

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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| 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 |

REPLY COMMENTS OF AT&T INC.

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May 26, 2006

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REPLY COMMENTS OF AT&T INC.

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

INTRODUCTION AND SUMMARY

Over ten years ago, Congress directed the Commission and the states to overhaul the nation’s universal service support system by establishing specific, predictable, and sufficient support mechanisms to preserve and advance universal service objectives in a competitive environment, and ensure that all consumers continue to have access to telecommunications and information services (including interexchange and broadband services) at rates that are affordable and comparable to urban rates. Congress rightly recognized that, in a competitive market, state and federal regulators could no longer rely on the existing patchwork of implicit

¹ 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.

² *Federal-State Joint Board on Universal Service, High-Cost Universal Service Support*, CC Docket No. 96-46 and WC Docket No. 05-337, Notice of Proposed Rulemaking, 20 FCC Rcd 19731 (2005) (“*Notice*”).

subsidies, which plainly could not survive the elimination of government-sanctioned monopolies in the 1996 Act, to achieve universal service objectives.

Despite Congress's unequivocal mandate, over the past decade, the Commission and the states have repeatedly shied away from undertaking the type of reform required by the Act. Instead, they have pursued the expedient course of minimizing the size of the universal service fund by forcing large, so-called "non-rural" carriers to continue to rely primarily on fast eroding implicit subsidies to achieve universal service objectives, and adopting the type of explicit support mechanisms envisioned by the Act only for small "rural" carriers.³

The resulting high-cost support regime, which bases support on a carrier's identity rather than the customers and areas it serves as Congress intended, provides little or no support to most rural areas and customers. And while rural rates have remained largely comparable to urban rates under that regime (indeed, as discussed below, rates in rural areas generally are below rates in lower-cost urban areas), that is because federal and state regulators have continued to require non-rural carriers to geographically average and integrate their rates, and thus to serve customers in rural and high-cost areas at rates significantly below their costs. It should come as no surprise that, under this government-mandated price-squeeze, so-called non-rural carriers have had difficulty developing a positive business case for investment necessary to upgrade their networks to provide advanced telecommunications and information services in rural and other high-cost areas. As a consequence, deployment of advanced telecommunications infrastructure lagged behind in the rural and high cost areas served by "non-rural" carriers, even as it has taken off in

³ The Commission and state regulators have sought to justify this disparate treatment on the grounds that so-called "rural" carriers primarily serve rural customers and thus have different cost structures from purportedly "non-rural" carriers, which regulators believed could afford to internally subsidize customers in rural and high cost areas. But, as AT&T previously has pointed out, so-called "non-rural" carriers actually serve the lion's share (approximately, two-thirds) of customer lines in rural and high cost areas, while "rural" carriers serve only about one-third of lines in areas classified as "rural" by the U.S. Census Bureau. Moreover, while "rural" carriers serve proportionately more "rural" lines than "non-rural" carriers, approximately half of the lines "rural" carriers serve are not in rural areas.

comparable areas served by so-called “rural” carriers.⁴ Requiring non-rural carriers to rely on evaporating implicit subsidies to fund to support operations in rural and other high-cost areas also has undermined their incentive and ability to maintain their existing networks in those areas. The existing regime thus has failed to meet Congress’s objective of preserving and advancing universal service objectives in a competitive environment, as the Tenth Circuit has twice found.

Despite the abject failure of the current regime to live up to the requirements of section 254, and the Tenth Circuit’s repeated rejection of that regime, a number of parties argue that the Commission need do little more than shore up its legal analysis for adopting that mechanism.⁵ Others maintain that the Commission should continue to focus solely on achieving reasonable comparability between urban and rural rates in this proceeding, rather than developing a regime that considers and balances all of the objectives and principles in section 254(b), as required by the Act and Tenth Circuit.⁶ So-called “rural” carriers generally maintain that a holistic review of the Commission’s existing high-cost support mechanisms is unnecessary, arguing that whatever the Commission does in this proceeding should have no affect on the existing rural high-cost support mechanism.⁷ A number of commenters acknowledge that the Tenth Circuit’s mandate requires the Commission to develop a support mechanism that advances the full range of

⁴ Comments of Vermont PSB, Vermont Dept. of Public Service and Maine PUC at 13-14 (Vermont Comments). Vermont observes that “rural” carriers receive additional incremental support when they upgrade their plant to provide advanced services, while so-called “non-rural” carriers receives no additional support because non of the model inputs is affected when the carrier upgrades its loop plant. *Id.* at 13. As a consequence, rural companies in Vermont and Maine have deployed significantly more DSL than Verizon, those two states’ only “non-rural” carrier.

⁵ *See* BellSouth Comments at 1 (“the Commission should not – and need not – radically depart from its existing funding methodology for calculating high-cost universal service support for non-rural carriers”).

⁶ *See* NASUCA Comments at 29; Vermont Comments at i.

⁷ *See* Western Telecommunications Alliance at 1-2 (“the *Qwest II* decision dealt solely and entirely with the non-rural high-cost support mechanism, . . . [h]ence, the definitions and mechanisms adopted in this proceeding should not have any direct or indirect application to, or impact upon, the rural high-cost support mechanisms”); OPASTCO Comments at 1-2 (“Regardless of how the Commission defines the statutory term ‘sufficient’ in this proceeding, it must make clear that this definition applies *exclusively* to non-rural carriers.”) (emphasis in original).

objectives specified in section 254, but assert that the Commission can best achieve these objectives by radically scaling back support and relying primarily on market forces.⁸ Still others contend that the Commission's focus here should be on limiting the growth of the fund.⁹

These commenters fail to explain how their proposals could preserve and advance the universal service objectives in section 254(b), and ensure that all Americans have access to high quality, advanced telecommunications and information services, in a competitive environment. Indeed, rather than seeking to promote universal service objectives and comply with the Tenth Circuit's mandate, many of these parties seek only to minimize the size of the universal service fund. The unstated premise of these parties' comments is that the Commission once again will shy away from undertaking the real reform required by the Act for fear that it will increase the size of the fund, and continue to force so-called non-rural carriers to rely on fast eroding implicit subsidies that not only will not preserve and advance universal service in a competitive environment but also will impede those carriers' ability to compete in today's rapidly changing telecommunications marketplace. As the Tenth Circuit made clear, however, the Commission cannot rely on fund size as a basis for avoiding its statutory obligations.

In any event, reforming universal service consistent with requirements of the Act need not result in explosive growth of the fund. Adopting an affordability-based federal support mechanism, such as the Mechanism for Affordable Rural Communications ("MARC") described in AT&T's initial comments, would target explicit support to the consumers and carriers in geographic areas that need it, and provide support sufficient to achieve the universal service objectives in section 254, without bloating the fund. Moreover, the Commission could minimize the impact of such reform on consumers by reforming the rules governing support for

⁸ See Verizon Comments at 2-3.

⁹ See *id.* at 2.

competitive eligible telecommunications carriers, which, as Chairman Martin has pointed out, result in excessive and duplicative support,¹⁰ applying an affordability-based support mechanism to so-called “rural carriers,” and replacing the existing universal service contribution methodology with a numbers-based system, which would broaden the contribution base and eliminate the competitive distortions inherent in the existing system.

DISCUSSION

I. The Commission Must Adopt a Complete Plan for Universal Service that Will Preserve and Advance Universal Service For All Consumers in Rural, High Cost and Insular Areas.

Section 254 of the Act requires the Commission and the states to overhaul the nation’s universal service support system by establishing specific, predictable, and sufficient support mechanisms to preserve and advance universal service objectives in a competitive environment. In 1996, Congress recognized that the existing system of price controls and implicit subsidies on which federal and state regulators relied to achieve universal service objectives in an era of government sanctioned monopoly franchises could not long survive the opening of telecommunications markets to competition. Congress rightly found that, unless the Commission and the states adapted universal service policies to the newly competitive telecommunications landscape, CLECs (which had no carrier of last resort obligations) would cherry pick the most lucrative customers, leaving the ILECs to serve rural and other high cost customers at regulated, below-cost rates. Congress therefore enjoined the Commission and the states to work cooperatively to replace that system of implicit subsidies with explicit federal and

¹⁰ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Notice of Proposed Rulemaking*, 19 FCC Rcd 10805, Separate Statement of then-Commissioner Kevin J. Martin, Dissenting in Part and Concurring in Part (2004) (“I have concerns with policies that use universal service as a means of creating ‘competition’ in high cost areas. In my view, the main goals of the universal service program are to ensure that all consumers – including those in high cost areas – have access at affordable rates. I remain hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier.”).

state support mechanisms that are “specific, predictable, and sufficient” to “preserve and advance universal service.”¹¹ Congress further required that any such mechanism should ensure that: (1) quality services are available at just, reasonable, and affordable rates; and (2) that consumers in *all regions of the country* – including consumers in rural, insular, and high cost areas – have access to telecommunications and information services (including interexchange, and broadband telecommunications and information services) that are reasonably comparable to services offered in urban areas and at rates that are reasonably comparable to urban rates.

Twice now, the Commission has ignored Congress’s mandate, and twice the Tenth Circuit has rejected the Commission’s high cost support mechanism for so-called “non-rural” carriers for failing to fulfill Congressional objectives. Rather than developing a mechanism that will promote the full range of objectives in section 254, the Commission has focused only on achieving reasonable comparability of rates and minimizing the size of the fund. And to that end, the Commission has developed a universal service regime that arbitrarily distinguishes between the support provided to carriers based on their designation as “rural” or “non-rural” – a designation that counter-intuitively is based on the size of the carrier rather than the customers and areas it serves, and which is found nowhere in the Act.¹²

The Commission’s approach has denied support to many of the purportedly “non-rural” carriers that serve the vast majority of consumers in rural and high cost areas on the incorrect premise that such carriers are large enough to internally subsidize the cost of serving those consumers and areas with revenues derived from customers in lower cost areas. For example,

¹¹ 47 U.S.C. § 254(b).

¹² Where Congress intended to distinguish between “rural telephone companies” and other carriers, it did so expressly, such as in section 251(f). Section 254, however, makes no such distinction. Rather, it requires the Commission to establish support mechanisms that are specific, predictable, and sufficient to preserve and advance universal service for *all* Americans – including those in rural, insular, and high cost areas – consistent with the principles in section 254(b).

even though non-rural carriers in aggregate serve approximately *twice* as many rural customers than do so-called “rural” carriers, the rural high cost mechanism provides “rural” carriers almost six times as much support as that provided to “non-rural” carriers.¹³ Moreover, although AT&T serves almost *four* times as many rural lines as any “rural” carrier, it receives no federal high-cost support because it has been classified as a “non-rural” carrier. This approach not only is patently arbitrary, but also inconsistent with the objectives of the Act, as the Tenth Circuit has twice ruled.

The irrationality and capriciousness of the Commission’s existing high-cost support regime is exemplified by Iowa Telecom’s recent petition for forbearance from application of the existing universal service high-cost support mechanisms to enable it to obtain support based on its forward-looking economic costs under the non-rural support mechanism, rather than on its embedded costs.¹⁴ Iowa Telecom is in the unique position of being a price cap carrier that is classified as a “rural” carrier under the Commission’s universal service regime, and thus may obtain support based only on its embedded costs. But because of the failure of Iowa Telecom’s predecessor to invest in its network, Iowa Telecom receives no high cost support under the rural mechanism.¹⁵ Iowa Telecom claims that allowing it to obtain support under the non-rural mechanism, even though it is classified as a rural carrier, “would have only a minimal impact on the ILEC portion of the universal service fund.”¹⁶ In particular, Iowa Telecom claims that, if the Commission grants its petition, it would receive “approximately \$22.2 million annually under the

¹³ See AT&T Comments at 6-7.

¹⁴ *Iowa Telecom Petition for Forbearance Under 47 U.S.C. 160(c) from Universal Service High-Cost Loop Support Mechanism*, CC Docket No. 96-45 (filed May 8, 2005).

¹⁵ *Id.*

¹⁶ *Id.* at 20-21.

non-rural mechanism,” but the net increase in the fund would be “only . . . \$7.7 million due to offsetting reductions in the funding levels of other non-rural carriers.”¹⁷ Thus, under the existing high-cost support regime, simply changing the classification of a carrier (with no change in that carrier’s circumstances or in the economics of serving that carrier’s customers) would significantly change the amount of support it receives. Worse yet, changing even one carrier’s classification would significantly change the amount of support other carriers receive – even though their costs of meeting their carrier of last resort obligations has in no way changed. Plainly, such an arbitrary result cannot be reconciled with the Act.

Aside from being arbitrary in the extreme, the Commission’s non-rural support mechanism has perpetuated the market distorting effects of implicit subsidies, which, in any event, are quickly eroding as service providers with no carrier of last resort obligations continue to snap up the most lucrative customers. The Commission’s existing regime thus is both unsustainable and incapable of ensuring that carriers serving rural and other high cost customers receive “specific, predictable, and sufficient” universal service support as required by section 254.

Half measures and token efforts to reform the current universal service support regime will no longer suffice. Rather, the Commission must develop a comprehensive framework that will promote all of the objectives in section 254(b), and thus preserve and advance universal service in today’s competitive marketplace, as required by the Act and the Tenth Circuit.

¹⁷ *Id.*

A. The Commission Should Reject Proposals that Would Do Little More Than Tweak the Existing “Non-Rural” Support Mechanism.

Despite the Tenth Circuit’s unequivocal injunction that the Commission must develop a “complete plan” for universal service that will achieve the full range of objectives in section 254, a number of commenters urge the Commission to maintain its focus only on achieving reasonable comparability of rates and services, and minimizing the size of the fund. NASUCA, for example, contends that the Commission should continue to focus myopically on reasonable comparability in this proceeding because, NASUCA claims, “[r]easonable comparability of rates is the only one of the principles [in section 254(b)] that is both relevant to [determining whether the non-rural support mechanism is sufficient] and capable of resolution at the federal level.”¹⁸ NASUCA also maintains that other principles are either subsidiary to comparability or irrelevant. It claims, for example, that, given the current level of urban rates, rural rates that are reasonably comparable likely will be affordable, but the converse will not necessarily be true, and that, in any event, the Lifeline and Link-up programs are there to assist low-income customers for whom local service rates are unaffordable.¹⁹ And it asserts that the other statutory principles (including the requirements that consumers have access to quality services at affordable rates; that

¹⁸ NASUCA Comments at 31.

¹⁹ *Id.* at 32-33. NASUCA further asserts that the affordability standard proposed by AT&T (originally, SBC), which is based on a percentage of median income in a particular geographic area, will not enhance the affordability of service because half the population will have income below the median, and that failure to support service in high-median-income areas will disadvantage many consumers with incomes below the median. *Id.* at 33-34. Likewise, Vermont asserts that AT&T’s proposal inaccurately assumes that income in a community is homogenous, and will discriminate against poor people living in wealthy communities. Vermont Comments at 7. However, AT&T does not assume that incomes within any given geographic area are homogenous. Indeed, the very reason that AT&T proposed an affordability-based support mechanism (which bases support on the difference between a carrier’s costs and revenues using an affordability benchmark, calculated on a wire center basis or other narrowly drawn geographic area) is that the existing mechanism, which is based on statewide averages, does not accurately reflect the cost of providing supported services within a particular area or whether rates in that area are affordable. Having said that, support cannot realistically be calculated on an individual basis. AT&T’s proposal thus strikes an appropriate balance between minimizing the costs and burdens of administering a national program and targeting high cost support to those areas, customers and carriers that need it.

contributions be equitable and nondiscriminatory; that support should be specific, predictable and sufficient), as well as the Commission’s competitive neutrality principle, are either wholly irrelevant or beyond the Commission’s purview.²⁰ Similarly, Vermont contends that the Commission’s “primary focus on remand should be to ensure reasonably comparable services and rates in rural and urban areas,” and that the high cost should rely on the Lifeline and Link-up programs to address affordability.²¹

Others, such as BellSouth, contend that, under the existing regime, rates in rural areas are reasonably comparable to – and in many cases lower than – rates in urban areas, and that the Commission therefore need do little more than tweak the existing non-rural high cost mechanism to satisfy the Tenth Circuit’s mandate.²² Thus, for example, BellSouth proposes that the Commission determine eligibility for high-cost support by comparing average rural and urban rates within each state and comparing each state’s average rural rates to a national urban benchmark.²³ So-called “non-rural” carriers must pass both tests to be eligible for full support,²⁴ which would be calculated by comparing the forward-looking costs of providing supported services, averaged at the statewide level, to a national urban rate benchmark.²⁵

²⁰ NASUCA Comments at 34- 37.

²¹ Vermont Comments at i.

²² BellSouth Comments at 1, 4-5. BellSouth too argues that the Commission should afford the greatest weight in this proceeding to the reasonable comparability objective of section 254(b)(3), and give little or no weight to the other principles in section 254(b), because – according to BellSouth – only the reasonable comparability principle is targeted at the preservation and advancement of universal service in high-cost areas. *Id.* at 20. As discussed herein, however, both the Act and the Tenth Circuit’s mandate requires the Commission to take into account all of Congress’s objectives in crafting its universal service policies, and only a mechanism – such as that proposed by AT&T – that advances the full range of goals specified in section 254(b) will preserve and advance universal service in a competitive environment as Congress intended.

²³ *Id.* at 2.

²⁴ *Id.* at 10-11.

²⁵ *Id.* at 2.

So-called “rural” carriers, apparently believing that universal service is a zero-sum game, contend that the Commission should continue its siloed approach to universal service and treat carriers serving rural and other high cost areas differently depending on whether they are classified as “rural” or “non-rural” carriers, rather than undertaking a holistic review of its high-cost support regime. In particular, they maintain that whatever the Commission does in this proceeding should have no impact on the existing rural high-cost support mechanism, and that any definitions the Commission adopts should have no direct or indirect application to the rural mechanism.²⁶

These parties’ proposals cannot fulfill the Commission’s mandate under section 254 and the Tenth Circuit’s remand, and thus are merely a recipe for further litigation and uncertainty. For example, NASUCA’s, and others’, proposal that the Commission continue to focus high cost support on achieving reasonable comparability to the exclusion of other principles enunciated in section 254 is directly at odds with consumers’ interests and the Tenth Circuit’s conclusion that the Commission may not pick and choose among the mandates of section 254(b) in crafting high-cost support for purportedly “non-rural” carriers, but rather must advance “the range of principles identified in the text of the statute.”²⁷ Indeed, the court admonished that it was “troubled by the Commission’s seeming suggestion that [besides rate comparability,] other principles, including affordability, do not underlie federal non-rural support mechanisms.”²⁸

²⁶ See *Western Telecommunications Alliance* at 1-2; *OPASTCO Comments* at 1-2.

²⁷ *Qwest II* at 1234.

²⁸ *Id.* See also *Qwest I*, 258 F.3d at 1200 (holding that the “plain text of the statute mandates that the FCC ‘shall’ base its universal [service] policies on the principles listed in § 254(b),” and 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”).

In any event, it is simply not the case that the Commission can ignore principles other than reasonable comparability (such as affordability) on the grounds that those principles are either irrelevant to the issue of high-cost support or can be addressed by other mechanisms as NASUCA, Vermont and others suggest. As GCI aptly observes, “[a]ffordability is a touchstone of universal service, and the Commission must define ‘affordable’ in order to determine if universal service support is sufficient.”²⁹ Moreover, even if affordability may be addressed by programs for low income consumers (such as the Lifeline and Link-up programs), affordability must be a consideration for all consumers, not just low-income consumers, in providing universal service support, as Qwest notes.³⁰ And, as AT&T pointed out in its comments, rates that are unaffordable in a particular community are not acceptable simply because they are approximately the same as rates in another, wealthier community: “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.”³¹ In addition, by focusing solely on reasonable comparability to the exclusion of affordability, NASUCA’s proposal unnecessarily expands the fund by failing to ensure that all consumers pay a reasonable, minimum portion of the cost of serving them.

Nor may the Commission continue to limit the focus of its “non-rural” high-cost support mechanism to promoting reasonable comparability between states on the faulty premise that states will implement policies and mechanisms to advance universal service objectives other than

²⁹ GCI Comments at 3.

³⁰ Qwest Comments at 11 n.24.

³¹ AT&T Comments at 16; *see id.* at 2.

reasonable comparability. For the past ten years, the Commission's high cost support mechanism has relied on the states to bear the primary responsibility for providing support to so-called "non-rural" carriers, and ensuring that congressional objectives in section 254(b) are met. In that time, virtually all of the states have continued to rely on a web of price controls and implicit subsidies, despite the fast erosion of those subsidies as competitors have gone after the large business and most lucrative residential and small business customers on which such subsidies are based, and left incumbents holding the bag for high cost customers as the carrier of last resort. Given the enormous political pressures on state regulators to keep rates down, as CenturyTel observes,³² it is by no means surprising that the states have failed to replace vanishing implicit subsidies with universal service policies and mechanisms that will preserve and advance universal service in a competitive environment.

But, in the face of state inaction, the Commission could not seriously contend that the existing "non-rural" support mechanism (which is expressly limited only to supplement state support mechanisms, which, as the Commission has repeatedly acknowledged, continue overwhelmingly to rely on implicit subsidies) is specific, predictable and sufficient to preserve and advance universal service.³³ Nor may the Commission conclude that its purported inducements for state action are working. Thus, as AT&T observed in its initial comments, the Commission's assumption that the states would address the rapid erosion of implicit subsidies on which the Commission's "non-rural" high-cost support mechanism is based, even if reasonable

³² CenturyTel Comments at 10.

³³ *See id.*

when adopted, plainly is unreasonable now, and any federal policy or mechanism based on that assumption would be arbitrary and capricious.³⁴

NASUCA's suggestion that implementation of principles other than reasonable comparability are beyond the Commission's purview or outside its authority because it might affect matters traditionally within the states' jurisdiction is incorrect.³⁵ AT&T has demonstrated, through its MARC proposal, that a unified universal service support mechanism that addresses all the principles, but does not impinge on the states' traditional authority to set rates, is possible. But in any event, Section 254(a) of the Act specifically authorizes the Commission to adopt rules to implement the requirements of section 254. In addition, section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of the Act."³⁶ And the Supreme Court has made clear that this section "explicitly gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies."³⁷ The Court emphasized that, "with respect to the matters addressed by the 1996 Act," the "Federal Government . . . unquestionably has" "taken the regulation of local telecommunications . . . away from the States."³⁸ The Court further explained that, "[i]f there is any 'presumption' applicable to th[e] question" whether state commissions' administration of "the new *federal* regime is to be guided by federal-agency regulation," "it should arise from the fact that a federal program administered by 50 independent state agencies is surpassing

³⁴ AT&T Comments at 10-11.

³⁵ See NASUCA Comments at 34.

³⁶ 47 U.S.C. § 201(b).

³⁷ *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 380 (1999) (emphasis in original).

³⁸ *Id.* at 379.

strange.”³⁹ Where, as here, Congress has established national universal service policies and objectives applicable throughout the country, charged the Commission with ensuring that those policies and objectives are met,⁴⁰ and enjoined the states from adopting regulations that are “inconsistent with the *Commission’s* rules to preserve and advance universal service,”⁴¹ the Commission plainly has ample authority to take appropriate action to ensure that federal and state policies and support mechanisms promote the full range of congressional objectives in section 254, and to step in if the states fail to do their part – as they plainly have. Indeed, the Tenth Circuit already has ruled that the Commission not only has such authority but is required to exercise that authority to “create some inducement – a ‘carrot’ or a ‘stick’” to ensure that the objectives of section 254 are met.⁴² Moreover, the federal support at issue here is intended to support intrastate services and rates – plainly, Congress could not have intended to require the Commission to develop mechanisms to support intrastate services but have no authority to ensure that such services are consistent with federal objectives. Accordingly, the Commission should flatly reject NASUCA’s cramped view of the Commission’s authority and responsibility in this area.

The Commission also should reject claims that, because rates in rural areas already are reasonably comparable to – and in many cases lower than – rates in urban areas, the Commission need do little more than make token changes to or provide some additional legal support for the existing non-rural high cost mechanism to satisfy the Tenth Circuit’s mandate. These claims

³⁹ *Id.* (emphasis in original).

⁴⁰ As CenturyTel correctly observes, the Tenth Circuit has made clear that “the Commission has the ultimate responsibility to ensure sufficient support” to achieve congressional objectives. CenturyTel at 18, citing *Qwest I*, 258 F.2d at 1203 (“stating that the FCC must ‘ensure’ that adequate federal and state mechanisms will provide sufficient support.”).

⁴¹ 47 U.S.C. § 254(f) (emphasis added).

⁴² *Qwest I*, 258 F.3d at 1204.

ignore the fact that existing rural rates have become comparable only because of unstable implicit subsidies or value-of service pricing, as the Commission has repeatedly acknowledged.⁴³ Rural rates are comparable to (and in many cases lower than) urban rates not because the Commission and states have implemented universal service support policies and mechanisms to preserve and advance universal service in a competitive environment, but because of regulatory fiat. The comparability of existing rates thus in no way justifies inaction or tweaking the Commission's existing policies and rules.

Rather than basing support on existing rates, the Commission should base it on the rates that would apply in the absence of implicit subsidies, and thus on rates that reflect the actual costs of serving a particular community. And, as the Commission itself has acknowledged, it must develop its policies and rules based not only on existing market conditions, but also on “its predictive judgment . . . about how that market is likely to develop.”⁴⁴ That is particularly true where, as here, the Commission has long acknowledged that implicit subsidies are unsustainable in a competitive market, and virtually no state has taken steps to replace those fast eroding subsidies with mechanisms that will promote the universal service objectives of the Act.

The Commission also should reject proposals to continue basing high cost support for so-called “non-rural” carriers on statewide average rates and costs. As AT&T observed in its initial comments, the express language of section 254(b)(3) requires the Commission to abandon statewide averaging, and focus instead on “a comparison of rural and urban areas.”⁴⁵ Statewide averaging, as CenturyTel points out, “necessarily forces non-rural carriers to charge above-cost

⁴³ Notice at para. 18 n.71.

⁴⁴ *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, et al., Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 at para. 43 (2005).

⁴⁵ AT&T Comments at 17, quoting *Qwest I* at 1204 (finding it “fundamental error” that the mechanism focused “only [on] enable[ing] reasonable comparability among states.”).

prices in urban areas, because [existing] explicit support is *designed* to be insufficient to make up for revenue shortfalls in rural areas.”⁴⁶ The Commission’s reliance on statewide averaging thus “has compelled non-rural carriers to rely on implicit subsidies notwithstanding [the Commission’s] acknowledgment that ‘competition would erode the implicit subsidies that state and, to a lesser extent, federal policies had relied on to keep rates comparable.’”⁴⁷ The Commission therefore should calculate support at a more granular level – such as on the basis of an individual wire center or census block group – so that the high costs of serving particular areas are recognized instead of netted out.⁴⁸ Only then will the Commission provide sufficient support to preserve and advance universal service in a competitive environment.

B. AT&T’s Affordability-Based Proposal Would Promote the Full-Range of Objectives in Section 254, Comply with the Tenth Circuit’s Mandate, and Preserve and Advance Universal Service in Today’s Competitive Market.

In its opening comments, AT&T proposed an affordability-based, federal support mechanism that promotes the full-range of objectives in section 254(b), eliminates reliance on unsustainable implicit subsidies, and thus is capable of preserving and advancing universal service in a competitive environment as Congress intended. This mechanism, which AT&T referred to as the Mechanism for Affordable Rural Communications (or “MARC”), is designed to narrowly target support only to those areas and consumers where the cost of service exceeds the rate consumer’s reasonably can be expected to pay themselves. Under this approach, the Commission would establish an “affordability” index based on a percentage of household income using publicly available data regarding consumers expenditures on telephone and other

⁴⁶ CenturyTel at 16.

⁴⁷ *Id.* at 16-17, quoting *Remand Order*, 18 FCC Rcd at 22568, para. 16.

⁴⁸ AT&T Comments at 18; CenturyTel Comments at 17 (urging the Commission to calculate support at the level of individual exchanges).

services. The Commission then would use that index to ensure comparability of rates across rural and urban areas using an objective, national standard, without having to consider the wide variation in state rates and rate designs across all fifty states. Federal universal service support would be available where the cost of providing universal service in a particular geographic area, such as a wire center or census block group, exceeds an affordability benchmark, which would be calculated by multiplying the affordability index by median household income in that area. The MARC thus would ensure that rates for supported services in all rural and other high cost areas are affordable and reasonably comparable to rates for such services in urban areas.

The MARC would achieve affordability and reasonable comparability without displacing the states from their traditional role of setting rates for intrastate services. At the same time, the MARC would transition universal service support away from implicit subsidies, and thus ensure that there are specific, predictable, and sufficient support to preserve and advance universal service in a competitive environment. In particular, the MARC would provide federal support up to the affordability benchmark (*i.e.*, for the difference between the cost of providing universal service in a particular area⁴⁹ and the revenue a carrier would derive from charging an affordable rate⁵⁰), replacing any state funding that supports rates at that level. States would remain free to

⁴⁹ As discussed in AT&T's initial comments, the Commission would determine the *cost of providing service* in a specific geographic area using the forward-looking cost model it currently uses to calculate support under the existing "non-rural" high-cost support mechanism, until or unless the Commission replaces that model with one that more accurately reflects carriers' costs. Qwest proposes that the Commission consider using a surrogate for costs, such as line density in a defined geographic area, rather than continuing to rely on the current forward-looking cost model. AT&T agrees that the Commission should consider the possibility of transitioning to such a proxy. While there are likely trade-offs in terms of granularity and accuracy, a proxy might save substantial financial and human resources, which would be needed to update the stale forward-looking cost model in use today.

⁵⁰ Under AT&T's proposal, if a carrier already is earning more revenues from providing supported services in a particular area than it would under the affordability benchmark, support would be limited to the difference between that carrier's actual revenues and the costs of providing such services. In calculating a carrier's revenues, the Commission should consider only those revenues derived from services provided using facilities for which support is intended. Thus, for example, the Commission reasonably could include revenues from switched-based vertical services (such as call waiting), but not revenues from services provided using other facilities, such as voice mail or DSL services, as Vermont proposes (Vermont Comments at 27-28), unless the Commission includes the cost of such

require carriers to charge rates lower than the affordability benchmark, but they then would be required to provide additional explicit support or defer to the Commission to do so through a supplemental, state-specific federal support mechanism that would be funded through contributions from that specific state.

AT&T recognizes that its approach will increase the size of the federal fund, but this increase is necessary to ensure that support is sufficient to preserve and advance universal service in a competitive environment. In any event, AT&T's proposal would reduce the burden of state explicit funding. Moreover, AT&T has proposed additional reforms that would offset the increase in the federal fund. Specifically, AT&T proposes that the Commission apply the affordability principle to its "rural" high-cost mechanism (with an appropriate transition), which would limit support to those areas and consumers that need it. Additionally, the Commission should amend its USF portability rules to eliminate excessive and duplicative support.⁵¹ Finally, AT&T's proposal would obviate the need to establish a separate insular fund only for Puerto Rico.⁵² The Commission therefore should adopt AT&T's proposal.

II. The Commission Should Reject Verizon's Suggestion that It Eliminate Universal Service Support in Any Market Where Competitive Alternatives Exist.

In its comments, Verizon urges the Commission to eliminate high-cost support in any area where competitive alternatives exist. It asserts that the fund has exploded to unsustainable

facilities in calculating the cost of serving that particular market. Vermont's proposal would perpetuate implicit subsidies, distorting the market and discouraging carriers' incentives to invest in facilities necessary to provide comparable services – including advanced telecommunications and information services – in rural and other high cost areas.

⁵¹ See AT&T Comments at 32.

⁵² *Id.* at 35-42. As discussed in AT&T's comments, the MARC would not address the concerns of Alascom, a non-LEC provider of transmission services in and to the high-cost Alaska Bush, which is not entitled to support because (*inter alia*) it is not a LEC. *Id.* Because of the unique challenges confronting Alascom and the customers and areas it serves, the Commission should adopt a separate support mechanism to ensure that Alascom can continue to meet its carrier of last resort obligations. *Id.* See also Section III of these reply comments.

levels, jeopardizing both the affordability of telecommunications services as well as the sustainability of the fund.⁵³ It claims that the Commission’s number one goal in this proceeding therefore must be to limit the size of the universal service fund, and narrowly target support “only to those areas where it is truly necessary to achieve the goal of providing consumers access to quality services at affordable rates.”⁵⁴ Verizon maintains that in areas where competitive alternatives to LEC services exist, universal service support is unnecessary because “the market – rather than explicit subsidies – can achieve . . . statutory [universal service] goals.”⁵⁵ In particular, Verizon argues that, as competition grows, the universal support should decrease because “new technologies and competition from intermodal carriers [will] serve to reduce rates, and make telephone services throughout the country ‘affordable,’ *without* the need for explicit subsidies.”⁵⁶ It further argues that, in any narrowly targeted area where support is necessary, the Commission should limit support to a single provider “to avoid a snowballing effect that jeopardizes the continuing viability of the fund.”⁵⁷

AT&T generally agrees with Verizon that the fund has experienced dramatic and excessive growth over the past seven years,⁵⁸ and that universal service support should be targeted narrowly to those areas where support is necessary to achieve congressional objectives. AT&T also agrees that the Commission should eliminate the waste that results from its current

⁵³ Verizon Comments at 23-24.

⁵⁴ *Id.* at 2.

⁵⁵ *Id.* at 17.

⁵⁶ *Id.* at 24.

⁵⁷ *Id.* at 2-3.

⁵⁸ Fund growth has been excessive insofar as the Commission’s policies and rules have allowed for unnecessary and duplicative support payments to CETCs in areas where the costs of providing universal service are prohibitively expensive for even one carrier.

USF portability rules, and therefore amend its rules to preclude the availability of support to multiple ETCs in any given area. But AT&T disagrees that the Commission’s primary objective should, or even could, be to minimize the size of the fund, and that the existence of competition is an appropriate test for determining whether high-cost support is necessary. .

As an initial matter, the Tenth Circuit already has held that the Act requires the fund to be large enough to achieve the principles and objectives in section 254(b), and that, while the Commission may balance those principles against one another when they conflict, it may not depart from them altogether to achieve some other goal – noting that “limiting federal expenditures” is not an express objective of the Act.⁵⁹ Accordingly, even if limiting the size of the fund were an express objective of the Act, which it is not, the Commission could not disregard its obligation to promote the full range of congressional objectives simply to minimize the fund. In any event, as explained herein and in AT&T’s initial comments, adoption of AT&T’s proposed reforms, including the MARC support mechanism, would narrowly target support only where it is needed and ensure that universal service objectives are met in a competitive environment, without significantly increasing the size of the fund.

Additionally, Verizon’s assertion that universal service support is unnecessary in any market where competition exists rests on the incorrect premises that competitors are ready, willing and able to serve any and every customer in the market and that competition necessarily will bring prices down to affordable levels. However, as the Commission repeatedly has acknowledged, competitors generally have focused only on the most lucrative customers and service offerings, rather than providing basic services to high-cost and/or low revenue customers. Consequently, even in markets in which robust competition has developed for many (or even most) customers, there remain significant numbers of customers that will need universal service

⁵⁹ *Qwest I*, 258 F.3d at 1200.

support to continue receiving access to affordable services. Thus, rather than obviating the need for universal service support, the growth in competition exacerbates the erosion of implicit subsidies and emphasizes the need to provide explicit support to the carrier of last resort. Unless and until Commission and the states are prepared to relieve that carrier of last resort of the obligation to serve all customers (including high-cost and/or low-revenue customers) at affordable rates, the Commission must continue to provide universal service support to the carrier of last resort even if competition has developed for many customers in the market.

III. The Commission Should Adopt a Specific High-Cost Support Mechanism for Alaska.

In its comments, AT&T observed that the Commission has authority under section 254 to establish a specific universal service support mechanism to address the unique needs of consumers in particular region if generally applicable mechanisms are insufficient to ensure that universal service objectives are met.⁶⁰ Numerous parties, including the Regulatory Commission of Alaska (“Alaska RCA”), agree. These parties further agree that the Commission should provide specific support for carriers, like Alascom, which have carrier of last resort obligations to serve remote villages and other communities in Alaska’s Bush country but are not eligible for support under generally applicable support mechanisms.⁶¹

As AT&T and the Alaska RCA explained in their opening comments, carriers like Alascom provide vital interexchange switching and transport to Bush communities that, in other states, typically are performed by a local exchange carrier. But because interexchange services

⁶⁰ AT&T Comments at 36.

⁶¹ Alaska RCA at 3. AT&T notes that, even with the significant modifications to the Commission’s high-cost support program, Alascom would not be entitled to support because, as an interexchange carrier, it does not have ETC status.

are not supported under existing federal mechanisms, even though section 254(b) specifically requires the Commission to ensure that all Americans have access to affordable interexchange services, Alascom is not entitled to any support.⁶² The Commission therefore should establish a discrete fund to support carriers of last resort that are required to provide interexchange services in rural communities, and operate under the mandates of section 254(b) and (g) of the Act.

CONCLUSION

For the foregoing reasons, the Commission should adopt the MARC proposal, and other reforms proposed by AT&T herein and in its initial comments.

Respectfully submitted,

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May 25, 2006

⁶² AT&T Comments at 40; Alaska RCA Comments at 3.