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 SBC COMMUNICATIONS INC.

Paul K. Mancini
SBC COMMUNICATIONS INC.
175 East Houston
San Antonio, TX 78205
(210) 351-3500

Gary L. Phillips
Christopher M. Heimann
SBC COMMUNICATIONS INC.
1401 Eye Street, NW
Suite 400
Washington, D.C. 20005
(202) 326-8903

John H. Harwood II
Lynn R. Charytan
Jonathan J. Frankel
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, DC 20037-1420
(202) 663-6000

Counsel for SBC Communications Inc.

January 14, 2003

TABLE OF CONTENTS

INTRODUCTION AND SUMMARY 1

DISCUSSION 4

I. The Act Requires the Commission To Take Meaningful Steps To Induce States To Transition to Explicit Universal Service Support Mechanisms. 4

A. The Act Requires the Commission To Move the States to Explicit Subsidies. 6

B. The Commission Itself Has Recognized That the Goals of Section 254 Cannot Be Achieved Unless the States Adopt Explicit Universal Service Mechanisms. 9

II. Neither the Order on Remand Nor the FNPRM's Proposed Additional "Inducement" Fund Satisfies the Commission's Obligation To Cause the States To Transition to Explicit Support. 17

A. The *Order on Remand* Does Not Even Attempt To Induce the States To Adopt Explicit Support Mechanisms in Lieu of Implicit Subsidies. 17

B. The FNPRM's Proposed "Additional Inducements" Would Create No Meaningful Incentive for the States To Transition to Explicit Funding. 20

III. The Commission Should Tailor Its Universal Service Regime To Induce States To Transition to Explicit Universal Service Support. 23

A. The Commission Should Expressly Condition All High Cost Federal Universal Service Funding on Whether a State Has Committed to Transitioning from Implicit to Explicit Subsidies. 23

B. The Commission Must Provide Guidance to the States Concerning the Required Contours of an Explicit Funding Mechanism 26

C. The Commission Should Adopt an Affordability Methodology to Ensure That the Goals of the Act are Met Without Unnecessarily Increasing the Size of the Federal High-Cost Fund, and the Possibility of an Increase in the Fund Would in No Event Justify a Failure To Promote a Transition to Explicit Subsidies. 28

CONCLUSION 30

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 SBC COMMUNICATIONS INC.

SBC Communications Inc., on behalf of itself and its operating company affiliates,[1] (collectively, "SBC") respectfully submits these comments in response to the Commission's October 27, 2003 Further Notice of Proposed Rulemaking in the above-captioned docket ("*FNPRM*").[2]

INTRODUCTION AND SUMMARY

The universal service goals of the Telecommunications Act of 1996 cannot be met unless the states take bold action to replace their jury-rigged systems of implicit universal service subsidies with explicit funding mechanisms. The language and structure of section 254 of the Act make this clear, and the Commission has repeatedly acknowledged it. Universal service is neither equitable nor nondiscriminatory if one carrier — the incumbent LEC — is primarily

---

[1] Those affiliates are: Southwestern Bell Telephone, L.P.; Nevada Bell Telephone Company; Pacific Bell Telephone Company; Illinois Bell Telephone Company; Indiana Bell Telephone Company, Incorporated; Michigan Bell Telephone Company; The Ohio Bell Telephone Company; Wisconsin Bell, Inc.; and The Southern New England Telephone Company.

[2] Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 03-249 (rel. Oct. 27, 2003) ("*FNPRM*").

responsible for sustaining it. And because competition makes implicit subsidies unsustainable, a universal service regime that rests on implicit subsidies cannot meet the statute's requirement that state and federal support be specific, predictable, and sufficient.

As the statute provides and the Tenth Circuit confirmed in *Qwest v. FCC*, 258 F.3d 1191 (10th Cir. 2001), the Commission must ensure that the universal service regime is designed to induce the states to make the transition to explicit support. The Act expressly requires the Commission to design the federal universal service regime to advance the goals set out in section 254(b), and that provision both requires that *all* universal support be equitable and non-discriminatory, and that *state* universal service support be specific, predictable and sufficient. The federal regime thus must take into account how federal funding will advance — or disserve — these goals with respect to state universal service funding. It is not enough for the Commission to give the states enough money to "enabl[e]" them to take action if they so choose; rather, as the Tenth Circuit made clear, the Commission "must also undertake the responsibility to *ensure* that the states act" by creating some "carrot" or "stick" significant enough "to induce," not merely encourage, "adequate state action."[3]

The proposals in section D of the *FNPRM* to induce states to implement explicit universal service mechanisms — "Additional Inducements for State Action" — fall far short of the mark. They are not sufficient to compel states to act. The *Order on Remand*[4] itself contains no "inducement" for the states to move to explicit subsidies. Indeed, the Commission explicitly disclaimed any effort to induce the states to move to explicit universal service support in the

---

[3] *Qwest Corp. v. FCC*, 258 F.3d 1191, 1204 (10th Cir. 2001) (emphasis altered).

[4] Order on Remand, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 03-249 (rel. Oct. 27, 2003) ("*Order on Remand*").

Order on Remand, noting that "states continue to be in the best position to determine when to eliminate implicit support in their rate designs and establish explicit, sustainable universal service mechanisms." The *Order on Remand* instead simply requires that the states certify that their rural rates are reasonably comparable to a national urban benchmark, even though the Commission itself recognized that current rates in the states are generally premised on implicit subsidies. The *Order on Remand* thus not only fails to stimulate a transition to state explicit support funding: it establishes a federal universal service support mechanism that *expressly relies* on the continued existence of *implicit* funding — funding that the Commission itself recognizes *will not* continue to exist in a competitive environment— in designing and defending the federal regime.

Only in the *FNPRM* does the Commission propose to do *anything* to "provide each state with a direct incentive to make its universal service support mechanisms explicit, rather than implicit"[5] — even though this is what Congress intended in 1996, and what the Tenth Circuit required in 2001. But its proposal, to give a relatively small amount of extra funding to states that adopt explicit support mechanisms, is woefully insufficient. The Commission cannot make the national high cost universal service program consistent with the principles of section 254 by way of what is no more than an afterthought.

Instead, the Commission's approach to universal service should be redesigned so that it can serve as the powerful incentive that the Tenth Circuit recognized is necessary. Specifically, the Commission should redesign its mechanism so that all high cost universal service support, for both rural and non-rural carriers, is expressly conditioned on a state having adopted or demonstrating a concrete commitment to transition to an explicit support mechanism. Any other

---

5 *FNRPM* ¶ 128.

approach renders purely voluntary what Congress clearly intended as a compulsory requirement of the Act. The Commission can and should give the states guidance concerning what qualifies as an explicit support mechanism, and should support the states during the transition to ensure that consumers and carriers are protected. And the Commission can ensure that the high cost fund does not become excessive and burdensome by revisiting its rejection of the "affordability" proposal outlined by SBC, which Congress itself adopted as one of the core principles of section 254 of the Act. SBC respectfully suggests that these steps would be more in accord with Congress's intent and the Tenth Circuit's directions than the meager proposal set forth in section D of the *FNPRM.*

DISCUSSION

I. The Act Requires the Commission To Take Meaningful Steps To Induce States To Transition to Explicit Universal Service Support Mechanisms.

Inducing the states to reform their universal service support mechanisms is a statutory imperative. Congress directed the Commission and the states to require *every* inter- and intrastate carrier, not just the incumbent LECs, to contribute to universal service on an "equitable" and "nondiscriminatory" basis.[6] That necessarily entails replacing implicit subsidy regimes — which place the total support burden on the incumbent LEC and depend entirely on the incumbent's rapidly diminishing ability to cross-subsidize its retail services — with explicit support mechanisms that equitably assess all carriers for the support amounts. Congress also directed the Commission to ensure that "[f]ederal and State mechanisms to preserve and advance universal service" be "specific, predictable and sufficient."[7] These are criteria that the crumbling

---

[6] 47 U.S.C. §§ 254(b)(4), (f).

[7] 47 U.S.C. § 254(b)(5).

state implicit-subsidy-based programs cannot satisfy, given the rapid development of subsidy-eroding competition. Nor can any federal program designed merely to supplement those programs. As the Tenth Circuit made clear, these are binding instructions from Congress,[8] not just "aspirations" as the *FNPRM* suggests.[9]

From its first orders under the 1996 Act through the *Order on Remand* and *FNPRM* in this proceeding, the Commission has consistently recognized that accelerating competition for high-revenue business customers and low-cost customers inevitably strips away the implicit subsidies formerly contained in the rates for those customers, making a transition to explicit universal service support mechanisms an absolute necessity. The only recent change is that the Commission now denies that Congress specifically *required* this transition — even though the Commission has acknowledged exactly the opposite many times before. In any event, substantial competition for these high-margin customers has in fact developed, with the very results forecast by Congress, the Commission, and the Tenth Circuit: implicit subsidies are disappearing but states are unwilling or unable to put explicit funding mechanisms in their place. This leaves incumbent LECs to finance universal service out of their own pockets from a dwindling share of the market. The incumbents' ability to continue to serve higher-cost and rural markets at low rates is accordingly at risk, while, at the same time, *other* competitors are deterred from serving those markets specifically because of the artificially low rates the states require the incumbent to charge. Continued reliance on implicit subsidies thus serves neither universal service goals nor the public interest generally.

---

8 *Qwest*, 258 F.3d at 1200.

9 *FNPRM* ¶ 127.

A. The Act Requires the Commission To Move the States to Explicit Subsidies.

The *FNPRM* correctly recognizes that "section 254" of the Act "states a clear preference for explicit, rather than implicit, support," but then incorrectly suggests that the Act "does not require states to adopt explicit universal support mechanisms."[10] Certainly Congress thought it was doing otherwise. For example, the Conference Report to the 1996 Act, states, "To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be *explicit*, rather than implicit as many support mechanisms are today." S. Conf. Rep. No. 104-230, at 131 (1996) (emphasis added); H.R. Conf. Rept. No. 104-458, at 131 (1996) (containing the same language). And the provisions of section 254 of the Act itself direct both the states to move to explicit universal service funding mechanisms and the Commission to ensure the accomplishment of that result. Nothing other than such a transition can fulfill the goals of the Act, and the Commission is charged with ensuring that its program induces the states to fulfill those goals.

Several provisions of section 254 require universal service support mechanisms at both the federal and state levels to be explicit. (Although these provisions are alternatively directed to the Commission or the states, that is of no practical import when reviewing a federal program that consciously *incorporates* state programs, relies on them to provide the bulk of universal service support, and serves only as a supplement to those state programs. *See Order on Remand* ¶ 21.) First, Congress directed the Commission to ensure that its own universal service support mechanisms were explicit. *See* 47 U.S.C. § 254(e) (providing that "specific Federal universal service support" for eligible telecommunications carriers "should be explicit"). In addition, Congress directed both the Commission and the States to ensure that universal service support

---

10 *Id.*

burdens were spread among *all* carriers in an equitable and nondiscriminatory fashion. *See* 47 U.S.C. § 254(b)(4) (directed to the Commission and the Federal-State Joint Board on Universal Service; "All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."); 47 U.S.C. § 254(f) (directed to states; "Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State.").

State universal service policies that rely in whole or in part on implicit subsidies necessarily violate the commands of the Act as much as does a federal mechanism that relies primarily on, and seeks merely to supplement, such policies. Only the incumbent LEC bears the burden of implicit subsidy obligations, because only the incumbent LEC must provide the resources for universal service support by raising the prices of some of its services to subsidize others. Thus, implicit subsidies do not require "every telecommunications carrier" in the state to contribute to universal service "on an equitable and nondiscriminatory basis."[11] And as competition grows, incumbents must continue to serve the great majority of high cost customers

[11] To the extent that some portion of the incumbent's universal service burden is passed on to interexchange carriers through increased prices on carrier-to-carrier services (such as interstate or intrastate access), such sharing is entirely fortuitous and *ad hoc*. Moreover, it will not last: As the Commission is well aware, both technical changes (such as the spread of cable telephony) and regulatory changes (such as the *Triennial Review Order*'s loosening of the restrictions on EELs) are making it increasingly easy for IXCs to avoid paying these charges. *See* Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610, 9616 ¶ 12 (2001) (describing regulatory arbitrage arising when companies pay different rates but provide the same service over different technologies); Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* 18 FCC Rcd 16978, 17001-02 ¶¶ 24-25 (2003) (noting that EEL restrictions were only intended to be a temporary transitional mechanism).

under their carrier of last resort obligations, while at the same time serving an ever-shrinking number of the higher-margin customers who generated the subsidies in the past — a result that is hardly "equitable" or "nondiscriminatory."[12]

The other mandates in section 254(b) likewise obligate the Commission to ensure that universal service mechanisms are designed to induce the states to transition their universal service regimes from implicit subsidies to explicit support mechanisms. Section 254(b) expressly directs the Commission and the Federal-State Joint Board on Universal Service to adopt policies that will foster "specific, predictable and sufficient . . . *State* mechanisms." 47 U.S.C. § 254(b)(5) (emphasis added). As the Tenth Circuit explained, section 254(b) imposes a "mandatory duty" on the Commission to tailor its own support policies to achieve "sufficient state mechanisms to promote universal service." *Qwest*, 258 F.3d at 1200, 1203. To achieve such "sufficient" mechanisms, as well as ones that are specific and predictable, the Commission must induce states to abandon the implicit subsidies that continue to predominate in state universal service support.

In the competitive telecommunications market that the 1996 Act was specifically designed to stimulate, implicit state universal service support cannot be "sufficient . . . to preserve and advance" universal service. 47 U.S.C. § 254(b)(5). As discussed further below, competition inexorably erodes implicit subsidies over time, by creating competition for the attractive high-margin customers that provide support for higher-cost customers. Thus, in the face of the inter- and intramodal competition introduced by the Act, any universal service

---

[12] That these sections do not specifically use the word "explicit," as the *Order on Remand* notes (¶ 26), is irrelevant: as a practical matter, the only type of support mechanism that makes "every" carrier contribute to universal service on a potentially "equitable" and "nondiscriminatory" basis is an explicit one.

program that relies on incumbents' ability to continue to generate implicit subsidies will, by definition, not be "sufficient" even to "preserve," let alone "advance," universal service. Nor can an implicit subsidy mechanism be "specific" and "predictable" in a competitive environment, as also required by 47 U.S.C. § 254(b)(5). To begin with, the Commission has repeatedly acknowledged the difficulty of quantifying either the sources or the amounts of implicit subsidies;[13] hence, such subsidies are hardly "specific." Moreover, the growth of subsidy-eroding competition in the marketplace guarantees that the level of support that will be available over time is not "predictable" at all. A state universal service support mechanism that simply crosses its fingers and hopes those subsidies will not erode too quickly cannot satisfy section 254(b)(5).

B. The Commission Itself Has Recognized That the Goals of Section 254 Cannot Be Achieved Unless the States Adopt Explicit Universal Service Mechanisms.

As we have shown in Part I.A, section 254(b) requires a transition to explicit universal service support mechanisms because only such a transition can secure the accomplishment of that section's mandates. Until relatively recently, the Commission's own statements concerning the steps necessary to implement the 1996 Act's competitive regime recognized that fact. The Commission emphasized not only that implicit subsidies cannot support universal service when competition takes hold but also that the Act *commands* the replacement of implicit subsidies with explicit support mechanisms. Only now has the Commission begun to retreat from that stance,

---

[13] *See, e.g.,* Order, *Access Charge Reform*, 12 FCC Rcd 10175, 10182 ¶ 16 (1997) ("*Access Charge Reform Order*") (noting that the amount of implicit subsidies operating in universal service has "never been precisely quantified"); Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, *Federal-State Joint Board on Universal Service,* 16 FCC Rcd 11244, 11325 n.491 (2001) (citing Rural Task Force Recommendation at 31, noting "there is no agreement on how much or how to determine the amount of implicit support").

as it does in the *FNPRM* when it suggests that the Act expresses a mere "preference" but not a requirement that states adopt explicit mechanisms.[14] That view is plainly mistaken. State universal service support mechanisms must be explicit, and, as the Tenth Circuit ruled, the Commission is statutorily bound to induce the states to move to such mechanisms.[15]

In its first *Report and Order* concerning the future of universal service under the 1996 Act, the Commission recognized that "this system [of implicit subsidies] is not sustainable in its current form in a competitive environment."[16] The Commission went on to explain:

> Implicit subsidies were sustainable in the monopoly environment because some consumers (such as urban business customers) could be charged rates for local exchange and exchange access service that significantly exceeded the cost of providing service, and the rates paid by those customers would implicitly subsidize service provided by the same carrier to others. By adoption of the 1996 Act, Congress has provided for the development of competition in *all* telephone markets. In a competitive market, a carrier that attempts to charge rates significantly above cost to a class of customers will lose many of those customers to a competitor. This incentive to entry by competitors in the lowest cost, highest profit market segments means that today's pillars of implicit subsidies — high access charges, high prices for business services, and the averaging of rates over broad geographic areas — will be under attack.[17]

---

14 *FNPRM* ¶ 127.

15 To be sure, the Tenth Circuit did hold that section 254 does not require the "FCC alone [to] support the full costs of universal service" by replacing all implicit state subsidies with explicit federal support. *Qwest,* 258 F.3d at 1204. But this holding in no way suggests that it is permissible for states to continue to rely on implicit subsidies, or for the Commission to premise its universal service policy on the continued existence of such subsidies. To the contrary, the court specifically directed the Commission to ensure that its universal service mechanism included a "carrot" or "stick" designed to induce the states to adopt universal service support mechanisms that comply with the mandates of section 254, *id.*, and held that the Commission must "work to achieve [each requirement of section 254(b)] unless there is a direct conflict between it and another [one]." *Id.* at 1199. And as we demonstrate above, the principle of explicit support is inherent in several of the mandates of section 254(b).

16 Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8786-87 ¶ 17 (1997) (footnotes omitted, emphasis added).

17 *Id.*

Based on this analysis, the Commission concluded that a transition from implicit to explicit support mechanisms was required: "Over time, it will be *necessary* to adjust the universal service support system to respond to competitive pressures and state decisions so that the support mechanisms are sustainable, efficient, *explicit*, and promote competitive entry."[18]

In a 1997 order discussing access charge reform, the Commission reaffirmed that view. It noted that, "[o]ver the long run, it is clear that [] a system of implicit subsidies is sustainable only in a monopoly environment . . . , and we recognize that the new competitive environment contemplated by the 1996 Telecommunications Act will tend to undermine this subsidy structure over time."[19]

In its report to Congress the next year, the Commission not only recognized the incompatibility of implicit subsidies and competition, but affirmed its *own* duty and that of the states under the Act to see that that implicit subsidies are eliminated: "Recognizing the vulnerability of [] implicit subsidies to competition, Congress, in the 1996 Act, *directed the Commission and the states* to restructure their universal service support mechanisms to ensure the delivery of affordable telecommunications services to all Americans in an increasingly competitive marketplace."[20] That same year, in its *Fifth Report and Order*, the Commission again recognized that Congress had instructed it to eliminate implicit subsidies:

> The 1996 Act also *directed the Commission* to reform universal service support mechanisms to ensure that they are compatible with the pro-competitive goals of

---

18 *Id.* at 8787 ¶ 19 (emphasis added).

19 *Access Charge Reform Order*, at 10182 ¶ 17 (footnote omitted).

20 Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11505 ¶ 8 (1998) (emphasis added).

> the 1996 Act. In requiring incumbents to open their local markets to competitive entry, Congress rendered unsustainable the existing universal service support system, which is based on a complex system of implicit and explicit subsidies. Rate structures that contain implicit support flows, such as artificially inflated interstate access charges and business rates, are sustainable in a monopoly environment but not in a competitive environment.[21]

By 1999, it was already clear that competition *was* having a negative effect on implicit universal service support. In its *Seventh Report and Order*, the Commission lamented that "[i]mplicit universal service support is becoming less sustainable as competition increases . . . ." The Commission also recognized that, "[b]y contrast, explicit support . . . can preserve and protect universal service for all Americans."[22]

The Commission echoed these statements in the *Ninth Report and Order*. There, it explained, yet again:

> Although implicit universal service support was sustainable in a monopoly environment, it will become more difficult to sustain as competition increases. In a competitive market, a carrier that charges rates significantly above its costs to a class of customers may lose those customers to a competitor charging cost-based rates. As carriers lower their rates closer to their costs in urban areas, or lose low-cost customers to new entrants charging cost-based rates, the implicit support for below-cost rates in high-cost areas may erode.[23]

Finally, in the *Order on Remand* and the *FNPRM* here, the Commission recognized that implicit subsidy schemes cannot continue to support universal service in a competitive environment. For example, the *Order on Remand* provides: "We anticipate that the erosion of

---

[21] Fifth Report and Order, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 21323, 21326 ¶ 6 (1998) (footnotes omitted; emphasis added).

[22] Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 8078, 8081-82 ¶¶ 7-8 (1999) (footnotes omitted).

[23] Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 20432, 20441 ¶ 16 (1999) ("*Ninth Report and Order*") (subsequent history omitted).

implicit support by competition will, in time, compel states to replace those implicit support mechanisms with explicit support mechanisms, which will be sustainable in a competitive marketplace."[24] In fact, the Commission even acknowledged that Congress intended "support mechanisms continued or created under new section 254 to be explicit."[25] Similarly, the Commission noted in the *FNPRM* that "we agree with commenters that states should be encouraged to replace implicit support with explicit support mechanisms that will be sustainable in a competitive environment."[26] In the same vein, in his separate statement discussing the *Order on Remand*, Chairman Powell called attention to the folly of perpetuating implicit subsidies:

> Admittedly, our action today does not eliminate all implicit support in local rate structures. However, I remain convinced that *in a competitive market, we can only achieve Congress' universal service goals by creating an explicit support fund to benefit consumers who need it and by eliminating the vestiges of implicit support* that misallocate resources and distort competition.[27]

What is more, everything the Commission has predicted is coming to pass. The growth of local competition is rapidly destroying the implicit subsidies that have supported universal service. Inter- and intramodal competitors, which, unlike the incumbent typically do not have carrier of last resort obligations, have successfully targeted the high-margin, lower-cost

---

24 *Id.* ¶ 78.

25 *Order on Remand* ¶ 16 & n.35 (citing S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 131 ("To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.").

26 *FNPRM* ¶ 127.

27 Separate Statement of Chairman Michael K. Powell, *Order on Remand* (rel. Oct. 27, 2003) (emphasis added).

customers on whom the incumbents typically relied to subsidize high-cost local service.[28] At the same time, implicit subsidy schemes drive competitors away from residential and high-cost markets by keeping retail pricing in those market segments artificially low and depressing the margins that competitors are able to earn. A recent Commission report on the status of local telephone competition[29] showed that, as of June 30, 2003, competitors had successfully captured almost 23 percent of the market for medium and large businesses, institutional, and government customers nationwide. At the same time, competitors provided only 12 percent of the market for residential and small business lines,[30] and even there, the competitors have targeted the most lucrative residential and small business customers, leaving the ILECs to serve the lower margin

---

[28] *See* Letter from Jay Bennett, Executive Director, SBC Communications, Inc., to Marlene Dortch, Secretary, FCC, CC Docket No. 01-338, at 10 (filed Oct. 24, 2002) ("SBC Triennial Review *Ex Parte* Notification") (demonstrating CLEC erosion of SBC's high-margin customer-base); Press Release, AT&T, AT&T Chairman Outlines Aggressive Competitive Strategy at CSFB Conference, December 11, 2003 ("We continue to take a targeted approach to attract and retain high-value customers to our bundled services offerings, allowing us to drive profitability in this area of our business"); David W. Barden, AT&T Corporation: A Case for Consumer Services, Banc of America Securities—United States Equity Research, April 30, 2003, at 6 ("AT&T's approach to launching local service has been very granular. AT&T's 'cherry picking' approach has drawn Bell ire but it has worked. The company targets expansion by state, by neighborhood, and by profit hurdle, experiencing substantial success in the process."); *Q2 2002 AT&T Earnings Conference Call – Final*, Fair Disclosure Wire, Transcript 072302au.729 (July 23, 2002) (statement of Betsy Bernard) (assuring investors that AT&T is not "going into states where we don't have a *gross margin of 45 percent on the local*. That's kind of our threshold trigger to go in . . . .") (emphasis added). *See also U.S. Telecom Ass'n v. FCC*, 290 F.3d 415, 422 (D.C. Cir. 2002), *cert. denied sub nom. WorldCom, Inc. v. U.S. Telecom Ass'n,* 71 U.S.L.W. 3416 (U.S. Mar. 24, 2003) (No. 02-858) ("Competitors will presumably not be drawn to markets where customers are already charged below cost.").

[29] Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition: Status as of June 30, 2003* (December 2003) ("*Local Telephone Competition*").

[30] *Id.* at Table 2.

residential and small business customers at below-cost rates.[31] The report also showed that about 38 percent of CLEC local telephone lines provide service to medium and large business, government, and institutional customers, compared to less than 22 percent of ILEC lines for the same category of customers.[32] As time goes on, the incumbent carriers will continue to lose the high-margin customers upon which they and the regulators depend for support of the implicit subsidy system.

Moreover, competition is increasingly coming from network providers that do not contribute to universal service or purchase the incumbent LEC services (such as intrastate access services) that provide the implicit subsidies. For example, most cable telephony and voice over IP service providers are not currently contributing to the universal service fund,[33] further reducing the amount of universal service support. Indeed, the fact that these other service providers do not contribute to universal service *itself* gives them a competitive pricing advantage over the carriers that do contribute. Qwest recently noted that it could cut customers' bills by 25-

---

31 *See* SBC Triennial Review *Ex Parte* Notification at 10.

32 *Local Telephone Competition* at Table 2.

33 See, e.g., Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service 1998 Biennial Regulatory Review*, 16 FCC Rcd 9892, 9921 ¶ 13 n.45 (2001) (noting that "the Commission has not yet addressed the issue of whether cable operators that provide broadband transmission service over cable systems are providing 'telecommunications service' and, thus, absent forebearance, should be subject to universal service obligations."); United States General Accounting Office, 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, at 21-22 (rel. Feb. 2002) ("GAO Report") (noting that "companies offering IP telephony are not currently required to make contributions to the universal service fund" and recognizing that "the question arises as to whether a decline in the funding for universal service could result.").

30% if it could avoid universal service contributions by offering voice-over-IP-based services.[34] This pricing advantage enables competitors to cherry-pick the highest margin, subsidy-generating customers, which only accelerates the erosion of implicit subsidies even faster, as the incumbent is left with a higher proportion of low-margin, subsidized customers and a smaller customer base from which to collect the costs of support. This forces the incumbent to raise the per-capita levy on its remaining customers even further, which only exacerbates the regulation-driven pricing differential and causes more customers to defect. As a regulator quoted in a recent New York Times article noted, "The pot of money used to make sure people can communicate will shrink. . . . It's a death spiral."[35]

In short, it is more than time for the Commission to take effective measures to move state universal service programs to explicit support mechanisms. The Commission *must* design universal service to achieve the goals of section 254(b), and thus must induce states to transition to explicit funding mechanisms. The statute itself so states, providing that the Commission "*shall* base policies for the preservation and advancement of universal service on the following principles." 47 U.S.C. § 254(b) (emphasis added). The Tenth Circuit confirmed that "[t]he plain text of the statute mandates that the FCC 'shall' base its universal policies on the principles listed in § 254(b). This language establishes a *mandatory duty* on the FCC. . . . Thus, the FCC must base its policies on the [section 254(b)] principles." *Qwest*, 258 F.3d at 1200 (emphasis added). The Commission is not allowed to ignore even one of the statutory principles but, instead, "must work to achieve each one." *Id.* at 1199. Thus, when the *FNPRM* refers to the

---

34 Matt Richtel, *A Debate on Web Phone Service*, N.Y. Times, Jan. 5, 2004, at C1.

35 *Id.*

principles enumerated in section 254(b) as mere "aspirational provisions of the Act,"[36] it is simply wrong.

And as the Tenth Circuit properly recognized, "the FCC may not simply assume that the states will act on their own to preserve and advance universal service. It remains obligated to create some inducement — a 'carrot' or a 'stick,' for example, or simply a binding cooperative agreement with the states — for the states to assist in implementing the goals of universal service." *Qwest*, 258 F.3d at 1204. Since the court itself observed that "implicit subsidies are suited to a monopoly environment, but become difficult to sustain as competition increases," *id.* at 1196, *Qwest* confirms the Commission's obligation under the Act to adopt a universal service mechanism that finally induces the states to end their reliance on implicit subsidies and move to an explicit mechanism.

II. Neither the Order on Remand Nor the FNPRM's Proposed Additional "Inducement" Fund Satisfies the Commission's Obligation To Cause the States To Transition to Explicit Support.

The *Order on Remand* makes no meaningful progress toward compliance with the requirements of section 254. In particular, it does nothing to induce the states to transition to explicit universal support mechanisms, and the "additional inducement" fund proposed in the *FNPRM* for this purpose would not remedy that failure.

A. The *Order on Remand* Does Not Even Attempt To Induce the States To Adopt Explicit Support Mechanisms in Lieu of Implicit Subsidies.

As noted above, the *Order on Remand* starts from the erroneous premise that, while "section 254 states a clear preference for explicit, rather than implicit, support, . . . the 1996 Act

---

36 *Order on Remand* ¶127.

does not require states to adopt explicit universal support mechanisms."[37] In fact, the *Order on Remand* concludes that the states' only section 254(b) obligation (and thus the only compliance that the Commission must "induce") is to ensure that their rural rates are reasonably comparable to some averaged national urban benchmark. *See, e.g.*, *Order on Remand* ¶ 64 (noting that, "to provide sufficient support for statutory purposes, the non-rural mechanism must provide enough support to enable states to achieve reasonable comparability of urban and rural rates").[38] The Commission readily acknowledged that its mechanism is premised on its determination that "states continue to be in the best position to determine when to eliminate implicit support in their rate designs and establish explicit, sustainable universal service mechanisms," and that the Commission was relying on "the erosion of implicit support by competition," rather than the federal funding mechanism, to "compel states to replace . . . implicit support mechanisms with explicit support mechanisms." *Id.* ¶¶ 77-78.

Not surprisingly, then, the one and only "inducement" in the *Order* — the "expanded certification" requirement — is directed to an entirely different end than pressing the states to replace implicit subsidy mechanisms with explicit ones: states must simply state whether their rural rates are in fact reasonably comparable to the national benchmark. *See, e.g.*, *id.* ¶ 2 ("[S]tates will be required to certify that the basic service rates in their rural, high-cost areas

---

[37] *Order on Remand* ¶ 26 (citations omitted).

[38] *See also id.* ¶ 30 (defining "sufficient" as "enough federal support to enable states to achieve reasonable comparability of rural and urban rates in high-cost areas served by non-rural carriers," effectively subordinating sufficiency to reasonable comparability only, even though section 254(b)(5) clearly states that mechanisms should be "sufficient . . . to preserve and advance universal service" which the Tenth Circuit has held requires the Commission to apply all of the 254(b)(5) principles); *id.* ¶ 39 ("We conclude that the range of variability of urban rates is an appropriate measure of what should be considered reasonably comparable rural and urban rates for purposes of assessing the sufficiency of non-rural high-cost support.").

served by non-rural carriers are reasonably comparable to a national urban rate benchmark or explain why they are not.").[39]

Basing federal universal service support on whether state rural rates are reasonably comparable to urban rates clearly does nothing to encourage states to fund universal service support through explicit mechanisms. To the contrary, the Commission *relied* on state implicit subsidies to tailor the federal fund mechanism, rather than designed the federal funding mechanism to eliminate implicit mechanisms. Specifically, although the Commission admits that state rates currently are premised on implicit support, *see, e.g.*, *id.* ¶ 22, n.55 (cataloging implicit support mechanisms; acknowledging that "most states" engage in geographic averaging for residential customers of non-rural LECs; and noting that more than half of those use value-of-service pricing), the Commission proceeds to rely on the comparability of those rates in determining which states will qualify for federal support. And it does so even while conceding that "comparing only rates" is of limited utility because they "may or may not include implicit support." *Id.* ¶ 23. States that have achieved "reasonable comparability" specifically through using implicit subsidies are certainly not penalized for doing so. A state may file a certification with the Commission that its rates are "reasonably comparable" without any further explanation or inquiry concerning *how* it has achieved such comparability. And states in which rates are *not* comparable are entitled to support, even if their rates, whatever they may be, are supported by implicit state subsidies. *See Order on Remand*, at Appendix A (promulgating new 47 C.F.R. § 54.309).

---

[39] *See also id.* ¶ 4 ("To induce states to achieve reasonably comparable rates, . . . [e]ach state will be required to review its rates in rural, high-cost areas served by non-rural carriers annually to assess their comparability to urban rates nationwide, and then to file a certification with the Commission stating whether its rural rates are reasonably comparable to urban rates nationwide or explaining why they are not.").

Indeed, because the *Order on Remand* adopts only a very limited federal funding mechanism and leaves with the states "primary responsibility for ensuring reasonably comparable rural and urban rates," *id.* ¶ 21, the *Order* makes the Commission even *more* dependent than ever before on the states' continuation of these implicit subsidy mechanisms to achieve its own statutory compliance. Far from weaning the states and the Commission from their dependency on implicit subsidies, the *Order on Remand* actually uses them as an excuse not to take meaningful action at all.

B. The FNPRM's Proposed "Additional Inducements" Would Create No Meaningful Incentive for the States To Transition to Explicit Funding.

The *FNPRM* proposes "additional targeted federal support" for states that implement explicit universal service mechanisms, even while the Commission continues to insist that this is not "required" under the 1996 Act. *FNPRM* ¶¶ 126-27. Under the proposal, the Commission might make a relatively modest amount of additional funds available to certain high-cost wire centers in states that have adopted explicit funding regimes.[40] The proposal falls well short of the "carrot" or "stick" required to "ensure" that the states take action, as the Act and the Tenth Circuit decision require. *See* 47 U.S.C. § 254(b); *Qwest*, 258 F.3d at 1204.

The *FNPRM* underestimates just how heavily the states are dependent on (and committed to) implicit rather than explicit subsidy mechanisms. From the perspective of an elected or appointed state commissioner, explicit subsidies are risky because they get passed on to consumers as higher rates, taxes, or suspicious-looking line items on their bills, while implicit subsidies are invisible. Indeed, the Commission itself is all too aware of such political realities. When it first attempted to set up the schools and libraries fund, the Commission was forced to

---

[40] *FNPRM* ¶ 126.

reduce the overall size of the fund once AT&T and the other IXCs threatened to disclose the fund assessments on consumer bills.[41] Similarly, ending implicit subsidies and moving to explicit subsidies requires retail rate rebalancing. By definition, that means some constituents' local telephone bills will go up (although much of the increase likely would be offset by reductions in intrastate toll or other services) — which is something state legislatures and commissions have gone to great lengths to avoid. By contrast, implicit subsidies shift all the risk and pain to the incumbent carrier that has, after all, survived the last hundred years and must (state commissions apparently still assume) be too big to fail.

Even though, as noted above, the Commission has been stressing the need for states to shift from implicit to explicit subsidies for almost eight years now, fewer than half the states have adopted explicit support mechanisms in the absence of any real federal inducement.[42] Indeed, five of the 13 states in SBC's region have no explicit support funds at all.[43] And even those states that *have* adopted explicit funds generally have shown no intention to end all reliance on implicit subsidies. In fact, only three of the thirteen states in SBC's region provide

---

[41] *See* James K. Glassman, *Gore's Internet Fiasco*, The Washington Post, June 2, 1998, at A13; Editorial, *Should We Wire Schools?*, The Washington Post, June 10, 1998, at A24 ("Four senators with a say over the FCC's own budget sent a letter demanding that it defund the program entirely. Some have hinted that the commission risks having its own budget zeroed out unless it kills the schools and libraries program"); Mike Mills, *One Year Old and Off to School; The First Installment of SLC's Controversial E-Rate Program Is in the Mail*, The Washington Post, Nov. 30, 1998, at F05.

[42] *See Order on Remand* at ¶ 22 & n.55 (citing the *GAO Report* for the fact that only "21 states report having programs that provide assistance to high-cost local exchange carriers"); *see also GAO Report* at 37 (reporting that 27 states do not have a universal service fund).

[43] Those states are Connecticut, Michigan, Ohio, Missouri, and Indiana. Other states in SBC's region have specifically declined to adopt explicit funds. *See* Order Concluding Investigation, *on the Commission's own motion, to consider issues related to the creation of a state universal service fund*, Case No. U-13477 (Michigan Pub. Serv. Comm'n, Feb. 5, 2003).

any high-cost support to non-rural carriers,[44] leaving SBC in most of its states to continue to support low-cost rates solely through implicit subsidies. Indeed, according to the Commission, only one state with any significant rural territories — Wyoming — has actually deaveraged retail rates and eliminated implicit subsidies.[45] In some states, the public utility commissions do not even have the necessary statutory authority to implement an effective explicit universal service mechanism. For example, some state statutes preclude the regulators from assessing the complete base of telecommunications providers, especially, for example, wireless carriers.[46] And the states have failed to act to rectify this situation even as competition has flourished and eroded the incumbents' market share. Thus, while the Commission suggests that it may rely on the states to establish explicit support mechanisms to replace implicit subsidies as competition develops,[47] this has not occurred, and the Commission has no valid basis to simply assume it will.

Inducing state action and accomplishing the necessary shift to explicit state funding mechanisms will require substantial motivation — motivation that the Commission's "additional

---

[44] These states are California, Kansas, and Texas. By contrast, Illinois, for example, established a fund limited only to rural carriers with less than 35,000 lines, despite statutory authority to establish a broader fund. *See* Second Interim Order on Rehearing, *Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act*, Docket Nos. 00-0233/00-0335 (cons.) (Illinois Commerce Commission, March 13, 2002) at 69-71. *See also* Ill. Comp. Stat. 5/13-301(d).

[45] *See* Memorandum Opinion and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 03-249 ¶ 144 (rel. Oct. 27, 2003) ("*Memorandum Opinion and Order*").

[46] *See, e.g.,* Mo. Rev. Stat. § 392.248(3) & § 386.020(51) (Missouri); Ill. Comp. Stat. 5/13-301 13-301 (Illinois).

[47] *Order on Remand* ¶ 78.

inducements for state action" do not provide. In light of the many billions of dollars in implicit subsidies buried in the system, the $116 million that the Commission is proposing for this additional inducement is too small an amount to motivate state commissions to face the significant political and legal hurdles needed for a transition to an explicit support mechanism — not least because the states themselves (as opposed to the carriers in the states) would not actually see any of this additional money. In order to induce states to undergo this transition, and, in some cases, to adopt the legislative solutions that will be required even to authorize that transition, far greater and innovative financial and other incentives will be required.

III. The Commission Should Tailor Its Universal Service Regime To Induce States To Transition to Explicit Universal Service Support.

The best means of ensuring that states undertake the transition to explicit universal service support mechanisms is for the Commission to condition the receipt of *all* high-cost support, including such support for rural carriers, not just some incremental funding, on a state's commitment to implement a transition to explicit subsidy mechanisms. As part of its framework for inducing that transition, the Commission also must provide adequate guidance to states on how to implement their plans. Finally, SBC emphasizes that the Commission can establish a transition-inducing regime that does not unreasonably increase the size of the federal universal service fund.

A. The Commission Should Expressly Condition All High Cost Federal Universal Service Funding on Whether a State Has Committed to Transitioning from Implicit to Explicit Subsidies.

As we have shown, the states are unlikely to respond to a plan that merely dangles the possibility of minor additional funding as a reward to states that have already implemented explicit funding regimes. That incentive is not nearly enough. The states will be motivated to make the tough choices — and in some cases, legislative initiatives — necessary to transition to

explicit funding mechanisms only where there are serious negative consequences for failing to do so. Thus, the Commission should condition *all* of a state's high cost federal universal service funding — for both rural and non-rural carriers — on whether a state has committed to implementing a plan for transitioning from implicit to explicit subsidies.[48] States that are unwilling to act in order to achieve some meager additional funding out of the $116 million "additional inducement" pot will be significantly more motivated if they face the prospect of losing *all* high-cost support in the state, and a corresponding increase in rates. The loss of *all* high cost support finally would force states to act by making it difficult, if not impossible, to support low-cost rates in areas served by rural carriers in particular, especially since many rural carriers do not provide enough higher-margin service to implicitly subsidize their own higher-cost rates.[49] The "rate shock" states are loathe to risk today by moving to explicit support would then attach as a likely consequence of *failing* to move to explicit support.

---

[48] Of course, if the Commission adopts this approach, it will be critical to ensure that the states do not simply force incumbents to somehow bear the burden of continuing to offer low rates in the absence of any federal support. This would impose a terrible burden on the incumbent, and would at the same time undermine the effect of the Commission's inducement mechanism. The Commission thus might consider increasing the SLC cap, which would allow carriers to make up for any lost federal support through increases in subscriber line charges; the Commission should consider whether there are other appropriate measures it could adopt.

[49] States typically have been less concerned about receiving federal *non-rural* high-cost support, because the incumbents that serve those areas often serve other, higher margin markets and historically have been able to maintain low basic rates in high cost areas through implicit subsidies established by state pricing regimes. But as discussed above, no incumbent's ability to implicitly subsidize its own rates can survive in the face of competition. Thus, the Commission *must* integrate its approach to rural and non-rural high cost support in order to ensure a unified and functional national universal service program that complies with the mandates of section 254. This is especially the case given that in 2002 high cost support disbursed to rural carriers was two and a half times the support provided to non-rural carriers. Universal Service Administrative Company, Annual Report 2002, at 26, *available at* http://www.universalservice.org/download/pdf/2002AnnualReport.pdf ($2.4 billion compared to $840 million). Because the impact of losing this larger pot of rural support is so substantial, it is critical that the Commission include rural high-cost support in tailoring any mechanism designed to induce state action.

The *FNPRM* suggests, without any explanation or support, that conditioning a state's receipt of existing non-rural high-cost support on the reform of implicit subsidies would present some "risk to our universal service goals."[50] But it would be far riskier in the long term to permit states to avoid making the transition to explicit support mechanisms. With competition making implicit subsidies unsustainable, basing the size of the federal universal service fund — or the design of the mechanism — on the existence of those subsidies ensures that universal service support in this country will be neither nondiscriminatory nor specific, predictable, or sufficient. And the prospect that carriers might be forced to seek to withdraw from their carrier of last resort obligations as their implicit support sources erode away presents far more jeopardy to universal service than a mechanism that gives the states material incentives to put their subsidy programs on a sustainable footing for the long run.

Moreover, the *FNPRM*'s expressed concern is exaggerated. Presumably, any incentive plan would condition a state's federal support on the state's *initiating* or committing to the transition and progressing according to a concrete timetable, and not on *completing* it. Though the Commission has suggested designing its "additional inducement" to reward a state that has actually accomplished such a transition, the Commission should not limit itself to that approach. Instead, the Commission should require the states that have not done so already to demonstrate that they have committed to a multi-year transition plan that removes implicit subsidies and allows residential local telephone prices the opportunity to rise to levels that are self-supporting and affordable if the market will support those levels. The Commission should first establish a general framework explaining what state universal service mechanisms should look like and set a

---

50 *FNPRM* ¶ 128.

deadline for the states to put in place mechanisms consistent with that framework. Over a reasonable period of years, the Commission should gradually increase support as the state's program is implemented, or decrease it if the state fails to put the program in place.[51] The Commission should monitor state progress over this transition period.

Further study would be required to determine the contours of an ideal plan. The Commission does not yet even have any information that would allow it to analyze state universal service mechanisms, or to determine state commissions' statutory authorities, and the times they would require to put explicit mechanisms in place. SBC thus endorses the *FNPRM*'s proposal to expand the certification process to collect data regarding the current extent of implicit subsidies and the states' authority to implement explicit support programs, but such data should be used to develop a robust plan to eliminate implicit subsidies.[52] That is clearly a critical starting place, though it comes late in the game.

B. The Commission Must Provide Guidance to the States Concerning the Required Contours of an Explicit Funding Mechanism.

Success of the Commission's plan requires not just the proper inducements but guidance as well. The states should not be required or permitted to invent a transition plan from scratch: the Commission has the power and expertise to provide a minimum framework for state transition plans across the nation. The Commission thus should promulgate general standards for an explicit support mechanism that would satisfy the requirements of section 254 and require the states to implement mechanisms that are consistent with these standards. The Commission

---

[51] The Commission must also of course take other appropriate steps, such as lifting the SLC cap.

[52] *FNPRM* ¶ 112.

adopted a similar process to implement the local competition requirements of the 1996 Act. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378-85 (1999), *aff'd in part and rev'd in part, sub nom. Verizon Communications v. FCC*, 535 U.S. 467 (2002) (validating the Commission's power to issue rules guiding the judgments of state commissions).

More particularly, the Commission should provide generally that the states' explicit support mechanisms must be competitively and technology neutral[53] — just like the statutory definition of "universal service" itself. *See* 47 U.S.C. § 254(c)(1) (noting that definition must take "advances in telecommunications and information technologies and services" into account); *see id.* § 254(e) (providing that, in addition to telecommunications carriers, "[a]ny other provider of interstate telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires."). Wireless carriers and cable broadband companies offering telecommunications services should not be exempt from contributing to a state's explicit funding mechanism based solely on the technology they use when they are providing exactly the same telecommunications services as traditional carriers. No other approach would be consistent with section 254(f)'s and section 254(b)(4)'s requirement that support be equitable and nondiscriminatory.

In addition, the Commission should require that state explicit universal service funds be calculated taking into account costs at each wire center in the state, rather than looking at averages across the state or a broad region. Only this approach will ensure the elimination of hidden implicit subsidies that arise when carriers are forced to cross-subsidize high-cost

---

[53] *See* Report and Order, *Federal-State Joint Board On Universal Service*, 12 FCC Rcd 8776, 8801 ¶ 47 (1997) ("[C]ompetitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and *neither unfairly favor nor disfavor one technology over another*.") (emphasis added).

customers from the revenues they earn from higher-margin customers in lower-cost areas. The Commission itself has recognized that this is the correct approach at the federal level: it used wire-center costs to calculate the amount of the subsidy to be paid to non-rural carriers in states where the statewide average exceeds the national benchmark,[54] and it proposed this approach for determining which states may be eligible for either type of additional targeted federal support under the regime in its FNPRM.[55] Because the Commission has acknowledged that wire-center calculations are proper, there is no reasonable justification for failing to require the states to implement this approach as well.

In addition, as discussed below, SBC believes that an explicit support mechanism should be designed to produce *affordable* rates, based on a benchmark consisting of the average household income of a particular geographic area: an explicit program should fund only the difference between such rates and the carrier's costs. And only essential services should be supported by the state universal service program. Both these measures will ensure that states can design rational explicit funding mechanisms that are not excessive.

C. The Commission Should Adopt an Affordability Methodology to Ensure That the Goals of the Act are Met Without Unnecessarily Increasing the Size of the Federal High-Cost Fund, and the Possibility of an Increase in the Fund Would in No Event Justify a Failure To Promote a Transition to Explicit Subsidies.

The Commission should adopt an "affordability" methodology at the same time it redesigns its funding mechanism to induce a transition to explicit funding, to ensure that the goals of the Act are served without imposing new, overwhelming support burdens. There is no rational policy justification for compelling urban subscribers to pay a higher rate to subsidize

---

54 *See Ninth Report and Order* at 20472, 20473 ¶¶ 73, 76; 47 C.F.R. § 54.309.

55 *See Remand Order* at ¶¶ 108, 122, 129.

telephone service for subscribers in rural areas that is priced well below what could reasonably be deemed to be affordable. Ensuring that rates are not only "reasonably comparable," but also "affordable" to the population in a particular geographic area, as SBC previously has proposed, should control the fund size.[56] The Commission thus should create an affordability benchmark for each such area in order to determine whether household expenditures on telephone service are affordable given local average income, and should limit support to the difference between the cost of providing universal service and the lesser of the affordable rate or the reasonably comparable rate.[57] Such an approach would permit the Commission reasonably to limit the size of the required fund.

Even if the Commission were not to adopt the affordability approach proposed by SBC and the federal fund would grow substantially, that would not justify failing to induce the transition to 1996 Act-compliant universal service support mechanisms, as the Commission suggested in paragraph 37 of the *Order on Remand*.[58] The Tenth Circuit made clear that it is error for the Commission to focus on the size of the fund alone, without balancing it against the other considerations set forth in section 254(b); indeed, the court expressed skepticism that the size of the fund was a legitimate consideration at all. *Qwest*, 258 F.3d at 1200. In any event, the

---

[56] *See, e.g.*, Comments of SBC, *Recommended Decision of the Federal-State Joint Board on Universal Service*, filed in CC Docket 96-45, Dec. 20, 2002, at 15-17.

[57] As noted above, the affordability methodology should apply equally to any state universal service support mechanism.

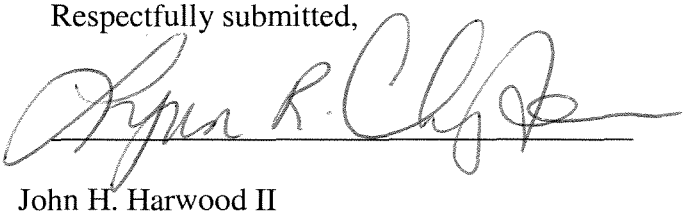
[58] *Order on Remand* ¶ 37 (footnotes omitted) ("In discussing whether support is sufficient, the Commission previously cited the Fifth Circuit's suggestion that 'excessive funding may itself violate the sufficiency requirements of the Act.' We find that the idea of minimizing the burden on contributors is inherent in the principle of sufficiency. For these reasons, we disagree with commenters who claim that we should not consider the size of the fund in determining how much support should be provided.").

express statutory goals of instituting "specific, predictable, and sufficient" and "equitable and nondiscriminatory" universal service funding mechanisms require that the fund be large enough to effectuate universal service — even if that means the fund has to grow larger.

CONCLUSION

For the reasons set forth above, the Commission should conclude that the "additional inducement" it has proposed in section D of the *FNPRM* is insufficient to satisfy the statutory requirement that the federal universal service support mechanism be designed to induce the states to move to explicit, non-discriminatory, and sufficient universal service support. The Commission should make substantial changes to the federal mechanism to address these shortcomings in its mechanism.

Respectfully submitted,



John H. Harwood II
Lynn R. Charytan
Jonathan J. Frankel
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, DC 20037-1420
(202) 663-6000

Paul K. Mancini
SBC COMMUNICATIONS INC.
175 East Houston
San Antonio, TX 78205
(210) 351-3500

Gary L. Phillips
Christopher M. Heimann
SBC COMMUNICATIONS INC.
1401 Eye Street, NW
Suite 400
Washington, D.C. 20005
(202) 326-8903

Counsel for SBC Communications Inc.

CERTIFICATE OF SERVICE

I, Carole Walsh, do hereby certify that true and accurate copies of the foregoing, Comments of SBC Communications, Inc., were served via e-mail this 14th day of December, 2004, to:

Eric Einhorn
Wireline Competition Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5-A426
Washington, D.C. 20554
eric.einhorn@fcc.gov

Carol Mattey
Wireline Competition Bureau
Federal Communications Commission
445 12th Street., S.W., Room 5-C450
Washington, D.C. 20554
carol.mattey@fcc.gov

Sheryl Todd
Wireline Competition Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5-B540
Washington, D.C. 20554
sheryl.todd@fcc.gov

Diane Hsu Law
Wireline Competition Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5-A423
Washington, D.C. 20554
diane.law-hsu@fcc.gov

Paul Garnett
Wireline Competition Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5C-315
Washington, D.C. 20554
paul.garnett@fcc.gov

Qualex International
Portals II
445 12th Street, S.W., Room CY-B402
Washington, D.C. 20554
QUALEXINT@aol.com

Carole Walsh

Carole Walsh