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April 3, 2006

Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 Twelfth Street, SW  
Washington, DC 20554

**RE: Erratum In the Matter of Federal-State Joint Board on Universal Service,  
CC Docket No. 96-45 and High-Cost Universal Service Support, WC Docket No. 05-337**

Dear Ms. Dortch:

On March 27, 2006, AT&T Inc. timely filed Comments in the above referenced proceedings. Due to a typographical error in the Discussion section, on line 2 of footnote 55, page 25, the word "understates" should be replaced by the word "overstates." Thus the sentence should read "The existing Synthesis Model is flawed in several respects; it is a model with stale inputs and one that overstates costs for rural areas to a significant degree. Nevertheless, for present purposes, there is no other generally accepted model that could be readily employed, and it goes without saying that the sorely needed overhaul of the overall universal service support mechanism should take precedence over replacement of the underlying cost model." Please substitute the attached version for the version filed on March 27, 2006.

Thank you for your attention in this matter. If you have any questions, feel free to contact me.

Sincerely,

/s/ Christopher Heimann

Enclosure

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	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337

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COMMENTS OF AT&T INC.

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March 27, 2006

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BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
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Universal Service	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337

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COMMENTS OF AT&T INC.

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AT&T Inc., on behalf of itself and its operating company affiliates (collectively, “AT&T”),<sup>1</sup> respectfully submits these comments in response to the Commission’s December 9, 2005 Notice of Proposed Rulemaking in the above-captioned dockets (“*Notice*”).<sup>2</sup>

**INTRODUCTION AND SUMMARY**

An overhaul of the Commission’s complete plan for universal service support is urgently needed and long overdue. In particular, seven years of experience have demonstrated that the current system is flawed and is not working to support consumers in rural, insular, and high-cost areas. And the Tenth Circuit now has twice invalidated the Commission’s “non-rural” mechanism for failing to meet Congress’s directive to preserve and advance universal service in

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<sup>1</sup> On November 18, 2005, SBC Communications Inc. closed on its merger with AT&T Corp. The resulting company is now known as AT&T Inc. Thus, in these comments, “AT&T” refers to the merged company, including its ILEC operating subsidiaries, unless otherwise noted.

<sup>2</sup> Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service, High-Cost Universal Service Support*, FCC 05-205 (rel. Dec. 9, 2005) (“*Notice*”).

a competitive environment. Simply tinkering with that mechanism on remand — or figuring how to shore up the Commission’s legal reasoning without changing its policies — is not a sufficient response. Both the Telecommunications Act and the public interest require that the Commission commit itself to adopting a universal service support mechanism that actually *works*: one that targets explicit support to the consumers and carriers in geographic areas that need it, and provides support sufficient to fund the universal service policies that Congress articulated.

In short, the Commission must return to first principles. The Commission’s charge is to craft a federal universal service support mechanism that advances the full range of goals Congress specified in section 254. For example, not only must the support mechanism ensure that consumers will have access to affordable, state-of-the-art telecommunications services, wherever they live, but it also must provide for specific, sufficient, and predictable support for carriers serving rural areas regardless of the size of the carrier. In the past, the Commission has focused myopically on particular principles to the exclusion of others. In particular, the Commission has failed, in the past, to give due consideration to the principle of “*affordability*,” adopting, instead, a single-minded focus on rate comparability. But rates that are *unaffordable* in a given community are not acceptable simply because they are close to the rates charged in a wealthier community. Likewise, the Commission has severely constrained support for large carriers that serve rural areas, too often leaving them to fend for themselves through unsustainable and insufficient implicit support. The Commission now must take a more holistic, principled approach, both because the Tenth Circuit specifically directed that the Commission do

so,<sup>3</sup> and because, as a practical matter, no other approach can provide support “sufficient” to ensure the meaningful universal service support in a competitive environment envisioned by Congress.

As we describe below, the Commission should adopt an affordability-based federal support mechanism that will provide support only where the cost of service exceeds the rate that consumers can reasonably be expected to pay themselves. An affordability index based on the percentage of household income would be established for this purpose. This measurement can be made in real-world, objective terms using publicly available data that shows the percentage of household income consumers spend on telephone and other services. This approach, which we refer to as the Mechanism for Affordable Rural Communications (“MARC”), would allow the Commission to address comparability of rates across rural and urban areas using a more meaningful yardstick that incorporates the principles enunciated in section 254(b), and without having to untangle the complexities of disparate rates between distant regions with different intrastate rate regimes. Support would be available where the cost of providing universal service in a particular geographic area, such as a wire center, exceeds an affordability benchmark calculated by multiplying the median household income in that area by the affordability index.

The MARC would leave states fully in charge of the actual rate-setting process for intrastate services. But it would at the same time finally and fully transition universal service support away from implicit mechanisms. The MARC would provide full federal support up to the affordable rate benchmark, replacing any state funding that now supports rates at that level. States would be free to require carriers to charge rates lower than the affordable rate benchmark,

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<sup>3</sup> *Qwest Communications Int’l v. FCC*, 398 F.3d 1222, 1236 (10th Cir. 2005) (“*Qwest II*”).

but they then would have to provide additional explicit support or defer to the Commission to do so through a supplemental, state-specific fund.

To be sure, AT&T's approach envisions an increase in the size of the explicit federal fund. This increase in explicit support is required so that the federal fund will be sufficient to preserve and advance universal service in a competitive environment. There will be a lesser burden on explicit state funding using this approach, however, and AT&T also proposes two parallel reforms that would *reduce* some elements of existing high-cost funding. First, we propose that the Commission apply similar "affordability" principles to its "rural" high-cost mechanism (and ultimately transition to one, unified mechanism for all high-cost funding). Applying the affordability principle to the rural mechanism (and subsequently to a unified high-cost mechanism) would better align the distribution of high-cost support with the areas and consumers that require such support. This would more effectively produce affordable, reasonably comparable rates, while still ensuring that carriers of all sizes that serve rural consumers receive adequate support. Second, the Commission should reform the rules governing support for competitive eligible telecommunications carriers ("CETCs"), which result in excessive and duplicative support. Contribution reforms would also help support a sufficient, affordability-based fund.

Adopting the MARC (and eliminating the rural/non-rural distinction) also would address the concerns raised by the Puerto Rico Telephone Company ("PRTC") and shared no doubt by carriers in other insular areas. However, even these reforms may not address the concerns of Alascom, a provider of service in the high-cost, rural, insular Alaska, that is now deprived of all support. This carrier and the consumers it serves face unique universal support challenges, and a unique approach should be adopted in response.

## DISCUSSION

### **I. The Commission Must Adopt a New, Comprehensive Framework to Preserve and Advance Universal Service for Rural, Insular and High-Cost Customers.**

This proceeding presents an ideal, and overdue, opportunity for the Commission to overhaul the universal service support mechanism for consumers in rural, insular and high-cost areas. Seven years' experience under the current hodgepodge of federal and state, explicit and implicit universal service support mechanisms illustrate that it will not suffice simply to tweak the current system at the margins, and two remands from the Tenth Circuit make clear that the Commission cannot simply burnish its legal reasoning and re-proffer the same broken mechanisms as before. The mandate of the *Qwest II* remand is far-reaching, challenging the FCC to answer questions that go to the heart of the non-rural support mechanism; the public interest mandate of section 254 of the Telecommunications Act is even broader. To address both, as well as the lingering questions from the *Qwest I* remand, the Commission must finally adopt a “complete plan”<sup>4</sup> for providing quality service to *all* “consumers . . . in rural, insular, and high cost areas,” regardless of the size or historical identity of the carrier serving them.<sup>5</sup> And that plan must assure support sufficient to advance *all* the goals of section 254 of the Act, including that of ensuring these consumers obtain service at “just, reasonable, and affordable

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<sup>4</sup> *Qwest Corp. v. FCC*, 258 F.3d 1191, 1205 (10th Cir. 2001) (“*Qwest I*”).

<sup>5</sup> 47 U.S.C. § 254(b)(3).

rates”<sup>6</sup> — a goal the Tenth Circuit specifically faulted the Commission for giving short shrift to in the past.<sup>7</sup>

This requires a return to first principles. In the ten years since the Act was passed, universal service support has languished rather than advanced. The Commission must take into account that reality, as well as the new competitive reality of the marketplace. In light of both, the Commission’s existing approach to universal service is in need of an overhaul rather than mere repackaging.

To begin with, the current high-cost support regime — a fractured approach that bases support not on a carrier’s costs but on its identity — provides insufficient support to most rural areas. While section 254 obligates the Commission to promote the interests of *all* “consumers . . . in rural, insular, and high cost areas,”<sup>8</sup> the Commission instead arbitrarily distinguishes between the amount of support it provides to carriers it designates as “rural” and those it designates as “non-rural” — designations based solely on the *size of the carrier*.<sup>9</sup> The amount of explicit support provided to “non-rural” carriers is severely constrained in comparison to “rural” carrier support, particularly on a per-line basis: The fund for “rural” carriers doles out almost six

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<sup>6</sup> *Id.* § 254(b)(1).

<sup>7</sup> *Qwest II*, 398 F.3d at 1234.

<sup>8</sup> 47 U.S.C. § 254(b)(3).

<sup>9</sup> AT&T notes in this regard that, where Congress intended to distinguish between “rural telephone companies” and other telephone companies, it did so expressly (such as 47 U.S.C. § 251(f)). But section 254 makes no such distinction, and makes no reference to “rural telephone companies.” Rather, it requires the Commission to establish support mechanisms that are specific, predictable, and sufficient to preserve and advance universal service and ensure that *all* Americans (including those in *rural areas*) have access to telecommunications at rates that are affordable and reasonably comparable to urban rates.

times the amount of support provided to larger “non-rural” carriers.<sup>10</sup> Yet larger, “non-rural” carriers (such as AT&T) in aggregate serve *twice* as many rural consumers than do “rural” carriers.<sup>11</sup> Further, notwithstanding that it serves a substantial number of consumers in very high-cost rural areas, AT&T receives no federal high-cost support even under the “non-rural” mechanism. As a result, service to the vast majority of rural consumers is supported by a relatively smaller high-cost fund, or only by unstable *implicit* subsidy mechanisms, which, as we describe below, are fast eroding in a competitive market.<sup>12</sup> It accordingly is time for the Commission to abandon the arbitrary rural and non-rural distinctions it uses in distributing

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<sup>10</sup> Universal Service Administrative Company, Fourth Quarter FCC Filings - 2005, Appendix HC02, at <http://www.universalservice.org/about/governance/fcc-filings/2005/Q4/HC02%20-%20High%20Cost%20Support%20Projected%20by%20State%20-%20Q2005.xls> (almost \$1.8 billion in support under the mechanism for “rural” carriers versus only \$290 million under the mechanisms for “non-rural” carriers). As *Qwest II* noted, federal high-cost support to “non-rural” carriers represents only 13.7% of federal high-cost support. *Qwest II*, 398 F.3d at 1230.

<sup>11</sup> AT&T estimate, using the HCPM/HAI Synthesis Cost Proxy Model, at <http://www.fcc.gov/wcb/tapd/hcpm/welcome.html>, and the U.S. Census Bureau’s definition of “rural,” see Census 2000 Urban and Rural Classification at [http://www.census.gov/geo/www/ua/ua\\_2k.html](http://www.census.gov/geo/www/ua/ua_2k.html).

<sup>12</sup> Maintaining two separate mechanisms also leads to perverse results that disserve the public interest. For example, a company that cannot receive sufficient support for serving rural areas may have no choice but to relinquish its COLR obligations and/or spin off lines in rural areas. At the same time, a small company may have an incentive to stay small so as to qualify as a “rural” carrier, even if consumers might be better served if it grew and took advantage of scale economies. See Order, *Federal-State Joint Board on Universal Service*, 19 FCC Rcd 11538, 11542 ¶ 8 (2004) (“*RTF Review Referral Order*”) (asking the Joint Board to consider the extent to which maintaining separate mechanisms “creates . . . incentives for arbitrage, or other inefficiencies.”); see also *id.* at 11542 ¶ 8 n.23 (noting that “[d]istinct support mechanisms may also discourage consolidation among carriers that would provide economies of scale”).

support, and instead adopt a more unified approach designed to provide *all* carriers, regardless of size, with sufficient support to meet real-world universal service needs in high cost areas.<sup>13</sup>

Nor can the Commission ignore the very real problem of eroding implicit support and the failure of states to address that ever more pressing issue. The FCC's high-cost mechanism relies on the states to bear "primary responsibility" for non-rural support and limits federal support amounts accordingly.<sup>14</sup> But a decade after the Act was passed, almost all states — and in turn, the "sufficiency" of the FCC's non-rural mechanism — continue to depend on a system of implicit cross-subsidies that is fast crumbling. Of the thirteen states in AT&T's local service area, for example, only three provide AT&T with any meaningful explicit support for its provision of service to high-cost and rural areas.<sup>15</sup>

Implicit subsidies assume that the incumbent can cross-subsidize service in rural and high-cost areas by charging above-cost rates to urban and business customers. As the Commission itself has acknowledged repeatedly, however, this approach is not sustainable in the

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<sup>13</sup> Moreover, this is the time to do so. The fund for "rural" carriers was designed only as an interim measure, and its "five-year life" is set to end on June 30, 2006. *See RTF Review Referral Order* at 11541 ¶¶ 5, 7 (2004) (referring to the Joint Board the issue of reevaluating the rural fund mechanism established in 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 (2001)). The Commission could account for the unique circumstances of rural carriers (with respect to costs, for example), even while moving its existing distinct mechanisms closer together and adopting one overarching general framework for all high-cost support. For example, the Commission reasonably could continue to provide support to smaller carriers serving rural areas based on embedded costs as an interim measure pending appropriate reform of the existing cost model. Even then, a transition period might be appropriate to ensure that no rural carriers or consumers are harmed by a shift to a more unified approach.

<sup>14</sup> Order on Remand, *Federal-State Joint Board on Universal Service*, 18 FCC Rcd 22559, 22570-71 ¶ 21 (2003) ("*Order on Remand*").

<sup>15</sup> California, Kansas and Texas.

competitive market that developed over the past decade. “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” or will have to reduce its own rates closer to cost, either of which inevitably cause “the implicit support for below-cost rates in high-cost areas [to] erode.”<sup>16</sup> Courts have repeatedly recognized this as well.<sup>17</sup>

And this is precisely what has occurred. Competitors have targeted business customers and only the most lucrative residential and small business customers, leaving the ILECs to serve the lower margin and higher-cost customers at below-cost rates.<sup>18</sup> This has led to the rapid and unsustainable erosion of implicit universal service support for the incumbents who are committed to serving these higher-cost customers, and are obligated to do so as carriers of last resort.

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<sup>16</sup> Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 20432, 20441-42 ¶ 16 (1999) (“*Ninth Report and Order*”) (subsequent history omitted); *see also* 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) (similarly noting implicit subsidies are not sustainable as a method of supporting universal service); Fifth Report and Order, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 21323, 21326 ¶ 6 (1998) (same); Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11505 ¶ 8 (1998) (same); Order, *Access Charge Reform*, 12 FCC Rcd 10175, 10182-83 ¶ 17 (1997) (same); Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8786-88 ¶¶ 17, 19 (1997) (same); *see generally* Comments of SBC Communications Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, at 4-16 (Jan. 14, 2003).

<sup>17</sup> *See, e.g., Qwest I* at 1196 (“[I]mplicit subsidies are . . . difficult to sustain as competition increases.”); *Qwest II* at 1226 (“[C]arriers entering the market would compete aggressively for low-cost, urban areas, leaving former monopoly carriers the unsustainable burden of providing service to rural areas in the face of a dwindling urban base.”).

<sup>18</sup> *See, e.g.,* News Release, Federal Communications Commission, *Federal Communications Commission Releases Data on Local Telephone Competition*, July 8, 2005 at 2, at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/lcom0705.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0705.pdf).

The Commission cannot maintain that its current non-rural high-cost support fund — intended merely to supplement state implicit subsidy programs, and therefore premised on their continued existence — is “specific, predictable and sufficient . . . to preserve and advance universal service.”<sup>19</sup> Nor can the Commission claim, at this point, that it has fulfilled *Qwest I*’s mandate to “ensure” that there are “specific, predictable and sufficient Federal *and State* mechanisms.”<sup>20</sup> In fact, the Commission itself has acknowledged that much more might be done to encourage states to transition to explicit support mechanisms, but the rulemaking it initiated in October 2003 to consider further inducements for state action has sat idle for *over two years*.<sup>21</sup> Meanwhile, the certification approach the FCC designed to “induce” state action<sup>22</sup> has had no discernible impact on states’ continued reliance on implicit subsidies. It is time for the Commission to tackle this issue head-on.

To be sure, *Qwest II* agreed with the FCC that Congress did not “dictate” that the FCC must enforce a specific “time line” for states to transition from “one system of support to another” or “foreclose the possibility of the continued existence of state implicit support mechanisms that *function effectively to preserve and advance universal service*.”<sup>23</sup> But the Court did not rule that the FCC could ignore the impact of the states’ failure to act in shaping its own mechanism. And it also did not find that the FCC could not act where state implicit support is

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<sup>19</sup> 47 U.S.C. § 254(b)(5).

<sup>20</sup> *Qwest I* at 1203 (emphasis added).

<sup>21</sup> See Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, 18 FCC Rcd 22559, 22628, 22631-33 ¶¶ 119, 126-32 (2003).

<sup>22</sup> *Order on Remand* at 22613-14 ¶¶ 89-92.

<sup>23</sup> 398 F.3d at 1233 (emphasis added).

frustrating, rather than effectively preserving or advancing, federal universal service policies. To the contrary, the Court reaffirmed that the FCC was obligated to adopt policies to induce states to act to reform universal service, and while it upheld the FCC’s certification approach, the Court noted that it could “envision various approaches to more effectively induce state action.”<sup>24</sup>

Given the patent lack of progress a decade after the Act’s passage, the Commission’s assumption that states would address the erosion of implicit support by establishing explicit support mechanisms or rebalancing local rates as competition develops, even if reasonable when adopted, plainly is unreasonable now, and any federal policy based on that assumption would be arbitrary and capricious in the extreme. The Commission thus must finally adopt an approach that does “more effectively induce state action;” burying its head in the sand and staying the course at this juncture simply is not an option.<sup>25</sup>

Finally, in revising its approach to universal service, the Commission must address the basic definitional questions that the *Qwest* courts posed, and do so in a manner that will serve *all* of section 254’s policy objectives. As we explain below, this requires that the Commission finally consider the principle of “affordability” that stands as one of the Act’s chief goals, rather than focusing exclusively on “comparability.”<sup>26</sup> There is no empirical evidence whatsoever that any of the Commission’s existing universal service mechanisms produce *affordable* rates.

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<sup>24</sup> *Id.* at 1238.

<sup>25</sup> See *People of State of Cal. v. FCC*, 905 F.2d 1217, 1230 (9th Cir. 1990) (“[T]he FCC is obligated to reevaluate its policies when circumstances affecting its rulemaking proceedings change.”); *Committee To Save WEAM v. FCC*, 808 F.2d 113, 117 (D.C. Cir. 1986) (quoting *FCC v. WNCN Listeners Guild*, 450 U.S. 582, 603 (1981)) (“[T]he Commission should be alert to the consequences of its policies and should stand ready to alter its rule if necessary to serve the public interest more fully.”).

<sup>26</sup> 47 U.S.C. § 254(b)(1).

Indeed, as the Commission recognizes in the *Notice*, it has never even identified what such a rate might be.<sup>27</sup> It is hard to see how a universal service program that failed to yield affordable rates could be defended as sufficient, nor what value consumers (or Congress) could see in reasonably comparable, *unaffordable* rates.

Thus, affordability should be the centerpiece of a new, revised universal service plan. Such an approach should best advance *all* the Act’s objectives in a meaningful way, ensuring that consumers in *all* areas have a comparable ability to purchase state-of-the-art telecommunications services, regardless of the size of their carrier. And the focus on *rates* rather than just costs will also better accord with the Tenth Circuit’s finding that “[r]ates cannot be divorced from a consideration of universal service” because “[i]f rates are too high, the . . . services encompassed by universal service may . . . prove unavailable.”<sup>28</sup> Accordingly, as we explain below, the Commission should determine an affordable level for telephone service in a particular geographic area based on a fixed percentage of median income, which it can determine based on reliable, public data concerning routine household expenditures. Support should be keyed to those areas where a carrier’s costs exceed the affordability threshold.

Only this type of comprehensive reworking of the Commission’s existing mechanisms can preserve and advance universal service in a competitive environment as required by the Act. Experience now shows that tinkering here with the existing non-rural support mechanism and there with the rural support mechanism does not address its underlying problems. The

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<sup>27</sup> See *Notice* ¶ 10.

<sup>28</sup> *Qwest II* at 1236; see also Recommended Decision, *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 20716, 20751 (2002) (separate statement of then-Commissioner Martin, approving in part, dissenting in part) (expressing doubt “that a mechanism based solely on costs would meet the statutory mandate requiring a comparison of rates”) (emphasis in original) (“*2002 Recommended Decision*”).

Commission has both a mandate and an opportunity to elaborate on a complete plan for universal service, and it should do so by crafting a plan that faces up to the real world challenges.

## **II. The High-Cost Support Mechanism Must Promote *All* of the Mandates of Section 254(b).**

When it shapes a new universal service support program, as it must, the Commission must adopt a mechanism that is “sufficient to achieve the purposes of” section 254.<sup>29</sup> Section 254(b) articulates several policy goals that federal universal service policy must follow.<sup>30</sup> The Tenth Circuit has repeatedly emphasized that “the FCC’s duty” to carry out these goals “is mandatory,”<sup>31</sup> and has faulted the FCC in the past for selectively picking and choosing to promote certain of these mandates while ignoring others entirely — in particular, section 254(b)(1)’s mandate that “[q]uality services should be available at just, reasonable, and affordable rates.”<sup>32</sup> On remand, the Commission should finally “consider [] the range of principles identified in the text of the statute.”<sup>33</sup> As we show here, a fresh evaluation of those principles, and one that takes all of the statute’s goals into account, should drive the Commission toward a revised universal service approach — in particular, to the mechanism we outline below.

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<sup>29</sup> 47 U.S.C. § 254(e).

<sup>30</sup> 47 U.S.C. § 254(b). All are relevant here, save § 254(b)(6), which deals specifically with subsidizing schools, libraries, and health care providers.

<sup>31</sup> *Qwest II*, 398 F.3d at 1234; *see also Qwest I*, 258 F.3d at 1200 (“The plain text of the statute mandates that the FCC ‘shall’ base its universal [service] policies on the principles listed in § 254(b).”); *id.* (noting that the Commission may “balance the principles against one another when they conflict, but may not depart from them altogether to achieve some other goal.”).

<sup>32</sup> *See Qwest II* at 1234 (“We are troubled by the Commission’s seeming suggestion that [besides rate comparability,] other principles, including affordability, do not underlie federal non-rural support mechanisms.”).

<sup>33</sup> *Id.*

The relevant section 254(b) mandates are as follows:

1. “Quality services . . . at just, reasonable, and affordable rates.” 47 U.S.C. § 254(b)(1).

As discussed above, the Tenth Circuit stressed that the Commission *must* address affordability of service in shaping its universal service support mechanism. The Commission has given this factor little consideration in the past. It is plain, however, that any consideration of whether services are “affordable” to consumers necessarily involves analysis of whether, and to what degree, consumers can bear the costs of service in the face of their financial means, or income. That, of course, is the very definition of “affordable.”<sup>34</sup> The Commission’s mechanism for high-cost support therefore cannot fulfill the statutory mandate if the agency continues to shy away from determining how much consumers can reasonably be expected to spend on telephone service. Support should be keyed to areas where costs exceed an affordability benchmark, to ensure that consumers in all areas can receive service at affordable rates.

Affordability can be measured in concrete, objective terms. As discussed in greater detail below, the Commission should start by examining the percentage of income consumers currently spend on telephone services and comparing that to the percentage they spend on other services. The Commission should take advantage of the extensive information it collects in compiling its regular surveys of telephone expenditures,<sup>35</sup> and it can use widely available data from other government sources to compare such expenditures to the percentage of their national median

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<sup>34</sup> Merriam-Webster Online Dictionary, at <http://www.m-w.com/dictionary/affordable> (last visited Mar. 20, 2006) (“to be able to bear the cost of”).

<sup>35</sup> See, e.g., Federal Communications Commission Industry Analysis Division, Report: “Trends in Telephone Service,” at 3-1 at [http://www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/trend605.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend605.pdf); TNS Telecoms, Bill Harvesting, <http://www.tnstelecoms.com/billharvesting.html> (used as a source for some of the data in the FCC’s report).

income consumers spend on other similar goods and services.<sup>36</sup> This data should provide a reasonable and objective measure of local telephone service “affordability” — one which, as we explain below, can readily be used as the organizing principle for a reformed universal service support mechanism.

2. *“Access to advanced telecommunications and information services.” 47 U.S.C. § 254(b)(2).*

Section 254(b)(2) makes clear that consumers should have broad access to advanced services, a mandate that requires support for investments in new facilities and upgrades of old ones. Once support is properly keyed to the areas that need it, carriers will have the incentives they need to invest in multi-use facilities that can provide advanced services to rural areas. Support that is insufficient to fund affordable rates even for *basic* services clearly stands as a barrier to broadband deployment in high-cost areas. Similarly, forcing carriers to commit the revenues from their broadband services to cross-subsidizing the carrier’s below-cost, basic service costs undermines the carrier’s investment incentives. The Commission thus should commit itself to reforming its mechanism in such a way as to remove impediments and create incentives for network upgrades and investment that can bring advanced, broadband services to rural high-cost areas.

3. *“Reasonably comparable” access to service for consumers in rural and urban “areas” at “reasonably comparable” rates. 47 U.S.C. § 254(b)(3).*

Section 254(b)(3) explicitly focuses on whether “*consumers*” in urban and rural “*areas*” are paying reasonably comparable rates for reasonably comparable offerings of service. To date, the Commission’s approaches have largely left consumers out of the analysis, relying instead on

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<sup>36</sup> See, e.g., Bureau of Labor Statistics, “Consumer Expenditure Surveys,” at <http://www.bls.gov/cex/>.

a simple arithmetic comparison of the costs — or rates charged — in each state. As the Tenth Circuit has found, comparing costs has no obvious relevance to rate comparability.<sup>37</sup> And as the *Notice* recognizes, comparing absolute rates across various states or even areas is complex given differences in rate structures and service categories.<sup>38</sup> Nor is it necessarily meaningful: from the point of view of consumers, the salient comparison is the impact telephone expenditures have on their pocketbooks. Spending \$30 per month for basic telephone service means something very different to a consumer in a rural community with a median household income of \$20,000 than it does to one in a suburban community with a \$100,000 median household income, even though in an absolute sense, the prices are the same.<sup>39</sup>

With a fixed “affordability” percentage that is the same for urban, rural, and insular areas, and median income data for particular geographic areas, the Commission would be able to make a “reasonable comparability” determination between geographic areas that really does focus on the consumer’s point of view, as the statute requires. Such an approach would ensure that consumers in every community, no matter how expensive to serve, would enjoy supported service where the cost of basic service exceeds a particular percentage of median income. Absolute rates would not be the same — a goal that would be complex, unattainable without Commission intervention in state ratemaking, and for this reason undesirable — but the impact of the rates on consumers would be comparable.

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<sup>37</sup> *Qwest II* at 1237.

<sup>38</sup> *See Notice ¶¶ 24-25.*

<sup>39</sup> Of course, there are variations within each community as well. Support for consumers with low incomes should continue to be addressed by the Lifeline mechanism and, if appropriate, increased to meet these consumers’ needs.

Further, and relatedly, “affordability”-based support should not be based primarily on a comparison of the affordability benchmark to existing *rates*. To begin with, that comparison, without more, would be misleading, since many rates are distorted by unstable implicit subsidies or value-of-service pricing, as the Commission has acknowledged multiple times.<sup>40</sup> Instead, it is more accurate to generally base support on the rates that would apply in an area in the absence of implicit subsidies — that is, rates that reflect the actual costs of serving a given community.<sup>41</sup>

Finally, in assessing rate comparability, the express language of section 254(b)(3) requires that the Commission abandon statewide averaging. As the *Qwest I* court succinctly held, section 254(b)(3) by its very terms “requires a comparison of rural and urban *areas*, not states.”<sup>42</sup> This dovetails with section 254(b)(3)’s explicit focuses on “consumers.” The entire point of the reasonable comparability inquiry is to examine what consumers in rural and high-cost areas actually spend on telephone service and receive for that money relative to what consumers in urban areas actually spend and receive. Combining these very different consumers into a hypothetical “statewide average” consumer is meaningless and guts the very purpose of

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<sup>40</sup> See, e.g., *Notice* ¶ 18 n.71; *Order on Remand* at 22571 n.55.

<sup>41</sup> As we explain below, the actual revenue a carrier can collect in connection with its provision of the supported service may be a factor in reducing the amount of MARC support to which a carrier is entitled when that revenue *exceeds* the affordability benchmark, and would be the basis for explicit support above and beyond the MARC, where it is below the benchmark.

<sup>42</sup> *Qwest I* at 1204 (finding it “fundamental error” that the mechanism concerned itself “only with ‘enabl[ing] reasonable comparability *among states*.”) (quoting *Ninth Report and Order* ¶ 38) (emphasis added) (alteration in original); see also *Order on Remand* (Statement of then-Commissioner Kevin J. Martin, Approving in Part, Dissenting in Part at 2, 3) (taking issue with the “presumption that the federal [] role . . . is apparently limited to equalizing cost discrepancies between states . . .” and noting that “[t]he 10th Circuit explicitly rejected the FCC’s contention that it had no duty to ensure the reasonable comparability of rural and urban rates.”). The *Qwest II* court invalidated the Commission’s definition of reasonable comparability on other grounds and did not reach the issue of statewide averaging.

section 254(b)(3). The analysis should take place on a much more granular basis, such as a wire center. As discussed below, data exists from which the Commission could readily determine the availability and amount of support on the basis of individual wire centers or even census block groups.<sup>43</sup>

4. “*Equitable and nondiscriminatory*” contributions. 47 U.S.C. § 254(b)(4).

Section 254(b)(4) was clearly intended to level the playing field for competition in local telecommunications while still supporting universal service. Increasingly, however, incumbent LECs and their customers are contributing an unequal share of universal service support because of reliance on implicit state subsidies. While the *Qwest II* court found that a similar principle in section 254(f) did not compel the *states* to eliminate implicit state subsidies, the Commission must make its own determination with respect to the federal mechanism in accordance with the mandates of section 254(b) and the evidence in the record.<sup>44</sup> The Commission may not blind itself to the effect its interpretations — and its continued reliance on implicit support (either

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<sup>43</sup> Census blocks are the smallest geographic area for which the Census Bureau collects data, and block groups are the next level above that. See U.S. Census Bureau, “Geographic Areas Reference Manual, Chapter 11: Census Blocks and Block Groups,” at <http://www.census.gov/geo/www/GARM/Ch11GARM.pdf> (“Census Bureau Reference Manual”).

<sup>44</sup> The *Qwest II* court declined to find that section 254(f) imposed a mandatory duty on the states because that provision explicitly commits the determination of what is an “equitable and nondiscriminatory” contribution to state universal service programs to the discretion of the states. See *Qwest II* at 1233; 47 U.S.C. § 254(f) (“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.”) (emphasis added). By contrast, section 254(b)(4), which governs the Commission's policies, does not contain any similar express grant. See *Notice* ¶ 14 (recognizing distinctions between sections 254(f) and 254(b)(4)). In any case, the Commission retains the authority and the obligation to interpret the statute, notwithstanding the court’s findings. See *National Cable & Telecommunications Association v. Brand X Internet Servs.*, 125 S. Ct. 2688 (2005).

federal or state) — are having on universal service and the competitive marketplace generally. The Commission must commit itself to a mechanism that does not depend on and thus perpetuate implicit subsidies, but instead is independently sufficient to serve section 254’s universal service goals.

The Commission has committed itself to revising its contribution rules in other ways in order to ensure sufficient support and address various competitive inequities in the existing regime, such as the exemption of certain providers or services. Elimination of the unfair burden of self-provided implicit support should be a piece of that effort.

5. *“Specific, predictable and sufficient Federal and State mechanisms.”* 47 U.S.C. § 254(b)(5).

Federal support must be “sufficient,” and sufficiency must have as its goal enough support to ensure that consumers are able to afford the cost of telephone service. Universal service funding that does not achieve this goal must by definition be insufficient. As noted above, it is hard to see how the Commission could defend as “sufficient” any mechanism that produces rates too high for consumers to pay. This, at bottom, must be the relevant measure, and the Commission should redefine this principle, as well as the mechanism itself, with this fundamental truth in mind.

As noted above, one way of achieving this is to revise the plan to provide enough support to ensure objectively affordable rates across the country. But another important revision is the elimination of any reliance on implicit support. The Commission can no longer maintain that its support mechanism are sufficient — much less “specific” or “predictable” — when so much depends on rapidly eroding implicit support. As implicit subsidies erode, they are increasingly *less* sufficient and predictable, and they have never been remotely “specific.” And, as noted,

they are woefully inadequate to ensure that universal service is ever “advanced” in high-cost areas, since self-subsidization can chill broadband investment.

To be sure, as discussed above, the Tenth Circuit recognized that this principle does not specifically or expressly *compel* the Commission to eliminate state reliance on implicit support. But the tension between the reality of universal service today and what Congress clearly envisioned grows daily, and in the interim, consumers are increasingly disserved. The public interest now *requires* that the Commission move forward once and for all, to eliminate implicit subsidies at all levels.<sup>45</sup>

The *Qwest II* court reiterated the view that the Commission should adopt effective means of inducing the states to move in this direction.<sup>46</sup> Thus, any program the Commission adopts must contain *effective* inducements to achieve that end — measures calculated to produce real results in the real world. Since the Commission’s existing mechanism has not effected any shift toward more explicit state support, the Commission cannot reasonably defend it as serving this statutory principle. In shaping a new program on remand, the Commission therefore must adopt new, more productive measures to “induce” the states to adapt their programs to comply with Congress’s vision of sufficient, explicit, and precise universal service support.

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<sup>45</sup> Indeed, the Court excused the FCC from acting based in part on its finding that Congress did not expressly foreclose “state implicit support mechanisms that function *effectively* to preserve and advance universal service.” *Qwest II* at 1233 (emphasis added). But the Commission can no longer in good faith maintain that *any* implicit subsidy approach is effective for that purpose, and therefore can no longer reasonably premise its own fund on such subsidies.

<sup>46</sup> *Qwest II* at 1238.

6. “Competitively neutral” mechanisms that “neither unfairly advantage nor disadvantage one provider over another.” *First Report and Order* ¶ 47.<sup>47</sup>

Pursuant to its authority under section 254(b)(7),<sup>48</sup> the Commission has adopted “competitive neutrality” as an additional universal service principle, above and beyond those specifically enumerated in the Act. In its *First Report and Order* on universal service, the Commission found that its universal service programs should be designed to avoid creating unfair competitive or technological advantages.<sup>49</sup> This idea, the Commission found, was “consistent with congressional intent and necessary to ‘promote a pro-competitive, de-regulatory national policy framework.’”<sup>50</sup> The Commission therefore committed to “minimize departures from competitive neutrality, so as to facilitate a market-based process whereby each user comes to be served by the most efficient technology and carrier.”<sup>51</sup>

This principle reinforces the need for the Commission to replace its current high-cost support regime with one that relies only on explicit support, funded in a competitively neutral manner and distributed fairly, without regard to carrier size. As discussed, the existing bifurcated mechanisms for “rural” and “non-rural” carriers force large carriers to rely overwhelmingly on eroding implicit subsidy mechanisms. This disparity in support, standing

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<sup>47</sup> Report and Order, Federal-State Joint Board On Universal Service, 12 FCC Rcd 8776, 8801 ¶ 47 (1997) (“*First Report and Order*”).

<sup>48</sup> 47 U.S.C. § 254(b)(7) (The Commission may base its universal service policies on “[s]uch other principles . . . [it] determine[s] are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with [the Communications Act].”).

<sup>49</sup> *First Report and Order* at 8801 ¶ 46.

<sup>50</sup> *Id.* at 8801-02 ¶ 48 (quoting the Joint Explanatory Statement of the Committee of the Conference, H.R. Rep. No. 458, 104th Cong., 2d Sess.).

<sup>51</sup> *Id.* at 8802 ¶ 48.

alone, unfairly disadvantages one class of carriers in violation of the Commission's own principle. Further, the mechanism's reliance on implicit support forces large incumbents to self-fund high-cost universal service through above-cost rates on lower-cost, high volume customers. This result creates significant competitive disparities in the marketplace, allowing competitors that are not similarly burdened to easily undercut the incumbent's above-cost rates and "cream skim" the most attractive high volume customers. In addition, of course, the Commission's *contribution* mechanism remains competitively skewed, requiring contributions of some providers and not others, even with respect to directly competing services like DSL and cable modem service.

In revising its high-cost support mechanism, the Commission should re-affirm the principle of competitive neutrality. This will require unifying its approach to high-cost support so that no class of carriers is uniquely burdened; eliminating implicit support, which perpetuates market distortions that undermine fair competition; and ensuring that all carriers are supported based on a fair measure of their costs as compared to the affordable rate consumers can pay. Notably, this does not mean simply increasing support for "non-rural" carriers: A truly objective, competitively neutral approach should mean that carriers that have *lower* costs receive less support so that they are not unfairly advantaged; similarly, carriers that can charge rates that cover their costs should not be subsidized at all.

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As noted above, the Commission must satisfy and balance *all* these principles in revisiting its universal service support mechanism on remand. Doing so will necessarily result in a plan very different from the Commission's current approach, which relies on implicit subsidies, is premised on costs without consideration of impact on consumers, and which is designed

primarily to limit the size of the federal fund. Below, we propose the approach the Commission should adopt instead.

### **III. AT&T Proposes a Mechanism for Affordable Rural Communications (“MARC”) that Will Provide the Universal Support Required by Section 254.**

As the *Notice* observes,<sup>52</sup> AT&T maintains that a plan that has affordability as its cornerstone will best carry out *all* the mandates of section 254 — as well as the Tenth Circuit’s specific directives.<sup>53</sup> To that end, AT&T now proposes a Mechanism for Affordable Rural Communications (“MARC”). The MARC is a federal funding mechanism that would compensate carriers serving consumers in rural and high-cost areas for the amount by which the cost of providing service to consumers in a given area exceeds a MARC affordability benchmark for local telephone service for that area. The MARC affordability benchmark for each area would be an objective measure of a reasonable level of consumer expenditure on local telephone service, based on readily available government statistics.

#### **A. Summary of the MARC**

The main elements of the MARC are as follows:

- The Commission would determine the *cost of providing service* in a specific geographic area using the forward-looking cost model it employs in the current mechanism for “non-rural” carriers (until or unless the Commission replaces that model with one that more accurately reflects carrier costs). However, that model would be used to compute a cost of service for specific geographic areas, such as wire centers, rather than statewide provisioning costs.

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<sup>52</sup> *Notice* ¶ 10 (citing Comments of SBC Communications Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, at 12-15 (April 10, 2002) (“SBC 2002 Comments”)).

<sup>53</sup> *Qwest II* at 1237 (“On remand, the FCC must utilize its unique expertise to craft a support mechanism taking into account *all* the factors that Congress identified in drafting the Act and its statutory obligation to preserve and advance universal service. No less important, the FCC must fully support its final decision on the basis of the record before it.”) (emphasis added).

- The Commission also would determine a national *affordability index*: the percentage of household income that consumers can reasonably be expected to spend on telephone service. Data indicate that consumers currently spend something on the order of 1.5% of their household income on local telephone service (and this is based on today's residential telephone rates which are frequently held artificially low). Readily available federal government data demonstrate that this level of expenditure is commensurate with or lower than spending for similar household goods and services.
- The Commission would then determine the *MARC affordability benchmark* for each area by multiplying the affordability index by the median income of households in that area.
- The Commission would provide federal high-cost support funds in each area where the cost of service exceeds the MARC affordability benchmark (or a measure of the carrier's actual revenues for the supported service in that area, whichever is higher), in an amount to cover the difference.
- States would retain their authority over local telephone rates. If a state chose to compel carriers to charge a rate lower than that benchmark (and below the cost of service), the state would have the option of establishing its own explicit support fund to make up the difference between actual rates and the benchmark. (In many cases, this could be a lower amount than what the state funds today, since MARC funds would be available to cover the difference between the actual cost of service and the benchmark.) Alternatively, the state could choose to defer to the Commission, which would then collect the same amount through a specific additional USF assessment on carriers in that state. Like federal USF contributions, carriers could then pass those contributions along to their customers.

The MARC would provide federal support sufficient to meet the mandates of section 254 and satisfy the Tenth Circuit's concerns. Unlike the Commission's current high-cost support fund, the MARC would provide an objective way to compare rates across jurisdictions that have a wide range of ratemaking histories and practices, and it ensures that consumers in all areas have comparable rates relative to an objective measure of affordability. And at the same time, AT&T's proposal would preserve state authority to set all local rates.<sup>54</sup>

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<sup>54</sup> As we explain below, these changes necessarily and appropriately increase the overall amount of funding to provide sufficient support. However, these changes would relieve states of some of the burden of universal service funding; in addition, we recommend changes that should mitigate the overall increases.

## **B. Components of the MARC**

### *1. Cost of providing service*

The MARC starts with a measure of the costs of providing service. Our proposal assumes that the MARC would be premised on the Commission's forward-looking cost of service model used in the existing mechanism for "non-rural" carriers.<sup>55</sup> Unlike the existing mechanism, however, the costs of providing service would be calculated for particular geographic areas, such as wire centers or smaller areas (like census blocks), individually rather than as a statewide average. As noted above, it is essential to determine the availability and level of support on the basis of particular areas, rather than state-by-state. As a legal matter, section 254(b)(3) expressly directs the Commission to consider the level of rates for consumers residing in rural and urban "areas."<sup>56</sup> And as a policy matter, calculating the need for support by smaller geographic areas enables support to be more accurately directed to where it is needed, while also reducing the dependence of carriers on the whims of state implicit funding mechanisms.

### *2. Affordability index*

The MARC implements the statutory principle of affordability by establishing a basic telephone service affordability index that would reflect the percentage of household income average consumers can reasonably afford for local telephone service. The index would be expressed as a percentage of median household income.

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<sup>55</sup> The existing Synthesis Model is flawed in several respects; it is a model with stale inputs and one that overstates costs for rural areas to a significant degree. Nevertheless, for present purposes, there is no other generally accepted model that could be readily employed, and it goes without saying that the sorely needed overhaul of the overall universal service support mechanism should take precedence over replacement of the underlying cost model.

<sup>56</sup> *Qwest I* at 1204.

Nationwide data on median income and consumer expenditures are readily available to assist the Commission in establishing the affordability index. These data indicate that consumers currently spend between 1 and 2 percent of their income on basic telephone service. For example, from an analysis of the TNS Bill Harvesting data,<sup>57</sup> AT&T determined that consumers currently spend approximately 1.5 percent of their household income on basic telephone services. That number may be at the low end of an appropriate measure of affordability, given that state regulators typically hold down the price of residential telephone service; substantial numbers of consumers could well afford to spend more and be subsidized less. Data on other household expenses also confirm that the 1.5% index is an objectively reasonable level of expenditure for local telephone service, and would be considered “affordable” in relation to what consumers currently spend on similar services. According to annual data published by the Bureau of Labor Statistics (“BLS”), 1.5 percent of household income is far less than the average household spends on energy expenses (3.1 percent), gasoline and motor oil (3.1 percent), and food away from home (4.7 percent). It is approximately the same as the average household spends on television (including cable television service), radios and sound equipment (1.5 percent) and miscellaneous household equipment (1.4 percent).<sup>58</sup> Given that some of the latter are clearly discretionary expenditures, a 1.5% level for telephone expenditures is more than reasonable.

The Commission may choose to set the affordability index at a different level or have it vary over time. But having an index based on household expenditure data is a straightforward,

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<sup>57</sup> See TNS Telecoms, Bill Harvesting, at <http://www.tnstelecoms.com/billharvesting.html>.

<sup>58</sup> Bureau of Labor Statistics, “Consumer Expenditure Survey, 2004,” Table 8. Region of residence: Average annual expenditures and characteristics, at <http://www.bls.gov/cex/2004/Standard/region.pdf>.

practicable means of determining whether telephone service rates are “just, reasonable, and affordable,” as section 254(b)(1) directs.<sup>59</sup> BLS data are public, readily available, and reliable. Indeed, for similar reasons, the BLS data are already used by the federal government and others for a variety of other federal aid programs, such as determining eligibility for certain student aid programs.<sup>60</sup> With this approach, the Commission will be able to measure rate affordability in objective terms, grounded in exactly the type of real, empirical data the *Qwest II* court “expected” the Commission to provide.<sup>61</sup>

### 3. *MARC affordability benchmark*

By applying the affordability index to the median monthly income for households in a particular geographic area, the Commission can easily calculate a MARC affordability benchmark for that area. For example, if the Commission chose to provide support on a wire center basis, median income per wire center could be determined by a weighted average of the median incomes of each census block group served by that wire center.<sup>62</sup> While the level of the

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<sup>59</sup> 47 U.S.C. § 254(b)(1).

<sup>60</sup> See The College Board, “IM: What is it?” at <http://www.collegeboard.com/highered/res/im/im.html>; see also, e.g., U.S. Department of Agriculture, Economic Research Service, “Food and nutrition assistance programs: recommended data,” at <http://www.ers.usda.gov/Briefing/FoodNutritionAssistance/data/> (encouraging use of BLS data for agricultural and nutrition assistance programs). The Consumer Expenditure Survey is also used to calculate the Consumer Price Index (CPI), which is in turn used in a variety of programs.

<sup>61</sup> *Qwest II* at 1237 (invalidating the cost benchmark because “the FCC based the two standard deviations *cost* benchmark on a finding that *rates* were reasonably comparable, without empirically demonstrating a relationship between the costs and rates surveyed in this context.”) (emphasis in original).

<sup>62</sup> There are many more census tracts and block groups than there are wire centers. See generally Census Bureau Reference Manual, *supra*. The available data is therefore granular enough to allow a high degree of accuracy in determining the average household income per wire center.

benchmark would be different in each wire center, the impact of that benchmark rate on consumers' pocketbooks in each wire center would be the same: the benchmark affordable rate would always represent the same fraction of median income for each wire center.<sup>63</sup> The result is a more accurate (and far more salient) yardstick for determining whether “[c]onsumers in all regions of the Nation” are in fact paying “reasonably comparable” amounts for local telephone service, as section 254(b)(3) requires.

#### 4. *Primary federal support*

In areas where the modeled costs of providing service exceed the higher of the MARC affordability benchmark or the applicable revenues actually available to the carrier in connection with the supported service in that area, the Commission should provide enough federal funds to support the entire difference between the two. Providing support keyed to affordability ensures that carriers have enough, but not too much, support to provide consumers with affordably priced service. And funding the entire difference through federal funds would decrease the burden (and carriers' dependence) on eroding state implicit subsidy programs, putting support on a more “specific” and “predictable” footing than exists today, as required by section 254(b)(5).

As discussed below, states would retain rate-setting oversight. Where a state currently permits a carrier to charge rates that generate revenue higher than the MARC affordability benchmark but still below the modeled costs of providing service, MARC support would be limited to the difference between the modeled cost and the revenues actually available to the carrier in connection with the service. And of course, where a carrier generates enough revenue from its rates to recover its full costs, no support would be available. Support would thus be no

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<sup>63</sup> It may be preferable to calculate support across areas that are smaller than wire centers, such as census block groups. In some cases, averaging costs across wire centers may produce distorted results, where costs vary significantly.

higher than necessary to ensure that consumers in all areas have comparable access to an objective measure of what consumers can reasonably be expected to pay for telecommunications, and would at the same time be *sufficient* to ensure that carriers are able to offer service at such rates.

To illustrate the working of the basic federal fund under the MARC, consider an area where the modeled cost of providing service is \$50 per line.<sup>64</sup> Where the MARC affordability benchmark for the area is \$30 per line, support would be \$20 per line. However, if the carrier charged rates that generated revenue of \$40 per line, federal support would be limited to \$10 per line. If the carrier charged rates that generated revenue of \$50 per line or above, support would not be available to that carrier for that area.

Federal support from the MARC fund would relieve those states that have already stepped up to meet the burden of universal service (through explicit high-cost funding mechanisms supported by intrastate services) from having to fund universal service goals entirely by themselves. Support from the MARC would relieve states of a portion of this obligation by supporting the difference between cost and the MARC affordability benchmark. To be sure, adoption of this element of the MARC is in the hands of the states, but the goal is to shift the responsibility for this level of funding exclusively to the federal mechanism, and the intent is to avoid duplicative state and federal funding to support “affordable” rates.

##### 5. *State support options*

A key feature of the MARC plan is that states would retain their current authority over rates for local telephone service. This includes whatever authority states now have to require

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<sup>64</sup> Support today is provided on a per-line basis. However, calculating support on another basis, such as per-household, may more accurately advance the core purposes of universal service.

carriers to charge rates that are below cost, and even below the MARC affordability benchmark. In the latter case, however, the federal support provided pursuant to the MARC would not be sufficient to ensure that a carrier could adequately cover its costs. To address that situation, the MARC would provide the states with several options.

First, in states where residential local prices currently result in revenues that are below the MARC affordability benchmark, the state could choose to allow adequate pricing flexibility to permit carriers to set rates that generate adequate revenues.<sup>65</sup> Second, where the state instead wishes to retain (or set) the price of residential local telephone service at levels that would generate per line revenues *below* the MARC affordability benchmark (and where the forward-looking cost of service *exceeds* the benchmark), the state can establish an explicit support mechanism that funds the additional required support. Support would have to make up the difference between the affordable benchmark and the state-constrained rates.

Third, the state can retain (or set) local service at a rate below the MARC affordability benchmark (and below cost), but choose not to establish an explicit fund, and instead defer to the Commission to establish an additional, state-specific federal fund for carriers in that state. The MARC would provide the Commission with authority to assess carriers in the particular state the additional amounts necessary to support the state-set rate. In this way, the MARC would discourage states from attempting to shift to carriers and consumers in other states the burden of maintaining rates below the MARC affordability benchmark, while maintaining state authority over local rates based on state priorities — to the extent, of course, that those priorities do not conflict with or undermine federal policies and objectives. The Commission would exercise this

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<sup>65</sup> Support for low-income individuals should be addressed by the Lifeline mechanism and increased if necessary.

authority only in the event that a state failed to act, and could be triggered at the request of the state, carriers within the state, or by the Commission itself.

For example, consider a rural community where the cost of providing service is \$70 per line, the federal MARC affordability benchmark is \$30 per line, and the state sets statewide rates at levels that generate per-line revenues of \$20. The MARC would provide \$40 per line in primary federal support, and the state would have the option of allowing price flexibility to generate revenue of at least \$30 per line, or keeping the \$20 rates. If it keeps the existing rates, resulting in per-line revenues of \$20, the state would need to provide explicit funding to cover the additional \$10 rate subsidy. Alternatively, it could allow the Commission to establish an additional state-specific assessment to fund that \$10.

This approach would satisfy section 254(b)(5)'s principle that the Commission ensure there are "sufficient Federal and State" mechanisms, a requirement the Tenth Circuit has twice made clear requires some "carrot" or "stick" significant enough "to induce" — and not merely encourage — "adequate state action."<sup>66</sup> The MARC would achieve this by providing the states with a significant incentive to eliminate implicit cross-subsidies and abandon below-cost rates, and encourages them to shift to more "specific, predictable and sufficient . . . mechanisms."<sup>67</sup> It would be far more effective than the Commission's current rate certification program, and it would finally tackle the problem that has been at the heart of the universal service crisis for years. The MARC also would achieve this without crossing any of the lines the Tenth Circuit identified as limits on the federal plan: it would leave states with the ultimate authority to make

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<sup>66</sup> *Qwest I*, 258 F.3d at 1204 (emphasis altered); see *Qwest II*, 398 F. 3d at 1233 (reaffirming this holding).

<sup>67</sup> 47 U.S.C. § 254(b)(5).

the decision to adopt their own explicit funds, and it would leave the states in the driver's seat with respect to all local rates.<sup>68</sup>

### **C. Additional Reform Proposals**

In addition to adopting the MARC for its “non-rural” mechanism, the Commission should commit itself to unifying the framework for all high-cost support, for “rural” and “non-rural” carriers alike. As discussed in Part I, maintaining separate funding mechanisms has resulted in underfunding for many rural and high-cost areas served by “non-rural” carriers. Further, it may have the effect of discouraging smaller carriers from taking advantage of economies of scale that would benefit consumers with lower prices, or encouraging use of federal support to keep rates below that which consumers reasonably can be expected to pay for service. Support should not be based on the identity or size of the *carrier* and whether the carrier met certain definitions; instead, it should be designed to ensure that *all* carriers had sufficient support to offer consumers basic local service at affordable rates — which, as discussed, is the proper guiding principle for universal service in the first place. As a first step, the Commission should incorporate an affordability principle into its existing rural mechanism. Over time, the Commission should transition to one, unifying framework for both mechanisms, albeit with whatever provisions are necessary to account for the unique characteristics of very rural areas.<sup>69</sup>

The Commission also should eliminate the waste that results from its current method of supporting competitive eligible telecommunications carriers (CETCs). As AT&T has previously

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<sup>68</sup> See *Qwest II* at 1233.

<sup>69</sup> For example, as discussed above, the Commission should modify its cost support model to account for the higher costs of serving very rural areas.

explained,<sup>70</sup> the Commission should amend its rules to preclude availability of support to multiple CETCs in an area (and even for the same customer).<sup>71</sup> Permitting multiple CETCs exaggerates the size of the fund needed to provide universal service and is not an efficient use of federal funding. Addressing these distortions would reduce the size of the fund necessary to support affordable service across the country.<sup>72</sup>

#### **D. Impact Assessment**

The MARC would necessarily increase the size of the “non-rural” explicit federal support mechanism — although much of this increase would be offset by reductions in state support and the federal “rural” support mechanism. AT&T’s preliminary estimate, based on initial data, is that the MARC would require an increase in the size of the non-rural support mechanism by roughly one and a half billion dollars.<sup>73</sup> This increase is required, however, because the existing non-rural support mechanism is grossly inadequate to provide specific, predictable and sufficient support to allow purportedly “non-rural” carriers serving rural areas to provide consumers with

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<sup>70</sup> See Comments of SBC Communications Inc., *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 (May 5, 2003).

<sup>71</sup> Indeed, even under the existing non-rural mechanism, the savings would be substantial if the Commission moved to a single CETC rule, according to AT&T estimates.

<sup>72</sup> Under a pure application of the MARC, support for most non-incumbent CETCs would be automatically eliminated, in any event, because each carrier’s support would depend on the relationship between its costs and the MARC affordability benchmark, which many non-incumbent CETCs exceed in any event.

<sup>73</sup> This estimate assumes that the MARC is applied to all areas, and that support is reduced (or in some cases, not available) where the basic rate already exceeds the affordability benchmark (or is at or above cost). This estimate does not assume that any adjustments have been made to the rural mechanism. Additionally, this estimate assumes an affordability index based on consumers’ existing average telecommunications expenditures as a percentage of median household income. If the index were set higher, which certainly would be feasible given the artificially low basic local rates required by many state commissions, the increase in the fund would be considerably lower.

reasonably comparable, “affordable” service. Under the FCC’s existing “non-rural” mechanism, states such as Missouri and Louisiana receive *no* support, even though carriers in those states most definitely serve a large number of high-cost, rural customers, and states like Texas with significant rural areas have been forced to meet universal service goals by relying entirely on in-state resources. The MARC would ensure, for the first time, that carriers in such states receive explicit support, and thus that consumers in those states can enjoy reliable and sufficient universal service support. The increase is therefore warranted to meet the demands of section 254 and the needs of consumers in rural areas.

The increase in the federal fund would, of course, be offset by the *reduction* in explicit state support in those states that already have high-cost support funds. By AT&T’s estimate, the MARC should result in a reduction of several hundred million dollars in current explicit state funding that otherwise would provide duplicative support.<sup>74</sup> Adopting the MARC would also end carriers’ need to rely on the implicit support still lurking in state rate structures, although the savings would depend on how quickly state commissions rebalanced rates. Moreover, if the Commission eliminates the arbitrary distinction between its rural and non-rural support mechanisms and applies the MARC to all carriers serving all high-cost areas, the increase in overall universal service funding should be less: AT&T estimates that applying the MARC to areas now subject to the support mechanism for rural carriers would *reduce* the support now provided through that mechanism. Fixing the CETC issues (described above) in the rural mechanism would result in a further substantial reduction in the overall amount of federal

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<sup>74</sup> In AT&T’s ILEC service area, for example, Texas and California, in the absence of any federal support for meeting universal service objectives, have developed state mechanisms designed to support all rural areas. Those states would be relieved of a portion of that burden under the MARC.

universal service funding. Finally, in any case, the Commission has already committed to increasing the USF contribution base,<sup>75</sup> which should make it easier to support and fund a more rational, adequately sized federal fund.<sup>76</sup>

**IV. The Commission Can and Should Adopt Specific High-Cost Support Mechanisms to Achieve Universal Service Objectives in Unique Circumstances, But Such a Mechanism is Not Necessary to Achieve those Goals in Puerto Rico.**

In the *Notice*, in response to a petition by Puerto Rico Telephone Company (“PRTC”), the Commission tentatively concludes that it can and should adopt a new high-cost support mechanism for non-rural insular areas, which the Commission proposes to define as “islands that are territories or commonwealths of the United States,”<sup>77</sup> to address the purportedly unique challenges of serving those areas.<sup>78</sup> In particular, the Commission tentatively concludes that section 254(b) authorizes the Commission to establish a new mechanism for non-rural insular areas based on embedded costs to ensure realization of the goal of section 254 that consumers in insular, rural and high-cost areas have access to affordable telecommunications and information

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<sup>75</sup> See, e.g., Notice of Proposed Rulemaking, *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, 20 FCC Rcd 11308 (2005).

<sup>76</sup> In any case, the Tenth Circuit has already held that a goal of “limiting federal expenditures” cannot trump the statute’s express directive to provide sufficient support: the Commission may “balance the principles against one another when they conflict, but may not depart from them altogether to achieve some other goal.” *Qwest I* at 1200.

<sup>77</sup> *Notice* ¶ 38.

<sup>78</sup> *Id.* ¶ 33. In its petition requesting the Commission to establish an insular support mechanism, PRTC asserted that it confronts particularly high costs in serving Puerto Rico because of purportedly “unique circumstances,” including the need to maintain a larger inventory of equipment and supplies than carriers on the mainland, which PRTC claims increase its infrastructure costs, as well as rough terrain, frequent tropical storms and hurricanes, and the need to reach sparsely populated areas in Puerto Rico’s rural interior. *Id.* ¶ 31.

services.<sup>79</sup> The Commission also tentatively concludes that low penetration rates in Puerto Rico demonstrate that this goal is not being met,<sup>80</sup> and that a special support mechanism would help combat low subscribership in Puerto Rico.<sup>81</sup> The Commission asserts that a non-rural insular support mechanism, among other things, would enable PRTC to build new infrastructure in unserved areas, update its existing facilities, improve service quality, and maintain affordable rates, without significantly impacting the size of the universal service fund because, under the Commission’s proposed definition of “insular areas,” only PRTC would qualify to benefit from the new mechanism.<sup>82</sup>

Section 254 plainly authorizes the Commission to establish a distinct universal service support mechanism to address the unique needs of consumers in a particular geographic region(s) or area(s), where, due to unique circumstances, generally applicable support mechanisms are insufficient to ensure that consumers in that area(s) will have access to affordable and reasonably comparable telecommunications and information services<sup>83</sup> — including “*interexchange* services and advanced telecommunications and information

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<sup>79</sup> *Id.* ¶ 33.

<sup>80</sup> *Id.* In its petition, PRTC claimed that over the past five years, since the Commission began to reduce its high-cost funding, its telephone penetration rate (which had increased from 25 percent in the 1970s to over 70 percent in 1996) has fallen back below 70 percent. *Id.* ¶ 31.

<sup>81</sup> *Notice* ¶ 33.

<sup>82</sup> *Id.* ¶ 34. The Commission observes in this regard that there is no need for a rural insular support mechanism because all rural insular carriers already receive rural high-cost support, and that PRTC is the only incumbent carrier serving a high-cost insular area that is not classified as a rural carrier. *Id.* ¶ 34.

<sup>83</sup> 47 U.S.C. § 254(a)(1) and (a)(2) (Commission to establish “Federal universal service support mechanisms” to implement the requirements of section 254).

services.”<sup>84</sup> But the Commission need not establish a separate insular non-rural support mechanism available only to PRTC to ensure that universal service objectives are met in Puerto Rico. As discussed above, modifying the non-rural high-cost support mechanism to apply the MARC, as we advocate herein, would provide sufficient support to ensure the preservation and advancement of universal service objectives in Puerto Rico without the need for a unique fund.<sup>85</sup>

PRTC’s plight is not dissimilar to that of other non-rural carriers serving high-cost areas. In particular, like AT&T and other non-rural carriers, PRTC is classified as a non-rural carrier for purposes of universal service support based solely on its size — and despite the fact that much of its serving territory is rural and high-cost. And because statewide average costs in Puerto Rico do not exceed the nationwide average cost benchmark by two standard deviations<sup>86</sup>

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<sup>84</sup> 47 U.S.C. § 254(b)(3) (emphasis added).

<sup>85</sup> However, as discussed below, a special support mechanism is necessary to ensure that consumers in remote areas of Alaska continue have access to affordable and reasonably comparable telecommunications services to those available to consumers in the lower 48 states.

<sup>86</sup> AT&T recognizes and concurs with PRTC that, because the existing universal service cost model is based on inputs and assumptions applicable to mainland carriers, the model likely does not accurately predict the cost of serving high-cost areas outside the contiguous United States — such as Alaska and insular areas. Puerto Rico Tel. Co. White Paper: Proposed Interim Insular Mechanism, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, at 8 (May 6, 2005) (noting that the Joint Board expressed doubt that the Commission’s proxy model would provide an appropriate determination of costs on which to base high-cost support in Alaska and rural areas) (citing *1996 Recommended Decision*, 12 FCC Rcd at 240 ¶ 298); *id.* at 21 (“asking ‘[h]ow should support be calculated for those areas (*e.g.*, insular areas and Alaska) that are not included under the proxy model?’”) (citing Public Notice, *Common Carrier Bureau Seeks Further Comment on Specific Questions in Universal Service Notice of Proposed Rulemaking*, CC Docket No. 96-45, DA 96-1078, Question 41 (Jul. 3, 1996)). But, as noted above, that is not the only deficiency in the model. As former Commissioner Bob Rowe pointed out in his dissent to the Joint Board Recommended Decision almost four years ago, several deficiencies in the model have been identified — calling into question the models ability to accurately predict the forward-looking costs of serving many rural areas that do not match the assumptions underlying the model. *2002 Recommended Decision*, 17 FCC Rcd at 20771 (2002) (Commissioner Rowe dissenting) (noting, for example, that the existing model deploys loop plant without regard to natural and manmade barriers, such as mountains, lakes and highways).

under the current mechanism, PRTC is entitled to no high-cost support even under the “non-rural” mechanism. Therefore — just like other purportedly non-rural carriers (including AT&T), PRTC is forced to internally subsidize the cost of serving rural and other high-cost areas.

But applying the MARC to the non-rural support mechanism would ensure that PRTC, along with other so-called “non-rural” carriers, receives support sufficient to ensure that universal service goals are met in high-cost areas of Puerto Rico. In particular, the affordability mechanism we propose would respond to PRTC’s twin concerns that the Commission’s existing mechanism does not account for the high cost of serving areas like rural Puerto Rico or for the lower incomes in Puerto Rico, by keying support to the relationship between these precise factors. Indeed, implementing the MARC should direct a significant amount of high-cost support to Puerto Rico, which now receives no support at all.

Rather than creating new, fragmented support mechanisms and, in particular, a discrete high-cost fund for “insular” areas, the Commission should focus on addressing the deficiencies of the existing “non-rural” support mechanism. It should develop a unified approach that provides support to all carriers serving rural and other high-cost areas throughout the nation, without regard to arbitrary distinctions between the “rural” and “non-rural” carriers serving those areas.

To be sure, even with the significant modifications we propose, a unified federal fund may still leave some areas without sufficient support. For example, companies like Alascom, with carrier of last resort (COLR) obligations in remote villages and other communities in

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As a consequence, while the Commission certainly should re-examine the model and make appropriate adjustments to ensure that it accurately reflects the cost of providing service in rural insular areas, it should do so only as part of broader review of the efficacy of the current cost model, rather than proceeding piecemeal.

Alaska’s Bush country, would not benefit from the revised plan because of unique circumstances that are not readily addressed by a plan designed to serve more typical high-cost carriers. These remote villages and communities, which are not connected to the Alaska highway system, are accessible only by boat or plane, and, even then, because of harsh weather conditions, often may be completely cut off from the rest of Alaska. As a consequence, these communities are in many ways more remote than Puerto Rico and other insular areas.<sup>87</sup> Targeted support is required so that Alascom can continue to meet universal service objectives established by Congress in section 254 of the Act. In particular, the Commission should establish a separate mechanism to ensure that carriers, like Alascom, with COLR obligations to provide interexchange switching and transport services can continue to provide such services to Bush communities consistent with Congress’s stated objective that “[c]onsumers in all regions of the Nation . . . should have access to . . . *interexchange* services and advanced telecommunications and information services” at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas.<sup>88</sup>

As the Regulatory Commission of Alaska previously has informed the Commission, carriers providing interexchange switching and transport to the Alaska Bush, such as Alascom, confront truly unique challenges because of circumstances and a network structure that are fundamentally different from those in the lower 48 states.<sup>89</sup> In particular, Alascom – an interexchange carrier – is primarily responsible for interexchange switching and transport

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<sup>87</sup> Consequently, these communities should be included in the definition of “insular areas” to the extent the Commission decides to establish a separate “insular” support mechanism.

<sup>88</sup> 47 U.S.C. § 254(b)(3) (emphasis added).

<sup>89</sup> Comments of the Regulatory Commission of Alaska, CC Docket No. 01-92, at 2-3 (filed May 23, 2005).

functions (such as intraLATA interexchange switching and transport<sup>90</sup>) that, in other states, typically are performed by a local exchange carrier. However, Alascom is not entitled to any support when it provides these services, because interexchange services currently are not supported services under the existing federal mechanism – even though section 254(b) directly directs the Commission to ensure that all Americans have access to affordable interexchange services. The few other carriers providing these services in Alaska, all of which are local exchange carriers, receive support to recover their costs of providing these services – in some cases, even for facilities that are shared with Alascom, which receives no support. For example, United Utilities, Inc. (UUI), a LEC operating in rural Alaska, co-owns and operates with Alascom satellite earth stations serving various Bush communities. Because UUI is a LEC, it includes the cost of these earth stations in the NECA pool and thus recovers these costs through the NECA traffic sensitive pooling arrangement.<sup>91</sup> In contrast, Alascom (as an IXC) receives no support for its share of the costs of operating the very same facilities and services. Plainly, such disparate treatment cannot be reconciled with the requirements of section 254 and sound public policy. In particular, this result — which discriminates between two carriers using the same facilities to provide the same service — is flatly inconsistent with the Commission’s express desire to adopt universal service mechanisms that minimize “departures from competitive neutrality.”<sup>92</sup>

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<sup>90</sup> AT&T recognizes that there is no LATA assigned in Alaska, but the entire state of Alaska is treated as a LATA for all intents and purposes.

<sup>91</sup> While the NECA pooling arrangement is not an explicit universal service support mechanism, it was established to enable carriers serving rural and other high-cost areas to obtain implicit support to ensure that universal service objectives are met.

<sup>92</sup> *First Report and Order* at 8801-02 ¶ 48 (adopting the principle of competitive neutrality pursuant to 47 U.S.C. § 254(b)(7)).

The approximately 200 Bush communities served by Alascom are not connected to Alaska's road system, and thus cannot be reached by conventional means. Consequently, Alascom, as the carrier of last resort for interexchange transport and switching services to those communities, has had to deploy and maintain extremely expensive satellite infrastructure to serve those communities, with no hope of achieving any economies of scale, scope and/or density. And because Alascom has offered such services at rates that are integrated and geographically averaged with rates offered by AT&T in the mainland, Alascom has had to absorb the full costs of that infrastructure with none of the explicit high-cost support mechanisms available to the local exchange carriers with whom Alascom interconnects to serve Alaska's Bush communities. This situation is untenable and unsustainable.

The Commission need not reform its overall support mechanism to address these unique circumstances. Unlike the case of PRTC, the challenges Alascom faces are not broadly shared throughout the industry, and will not be readily addressed except by changes that otherwise may not be necessary to support consumers in most other areas served by most other carriers. Consequently, the best way for the Commission to address the situation faced by Alascom and its customers (and other carriers and customers that may face similar challenges) would be to establish an explicit support mechanism designed to support carriers of last resort that are required to provide interexchange services to rural communities. The Commission should invite comment to see if other carriers share Alascom's plight and design any such plan accordingly. At a minimum, however, the discrete fund should support carriers of last resort that provide rural service in Alaska over satellite facilities at rates that are geographically averaged and integrated with rates in the lower 48 states.

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**CONCLUSION**

For the reasons set forth above, the Commission should revisit the basic assumptions underlying its high-cost support mechanisms, and adopt the MARC proposal, and the other reforms, AT&T proposes.

Respectfully submitted,

/s/Christopher M. Heimann

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