

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

Federal-State Joint Board on
Universal Service

CC Docket No. 96-45

COMMENTS OF VERIZON ON RECOMMENDED DECISION

Of Counsel
Michael E. Glover
Edward Shakin

Joseph DiBella

1515 North Court House Road
Suite 500
Arlington, VA 22201
Tel (703) 351-3037
joseph.dibella@Verizon.com

December 20, 2002

TABLE OF CONTENTS

INTRODUCTION AND SUMMARY 1

I. THE 10TH CIRCUIT DECISION DOES NOT REQUIRE CHANGES IN THE COMMISSION’S UNIVERSAL SERVICE FUNDING MECHANISM FOR NON-RURAL CARRIERS..... 2

II. THE JOINT BOARD PROPERLY DEFINED A “SUFFICIENT” FUND AS ONE THAT IS LARGE ENOUGH TO ENABLE STATES TO MAINTAIN REASONABLY COMPARABLE URBAN AND RURAL RATES. 4

III. THE COMMISSION SHOULD ADOPT THE JOINT BOARD’S RECOMMENDATION TO USE COSTS RATHER THAN RATES TO DETERMINE NON-RURAL HIGH-COST SUPPORT. 5

IV. THE COMMISSION SHOULD ADOPT THE JOINT BOARD’S RECOMMENDATION TO TARGET SUPPORT BY COMPARING STATEWIDE AVERAGE COSTS TO A NATIONAL BENCHMARK. 7

V. THE JOINT BOARD’S RECOMMENDATION FOR A BENCHMARK BASED ON 135 PERCENT OF NATIONWIDE AVERAGE COSTS IS SUPPORTED BY THE RECORD..... 7

VI. THE COMMISSION SHOULD ADOPT THE JOINT BOARD’S RECOMMENDATIONS FOR STATE INDUCEMENTS AND A TEMPLATE FOR ADDRESSING STATE REQUESTS FOR ADDITIONAL SUPPORT..... 12

VII. CONCLUSION 13

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

Federal-State Joint Board on
Universal Service

CC Docket No. 96-45

**COMMENTS OF VERIZON¹ ON
RECOMMENDED DECISION**

Introduction and Summary

The Joint Board's *Recommended Decision*² is a well thought-out, cohesive, and thorough response to the issues that were remanded to the Commission by the 10th Circuit Court of Appeals. The Court 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. The *Recommended Decision* provides the rationale that the Court is seeking. In addition, it addresses the Court's finding that the Commission's universal service mechanism must provide an inducement for the states to assist in the goals of universal service. The Commission should adopt the *Recommended Decision*, including the proposals for expanding the current annual state certification process and

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

² *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, FCC 02J-2 (rel. Oct. 16, 2002) ("*Recommended Decision*").

for providing a template for states to demonstrate the need for additional universal service support.

I. The 10th Circuit Decision Does Not Require Changes In The Commission’s Universal Service Funding Mechanism For Non-Rural Carriers.

At the outset, it is important to note that the 10th Circuit Court of Appeals did not find that the Commission’s high-cost funding mechanism for non-rural carriers was unlawful – it simply remanded the *Ninth Report and Order*³ for a better explanation and justification for the Commission’s decision that the mechanism meets the universal service goals of section 254 of the Act. *See Qwest v. FCC*, 258 F.3d 1191 (10th Cir. 2001). The Court required the Commission to provide a more reasoned definition of the principles that (1) 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 (2) 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). The court also directed the Commission to justify its selection of 135 percent of national average costs as a benchmark for qualifying a state for high-cost support. *See* 258 F.3d at 1202. In addition, the Court required the Commission to provide some sort of inducement for the states to assist in carrying out the universal service goals of section 254. *See id.* at 1204. None of this requires changes in the structure of the Commission’s high-cost funding mechanism for non-rural carriers; it merely

³ *Federal-State Joint Board on Universal Service, Ninth Report and Order & Eighteenth Order on Reconsideration*, 14 FCC Rcd 20432 (1999) (“*Ninth Report and Order*”).

requires the Commission to provide additional explanation of the reasons that this mechanism meets the statutory criteria.

The *Recommended Decision* shows that the existing high-cost funding mechanism does just that. The Joint Board addressed each of these issues and it provided an analysis that meets the statutory criteria.⁴ It defined “sufficient” in section 254(b)(5) of the Act as enough support to enable states to maintain reasonable comparability of rates between urban and rural areas. It explained why comparisons of state-wide costs between different states is the most accurate way of targeting high-cost support to states that need federal assistance to maintain reasonably comparable rates. It justified the 135 percent benchmark based on a statistical analysis of rate differences between urban and rural areas and of cost differences among the states. Using these analyses, it determined that providing federal support to states with costs above the benchmark would provide sufficient support. To provide an inducement for the states to meet the statutory universal service goals, it recommended that the Commission expand the state certification process to include a showing by states receiving high-cost funding that they are maintaining reasonably comparable rates in urban and rural areas of the state. For this purpose, the Joint Board recommended a standard template for comparing basic service rates. The Joint Board also recommended that the states be allowed to present additional data to demonstrate that additional federal support is needed to maintain reasonably comparable rates.

⁴ The Joint Board did not address the additional issue raised by the Court concerning how the high-cost funding mechanism for non-rural carriers will interact with other universal service programs, which the Commission’s *Remand Notice* reserved for a comprehensive review of the rural and non-rural universal service support mechanisms. *See Recommended Decision*, ¶ 9.

These recommendations are supported by the record and are directly related to the statutory goals. As such, they are responsive to the Court’s directions and provide a sound basis for the Commission to affirm its high-cost mechanism.

II. The Joint Board Properly Defined A “Sufficient” Fund As One That Is Large Enough To Enable States To Maintain Reasonably Comparable Urban and Rural Rates.

Section 254(b)(5) of the Act requires that there should be “sufficient” federal and state mechanisms to support universal service. The 10th Circuit Court found that the Commission’s previous *Ninth Report and Order* had not defined “sufficient” with regard to the statutory principles but that it had simply found that the high-cost funding mechanism would be sufficient. The Court found that this was inadequate to enable appellate review and that it was simply a circular argument. In the *Recommended Decision*, the Joint Board recommended that the Commission define “sufficient” as “enough support to enable states to achieve reasonable comparability of rates” between urban and rural areas. *See Recommended Decision*, ¶ 15. In addition, the Joint Board recommended that the Commission reaffirm its findings in previous orders that “sufficiency” should mean a non-rural high-cost support fund that is only as large as necessary to meet the statutory goal. *See id.*, ¶ 16.

These recommendations are responsive to the Court’s finding that the term “sufficient” should be defined with relationship to the statutory goals. The Court recognized that the Commission may balance the statutory goals, which sometimes are in conflict. *See Qwest*, 258 F.3d at 1200. Here, the goal of reasonably comparable rates in section 254(b)(3) of the Act must be balanced against the goal of maintaining “affordable” rates in section 254(b)(1). The Joint Board’s recommendation provides this balance by suggesting that the high-cost funding

mechanism should be no larger than necessary to meet the goal of enabling the states to achieve reasonably comparable rates between urban and rural areas. A fund that is too large would increase costs for all consumers and impair the ability of some customers to continue subscribing to telephone service. The funding mechanism as recommended by the Joint Board would provide federal support only to states that do not have the internal resources to maintain reasonable comparable rates, and it would provide only the amount of support necessary to assist the states in achieving the statutory goals. The Commission should adopt the Joint Board's recommendation for the definition of "sufficient."

III. The Commission Should Adopt The Joint Board's Recommendation To Use Costs Rather Than Rates To Determine Non-Rural High-Cost Support.

Although some may argue that it is anomalous to use comparisons of costs among states rather than rates to determine when a state needs federal universal service support to maintain reasonably comparable urban and rural rates,⁵ the Joint Board's recommendation to continue using cost comparisons to distribute support is a reasonable and practical approach. As the Joint Board observed, states may base rates on numerous considerations other than costs. *See Recommended Decision*, ¶ 19. States have pursued different rate structure policies, have used different types of implicit or explicit mechanisms to support universal service, and have used different rate-making methodologies (rate of return, price caps, etc.), to name a few. Consequently, simply comparing rates may not correctly identify states that need additional support from the federal fund to maintain reasonably comparable urban and rural rates.

⁵ *See, e.g., Recommended Decision*, Statement of Commissioner Martin, 2.

Ultimately, a state's need for additional funding depends on whether its costs are significantly higher than average. If not, the state should be able to design rates that are reasonably comparable to those prevailing nationwide. For this reason, the Commission has historically used cost comparisons to target universal service funding, whether using actual costs as in the past, or proxy model costs under the current mechanism. The Commission should continue to use cost comparisons to identify states that need federal support.

The fact that the Joint Board's recommendations for state inducements include a supplemental review of rates is not inconsistent with the recommendation to target support in the first instance using cost comparisons. The Commission currently does not have sufficient data on state rates to accurately use them to identify states that need federal support to offset their higher-than average costs. The supplemental rate review will provide a mechanism for individual states to demonstrate that they need additional support above and beyond the amounts produced by the Commission's cost model, but a rate demonstration would be only one part of that showing. A state also would have to show that it had taken all actions reasonably possible and had exhausted all available federal and state resources to make basic service rates reasonably comparable. *See Recommended Decision*, ¶ 50. In the end, a state will be able to justify more support only if its costs are so high above the national average as to prevent it from being able to generate sufficient revenues to cover those costs through rates that are reasonably comparable to the national average. Therefore, it is reasonable to use cost comparisons as the basic mechanism for targeting universal service support.

IV. The Commission Should Adopt The Joint Board's Recommendation To Target Support By Comparing Statewide Average Costs To A National Benchmark.

The Joint Board's recommendation that the Commission continue to target support to states by comparing statewide average costs to a national benchmark is consistent with the goal of providing federal support only to states that cannot maintain reasonably comparable rates without it. Regardless of whether a particular state has some rural areas where costs per-line are several times higher than the national average (and almost all do), the state will be able to maintain reasonably comparable rates in urban and rural areas by averaging rates between high-cost areas and low cost areas or through explicit support mechanisms that funnel revenues from low cost areas to high-cost areas. If a state's average costs are reasonably comparable to the national average, it will be able to maintain reasonably comparable rates within the state regardless of how much costs vary between wire centers in the state. However, if a state has above-average costs, balancing rates and revenues between high-cost areas and low cost areas within the state may not be sufficient for the state to maintain rates in rural areas that are reasonably comparable to the national average. Therefore, a comparison of statewide average costs to the national average is the true measure of a state's need for additional federal support to maintain reasonably comparable rates.

V. The Joint Board's Recommendation For A Benchmark Based On 135 Percent Of Nationwide Average Costs Is Supported By The Record.

The Commission should adopt the Joint Board's recommendation to retain a benchmark based on 135 percent of nationwide average costs in identifying states that need additional federal support to maintain reasonably comparable rates. This will enable the Commission to carry out

Congress' intent to maintain the reasonable comparability of urban and rural rates that existed at the time the Telecommunications Act of 1996 was enacted.

The Joint Board correctly observed that, when Congress passed the 1996 Act, it intended to maintain the reasonable comparability of urban and rural rates that existed at that time in the face of the increase in local competition that would be created by the Act. *See Recommended Decision*, ¶ 35. The 1996 Act would change all facets of the telecommunications industry by eliminating the barriers to competitive entry in all markets. While Congress expected this increase in competition to produce substantial public benefits, it also understood that new entry into the local exchange markets would undermine the ability of the states to maintain statewide average rates by the incumbent local exchange carriers, because new entrants would be able to concentrate their efforts in low cost areas where the statewide average rates were above cost, and to avoid serving high-cost areas where the statewide average rates were below cost. This would cause incumbents to lose the contribution that they needed to maintain below cost rates in high-cost rural areas. To address this issue, Congress enacted section 254 to give the Commission and the states the tools they needed to maintain universal service in the face of competitive change.

There is no evidence that Congress believed that urban and rural rates were not reasonably comparable in 1996, or that it intended to require rural rates to be reduced to the level of rates (much less costs) in urban areas. The record is clear that Congress intended to “preserve” and “maintain” the current level of affordability in rural areas that existed at that time. *See Recommended Decision*, fn. 88, citing congressional record. Therefore, in setting the benchmark, the Commission should seek to maintain the level of reasonable comparability between urban and rural rates that existed in 1996.

The Joint Board relied upon the *GAO Report* to find that today, six years after the 1996 Act, national averages of urban and rural rates for residential customers vary by less than 2 percent.⁶ In addition, the *GAO Report* shows that urban and rural residential rates within each state are substantially the same, if not actually lower in rural areas than in urban areas in some states. *See GAO Report*, Appendix IV. 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 densely 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. For these reasons, the Commission should find that rates generally are reasonably comparable between urban and rural areas throughout the country.

The Commission should adopt the Joint Board's recommendation to use a benchmark based on nationwide average cost to identify states that need additional federal support to maintain reasonably comparable rates. Since the *GAO Report* shows that the nationwide averages for rates in urban, suburban, and rural areas are almost identical, using the nationwide average cost for all areas as the basis for the benchmark will identify states that have above-average costs and therefore will target support to the states that have more difficulty maintaining rates, even when averaged between urban and rural areas within the state, at a level reasonably comparable to

⁶ *See Recommended Decision*, ¶ 34, citing United States General Accounting Office, *Telecommunications – Federal and State Universal Service Programs and Challenges to Funding*, GAO 02-187 (rel. Feb. 4, 2002) (“*GAO Report*”).

the average nationwide urban rate.⁷ A state's average cost is the best measure of its ability to maintain rates in rural areas within a reasonable range of the nationwide average urban rate, which in turn reflects the nationwide average cost due to the nearly universal practice of rate averaging between urban and rural areas in each state.

Using a benchmark based only on urban *costs*, an approach the Joint Board rejected, (*see Recommended Decision*, ¶¶ 39-41) would reduce rates in all rural areas (and in urban areas as well where rates are averaged throughout a state) to an arbitrarily selected urban cost level. This clearly is not what Congress intended when it directed the Commission to maintain the current affordable rates for telephone service. If Congress had intended to require such a drastic reduction of rates throughout the country, and to create the huge system of universal service subsidies that this would entail, it would have given the Commission explicit instructions to do so. Congress did not.

A national urban cost benchmark would have several consequences that are not supported by the record in this proceeding nor intended by Congress. First, changing the benchmark to a lower percentage would imply that the current fund size is insufficient to produce reasonably comparable rates. That is not the case, as the record has already demonstrated. A national urban cost benchmark would be substantially lower than today's national average cost benchmark of 135% and it would substantially increase the size of the high-cost fund.⁸ The need for this

⁷ The fact that the *GAO Report* included a sampling of rates for both rural and non-rural carriers supports this analysis, even though the benchmark will be used to target support only for non-rural carriers. The *GAO Report* shows that urban and rural rates are reasonably comparable throughout a state for all carriers, reinforcing the decision to compare statewide average costs to nationwide average costs to identify states that need additional federal support to maintain reasonably comparable rates within their borders.

⁸ *See, e.g.*, Comments of Rural State Commissions, 18-20 (filed Apr. 10, 2002).

additional support has not been demonstrated. As Verizon has pointed out and as the Joint Board concluded, rates already are reasonably comparable. In fact, in some rural areas, rates are lower than their urban counterparts. Accordingly, the Commission should not adopt a funding mechanism designed to provide support for costs above a benchmark of urban costs.

The Joint Board recommended a benchmark of 135 percent of nationwide average costs based on a statistical analysis recommended by Verizon and on the basis of a cluster analysis. *See Recommended Decision*, ¶¶ 35-38. The statistical analysis is based on the premise that Congress intended to maintain the level of comparability of urban and rural rates that existed at the time of the 1996 Act, which exists today as shown by the evidence of rate averaging in the GAO Report and the fact that rates have not changed substantially since 1996. *See Recommended Decision*, ¶ 35. Therefore, it is only the outliers – the states with significantly higher costs than the nationwide average – that will have difficulty maintaining the level of reasonably comparable rates that currently exists, and that has been supported in the past by a federal high-cost fund based on a similar benchmark tied to a percentage above nationwide average costs. A statistical measure of two standard deviations of the mean comprises approximately 95 percent of the observed data. As a result, any state with costs more than two standard deviations from the nationwide average cost is a true outlier that needs federal support to keep rates within a reasonable range of the national average. Based on the data in the GAO Report, the Joint Board determined that the measurement of two standard deviations results in approximately 132 percent of nationwide average costs. *See Recommended Decision*, ¶ 36. This supports retention of the 135 percent benchmark.

The Joint Board's cluster analysis also supports the 135 percent benchmark. *See Recommended Decision*, ¶ 37. The cluster analysis sorts groups of states into clusters with similar cost characteristics. The cluster analysis shows that the current states that receive high-cost support under the non-rural mechanism form separate high-cost clusters that have significantly higher costs than the rest of the states. This confirms the validity of the 135 percent benchmark currently used in the high-cost fund.

For these reasons, the Commission should adopt the Joint Board's recommendation to use 135 percent of nationwide average costs as the benchmark for identifying states that need federal support to maintain universal service.

VI. The Commission Should Adopt The Joint Board's Recommendations For State Inducements And A Template For Addressing State Requests For Additional Support.

The Joint Board addressed the Court's direction to establish an inducement for states to ensure reasonable comparability of urban and rural rates within a state. *See Recommended Decision*, ¶¶ 50-56. The Joint Board recommended that the Commission expand the current annual certification process to require a state to certify that rates in high-cost areas receiving universal service support are reasonably comparable to a national rate benchmark. The Joint Board recommended adoption of a standard template for comparing rates and a benchmark based on 135 percent of the national average residential rate. It also recommended allowing a state with rates above the benchmark to show that it needed additional federal support.

The Commission should adopt these recommendations, which will give states inducements to ensure reasonable rate comparability while providing a mechanism for requesting additional support if the state has been unable to achieve reasonably comparable rates despite taking all

reasonable actions and using all available state and federal resources. The Commission should make it clear that any state, not simply those submitting annual certifications in order to receive support, may submit rate information using the template to show that it needs additional federal support. While the burden will be on the state to demonstrate that it has no means other than additional federal support to achieve reasonably comparable rates, the Commission should not try to determine in advance what criteria a state must meet to satisfy this burden. Since such a showing would be an exception to the rule, the Commission should judge each submission based on the facts and circumstances in each case.

VII. Conclusion

For the foregoing reasons, the Commission should adopt the Joint Board's recommendations for addressing the issues raised in the 10th Circuit Court's remand of the *Ninth Report and Order*.

Of Counsel
Michael E. Glover
Edward Shakin

Respectfully submitted,

By: 
Joseph DiBella

1515 North Court House Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3037
joseph.dibella@verizon.com

Attorney for the Verizon
telephone companies

Dated: December 20, 2002

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.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.