circuit’s decision, may not – compromise on reasonable comparability among geographic areas by diluting that goal with income-related considerations; the Commission should continue addressing each of those considerations separately.

For similar reasons, the Court should reject BellSouth’s invitation to condition Lifeline funding on state compliance with “reasonable comparability” objectives. (*See* BellSouth Comments 12.) As their very name suggests, “Lifeline” funds are needed to support a necessity of life for the indigent, and the Commission should not withhold such funds because states have fallen short in meeting a largely *unrelated* universal service objective. Indeed, the lack of a close nexus between the federal requirement at issue (reasonable comparability between high- and low-cost areas) and the funds withheld (need-based Lifeline funds) could raise constitutional concerns.²⁹

CONCLUSION

For the reasons discussed above and in Qwest’s opening comments, the Commission should (1) provide federal funding for all *wire centers*, regardless of state boundaries, whose average per-line costs exceed a given dollar benchmark, (2) provide supplemental funding for *states* that have such high statewide average costs that, even taking into account the wire center funding just mentioned, would lack the internal resources to keep their rates reasonably comparable to those in other states, and (3) condition all federal funding on a state’s certification that it has achieved reasonable comparability within its borders and, over time, on the state’s

²⁹ *South Dakota v. Dole*, 483 U.S. 203, 107 S. Ct. 2793 (1987) (“Conditions on federal grants might be illegitimate if they are unrelated to the federal interest in particular national projects or programs.”) (internal quotation omitted).

progress in producing such comparability through explicit, competitively neutral support mechanisms rather than traditional implicit cross-subsidies.

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Certificate of Service

I, Carole Walsh, do hereby certify that on this 25th day of April, 2002, I caused true and correct copies of the foregoing Reply Comments of Qwest Communications International, Inc. to be served upon the following parties.

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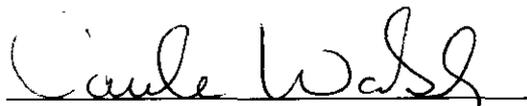
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