

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

In the Matter of
Federal-State Joint Board on
Universal Service
CC Docket No. 96-45

SECOND RECOMMENDED DECISION

Adopted: November 23, 1998

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By the Federal-State Joint Board (Commissioners Ness and Public Counsel Hogerty
issuing statements; Commissioners Johnson and Baker issuing a joint statement; Commissioner
Tristani dissenting in part and issuing a statement; and Commissioners Schoenfelder and
Furchtgott-Roth dissenting and issuing statements):

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I. INTRODUCTION

1. The Telecommunications Act of 1996 ("1996 Act")¹ explicitly recognized the need for federal and state support to "preserve and advance universal service."² In the 1996 Act, legislators recognized that existing support mechanisms could be threatened as effective competition materializes. Congress also made clear in the 1996 Act that federal and state regulators together must ensure that universal service is preserved and advanced as we move from a monopoly to a competitive market. Although never quantified or targeted in traditional rate designs, these mechanisms have included support flowing from urban to rural consumers implicit in rate averaging, and from interstate and intrastate access charges.

2. The Act requires that rates be "just, reasonable and affordable," and that rates in rural, insular and high cost areas be "reasonably comparable" to rates charged for similar services in urban areas.³ The Act also requires "specific, predictable and sufficient Federal and State

¹ Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). The 1996 Act amended the Communications Act of 1934, 47 U.S.C. §§ 151 *et seq.* (Act). Hereinafter, all citations to the Act will be to the relevant section of the United States Code unless otherwise noted.

² 47 U.S.C. § 254(b).

³ 47 U.S.C. §§ 254(b)(1), (b)(3), (i).

mechanisms to preserve and advance universal service."⁴ Goals of reforming universal service include: (1) revising support mechanisms that do not currently meet new statutory mandates, such as the need for nationwide reasonably comparable rates; (2) ensuring that support mechanisms are not eroded as local competition develops; and (3) establishing universal service support mechanisms that are part of a new regulatory structure consistent with Congress's pro-competitive goals.

3. The Joint Board and the Federal Communications Commission ("Commission") determined previously that rates generally are affordable. While keeping in mind the need to ensure continued affordability, we focus to a greater degree in this *Second Recommended Decision* on the issue of reasonable comparability, and how to ensure the sufficiency of federal support to assure both of those important public interest goals. As effective competition develops for high-volume, urban customers, one consequence may be erosion of the implicit support system that protects consumers in rural, insular and high cost areas from unaffordable rates. The Joint Board recommends a federal high cost support mechanism for non-rural carriers that enables rates to remain affordable and reasonably comparable, even as competition develops, but that is no larger than necessary to satisfy that statutory mandate. The Joint Board believes that sizing the fund correctly is essential to ensuring that all consumers across the country benefit from universal service. The transition to a competitive environment requires us to be mindful of two competing goals: (1) supporting high cost areas so that consumers there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, overburden consumers across the nation.

4. As an initial matter, we note and support the Commission's "hold harmless" commitment not to reduce the current levels of explicit high cost support to states.⁵ In this *Second Recommended Decision*, consistent with that commitment, we outline an initial methodology for directing sufficient federal support to non-rural carriers to offset high intrastate costs in states with insufficient internal resources to ensure affordable and reasonably comparable rates. We recognize that further changes may be necessary as competition develops to change certain amounts of current implicit support into explicit support. We recommend that the Commission replace the 25/75 jurisdictional division of responsibility for high cost universal service support, adopted in the *Universal Service Order*, with the methodology for non-rural carriers outlined herein. Under this approach, the federal mechanism should instead provide the necessary support set by the methodology that we outline today.

5. We recommend that the Commission compute federal high cost support for non-rural carriers through a two-step process. First, the Commission should develop a total support amount necessary to reflect those areas considered to have high costs relative to other areas.

⁴ 47 U.S.C. § 254(b)(5).

⁵ See *infra* Section VI.

Second, for areas that have high costs relative to other areas, the Commission should consider, in a consistent manner across all states, any particular state's ability to support high cost areas within the state. Federal support should be provided to the extent that the state would be unable to support its high cost areas through its own reasonable efforts.⁶ We also make recommendations about the information that consumers should receive from carriers in connection with the recovery of universal service contributions. We recommend as well that the mechanisms outlined here be reviewed no later than three years from July 1, 1999. While we recommend a shared federal-state responsibility, we also conclude that, consistent with the statute, no state can or should be required by the Commission to establish an intrastate universal service fund.

6. The Act acknowledges and maintains the complementary roles that state and federal authorities have played in preserving and advancing universal service.⁷ Historically, both state and federal regulators have exercised their jurisdictional authority to ensure the availability of universal service. The ongoing cooperation throughout this proceeding between the federal and state staff and members of the Joint Board is a further example of the vitality of the federal-state partnership for ensuring universal service, and this referral proceeding represents the latest chapter in that cooperation. We look forward to continued collaboration with the Commission as universal service reform proceeds. In addition, we note that this proceeding involves the balancing of many difficult, competing interests. In resolving these issues in light of our guidance, therefore, the Commission has the difficult task of selecting a national solution that balances these competing interests.

7. This *Second Recommended Decision* is designed to take into account this dual federal and state responsibility in a manner that effectuates the principles and requirements of section 254. The federal mechanism should provide support in a manner that is designed to ensure that state universal service needs are fully met, consistent with the states' role with respect to universal service. We believe that this *Second Recommended Decision* establishes a framework for accomplishing that difficult mission.

II. BACKGROUND

8. In the 1996 Act, Congress codified the long-standing commitment of state regulators and the Commission to ensuring the preservation and advancement of universal service in rural,

⁶ We also recommend that the Commission take steps to hold states harmless, so that no non-rural carrier will receive less federal high cost support than the amount it currently receives from explicit federal support mechanisms. See Section VI, *infra*.

⁷ See, e.g., 47 U.S.C. § 254(b)(5) ("There shall be specific, predictable and sufficient *Federal and State* mechanisms to preserve and advance universal service."); 47 U.S.C. § 254(f) (preserving state jurisdiction to adopt intrastate universal service support mechanisms); 47 U.S.C. § 254(a)(1) (mandating the reform of universal service mechanisms through a Federal-State Joint Board process.) (emphasis added).

high cost, and insular areas.⁸ The Act requires that sufficient and predictable universal service support mechanisms be maintained,⁹ and states that federal support mechanisms should be explicit and sufficient to achieve the purposes of section 254 even as competitive markets develop.¹⁰ As the Act required, the Commission convened this Federal-State Joint Board on Universal Service¹¹ and the Joint Board produced its first set of recommendations to the Commission in November 1996.¹² In light of those recommendations, the Commission on May 8, 1997, released the *Universal Service Order*, which, among other things, identified the services included within the definition of universal service and established a specific timetable for implementation of revised universal service support mechanisms.¹³

9. Consistent with the Joint Board's recommendations, the Commission determined that carriers should receive support for serving rural, insular and high cost areas based on the forward-looking cost of providing the supported services, because forward-looking costs provide the best measure of sufficient support that sends the correct signals for efficient entry and investment.¹⁴ We recommended that the Commission continue to work with the Joint Board and the industry to

⁸ 47 U.S.C. § 254. Section 254 also addresses universal service support for schools, libraries, rural health care providers, and low-income consumers. *See* 47 U.S.C. §§ 254 (a), (b)(1), (b)(3), and (h).

⁹ 47 U.S.C. § 254(b)(5).

¹⁰ 47 U.S.C. § 254(e). Congress placed section 254 in Part II of the title dealing with common carriers, which it entitled "Development of Competitive Markets." *See also* 47 U.S.C. §§ 251, 253.

¹¹ Federal-State Joint Board on Universal Service, *Notice of Proposed Rulemaking and Order Establishing Joint Board*, CC Docket No. 96-45, 11 FCC Rcd 18092 (rel. March 8, 1996).

¹² Federal-State Joint Board on Universal Service, *Recommended Decision*, CC Docket No. 96-45, FCC 96J-3, 12 FCC Rcd 87 (Jt. Bd. 1996).

¹³ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776 (1997) (*Universal Service Order*), as corrected by Federal-State Joint Board on Universal Service, *Errata*, CC Docket No. 96-45, FCC 97-157 (rel. June 4, 1997), *appeal pending in Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir. 1997); Federal-State Joint Board on Universal Service, *Order on Reconsideration*, CC Docket No. 96-45, 12 FCC Rcd 10095 (rel. July 10, 1997); Federal-State Joint Board on Universal Service, *Third Report and Order*, CC Docket No. 96-45, (rel. Oct. 14, 1997), as corrected by Federal-State Joint Board on Universal Service, *Erratum*, CC Docket Nos. 96-45 and 97-160 (rel. Oct. 15, 1997); Federal-State Joint Board on Universal Service, *Third Order on Reconsideration*, CC Docket No. 96-45, FCC 97-411 (rel. Dec. 16, 1997); Federal-State Joint Board on Universal Service, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge, *Fourth Order on Reconsideration*, CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, FCC 97-420, 13 FCC Rcd 5318 (1997).

¹⁴ *Universal Service Order*, 12 FCC Rcd at 8899-8900, para. 224-226; *Recommended Decision*, 12 FCC Rcd at 232, para. 276.

refine the models that were on the record at that time for estimating forward-looking costs.¹⁵ The Commission determined that non-rural carriers would begin to receive high cost support based on forward-looking costs on July 1, 1999, but that the implementation of support based on forward-looking costs for rural carriers would be delayed pending further review by the Commission, the Joint Board, and a Joint Board-appointed Rural Task Force, but at least until January 1, 2001.¹⁶ On October 28, 1998, the Commission released an Order adopting a platform for a federal mechanism for determining non-rural carriers' forward-looking costs.¹⁷ This platform establishes a framework of fixed assumptions about network design and other basic issues, and will be used, in conjunction with input values for the cost of network components and other parameters, to estimate non-rural carriers' forward-looking cost of providing the supported services.¹⁸ The model is used to estimate forward-looking costs, but does not itself determine federal support levels.

10. The Commission also concluded in the *Universal Service Order* that the share of support provided by federal mechanisms initially should be set at 25 percent.¹⁹ This share of support was based on the need to avoid double-recovery by carriers pending reform of state rates and support mechanisms, and the Commission stated that the federal share of support would be subject to review in light of state proceedings, the development of competition, and other relevant factors.²⁰ The Commission's determination relating to the federal share of support generated several petitions for reconsideration²¹ and significant comment.²² On March 11, 1998, the state members of the Joint Board filed a request that certain issues related to the determination of high

¹⁵ *Recommended Decision*, 12 FCC Rcd at 229, para. 268.

¹⁶ *Universal Service Order*, 12 FCC Rcd at 8910, para. 254; 8917-18, paras. 252-56. The *Universal Service Order* determined that non-rural carriers should begin to receive support based on forward-looking costs on January 1, 1999. This implementation date was extended to July 1, 1999, in conjunction with the referral of issues back to the Joint Board. Federal-State Joint Board on Universal Service, *Order and Order on Reconsideration*, CC Docket No. 96-45, FCC 98-160 (rel. July 17, 1998) (*Referral Order*).

¹⁷ Federal-State Joint Board on Universal Service, *Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, FCC 98-279 (rel. Oct. 28, 1998) (*Platform Order*).

¹⁸ The input values will be determined in a separate order at a later date. *Platform Order* at para. 2.

¹⁹ *Universal Service Order*, 12 FCC Rcd at 8925, para. 269.

²⁰ *See Universal Service Order*, 12 FCC Rcd at 8926, paras. 271-72. *See also* Federal-State Joint Board on Universal Service, *Report to Congress*, CC Docket No. 96-45, FCC 98-67 (rel. April 10, 1998) at paras. 219-234.

²¹ *See, e.g.*, Alaska PUC petition at 5-6; Arkansas PSC petition at 1-3; U S West petition at 6; Western Alliance petition at 18-19; Texas PUC petition at 2; Rural Telephone Coalition petition at 1-6.

²² *See, e.g.*, *Report to Congress* at paras. 222-223 and associated notes.

cost support, including issues regarding the share of federal high cost support, be referred back to the Joint Board.²³ Shortly after an en banc hearing on these issues convened by the Commission with the participation of the state Joint Board members, the state members filed a letter requesting referral of two additional issues.²⁴ In April 1998, the Commission committed to completing a proceeding reconsidering the federal share of support before revised support mechanisms are implemented for non-rural carriers,²⁵ and sought proposals and comments on how to reform high cost support for non-rural carriers.²⁶ Parties submitted a variety of proposals and comments, and provided input in a number of en banc hearings, which we have considered in formulating our recommendations today.²⁷

11. On July 17, 1998, the Commission referred to the Joint Board essentially the same issues of which the state members had requested referral.²⁸ In the *Referral Order*, the Commission requested our recommendations on the following issues:

- "(1) An appropriate methodology for determining support amounts, including a method for distributing support among the states and, if applicable, the share of total support to be provided by federal mechanisms. If the Commission were to maintain the current 25/75 division as a baseline, the Commission also requests the Joint Board's recommendation on the circumstances under which a state or carrier would qualify to receive more than 25 percent from federal support mechanisms.

- "(2) The extent to which federal universal service support should be applied to the intrastate jurisdiction. In its recommendation on this issue, the Commission requests the Joint Board's recommendation on the following topics:

²³ Formal Request for Referral of Designated Items by the State Members of the § 254 Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *filed* March 11, 1998.

²⁴ Letter from the State Members of the Joint Board to William Kennard, Chairman, FCC, CC Docket No. 96-45 (*filed* June 18, 1998).

²⁵ *Report to Congress* at para. 224.

²⁶ *Common Carrier Bureau Seeks Comment on Proposals to Revise the Methodology for determining Universal Service Support*, Public Notice, DA 98-715 (rel. April 15, 1998).

²⁷ In connection with the preparation of the *Report to Congress*, the Commission held an en banc hearing on March 6, 1998, covering, among other things, revisions to the support methodology for non-rural carriers. On June 8, 1998, the Commission convened an en banc hearing including the state Joint Board commissioners that addressed options for revising the support mechanisms for non-rural carriers. On October 29, 1998, the Commission held an en banc hearing including the state Joint Board commissioners that addressed the consumer billing and information issues that had been referred to the Joint Board.

²⁸ *Referral Order*.

- "(a) To the extent that federal universal service reform removes support that [is] currently implicit in interstate access charges, whether interstate access charges should be reduced concomitantly to reflect this transition from implicit to explicit support, and whether other approaches would be consistent with the statutory goal of making federal universal service support explicit. The Commission also requests a recommendation on how it can avoid "windfalls" to carriers if federal funds are applied to the intrastate jurisdiction before states reform intrastate rate structures and support mechanisms.
- "(b) Whether and to what extent federal universal service policy should support state efforts to make intrastate support mechanisms explicit. The Commission recognizes that section 254(k) envisions separate state and federal measures related to the recovery of joint and common costs, but nevertheless welcomes the Joint Board's input on how section 254(k) may relate to the Commission's role in making intrastate support systems explicit.
- "(c) The relationship between the jurisdiction to which funds are applied and the appropriate revenue base upon which the Commission should assess and recover providers' universal service contributions and, if support for federal mechanisms continues to be collected solely in the interstate jurisdiction, whether the application of federal support to costs incurred in the intrastate jurisdiction would create or further implicit subsidies, barriers to entry, a lack of competitive neutrality, or other undesirable economic consequences.
- "(3) To what extent, and in what manner, is it reasonable for providers to recover universal service contributions through rates, surcharges, or other means."

12. Several parties filed proposals on the proper method of determining federal high cost support for non-rural carriers. The various proposals differed in key areas, such as whether to take a state-specific or nationwide approach to determining federal support, but almost all proposals agreed that the federal share of high cost support should be based on a forward-looking economic cost model. Several proposals would specifically tailor the support amount in states to the state's specific needs and circumstances. For example, the South Dakota and Colorado Commissions proposed that the federal mechanism should provide support based on either a state-specific benchmark or a state-specific federal support percentage. In either case support would be determined by comparing a benchmark to a cost model's estimate of the forward-looking cost of providing the supported services. The Ad Hoc Working Group's (Ad Hoc) proposal would, in broad terms, provide federal support for state loop costs that exceed the nationwide average cost per loop (considering the lower of embedded or forward-looking cost).

13. Other proposals took a nationwide approach to determining the proper amount of federal support. For instance, Ameritech and AT&T suggested that the Joint Board support the *Universal Service Order's* federal high cost mechanism, which set federal support at 25 percent of the difference between a cost model's estimate of the forward looking cost of providing the supported services and nationwide revenue benchmarks. AT&T further proposed that the Commission delay implementation of any new universal service system that would increase federal support until more evidence of local competition has been presented. US West proposed retaining the *Universal Service Order's* 25 percent federal share of support, but would also provide federal support for 100 percent of costs above a nationwide "super benchmark." BellSouth's proposal began with an estimate of forward-looking economic costs, derived from a cost model, based on areas no larger than wire centers, and then calculated federal support equal to the amount of current explicit and implicit support. Time Warner proposed that federal support only be provided if the average household income in the Census Block Group is not greater than a certain income threshold. MCI proposed that, in determining federal high cost support levels, the Commission should average a cost model's forward-looking cost estimates over the same geographic area as a given state averages unbundled network element rates. The Arizona Corporation Commission proposed that a portion of federal support be set aside to address the problem of unserved areas.

III. THE PURPOSE OF SUPPORT

14. In mandating the reform of universal service support mechanisms, Congress clearly envisioned that the reform process would be conducted as a joint federal and state effort. The creation of this Joint Board is perhaps the plainest expression of this vision. Other provisions of section 254 reflect this shared responsibility.²⁹ A primary aspect of the Joint Board's task in reforming universal service mechanisms is to ensure that consumers in high cost areas have access to telecommunications and information services that are affordable and reasonably comparable to those in urban areas, at rates reasonably comparable to those in urban areas.³⁰ We believe that the demarcation of the respective responsibilities of state and federal regulators can be found in the mandate to ensure reasonably comparable rates. Regulators in the two jurisdictions have different tools available to them to meet universal service challenges. Issues of affordability and reasonable comparability can be dealt with through a combination of approaches, including: (1) through the rate design issues of a single local carrier, (2) through mechanisms that affect the rates of all carriers within a state, and (3) through mechanisms that affect rates across state lines. State commissions and the Commission each can use the first two tools with respect to rates in their

²⁹ Section 254(b): "There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service." Section 254(f) further defines a state's authority. Section 254(i) of the Act states: "The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable."

³⁰ 47 U.S.C. § 254(b)(3).

respective jurisdictions. Only the Commission is able to employ the last. Our recommendations reflect both the availability of, and the relationship among, these approaches.

15. While the Act does not define reasonable comparability, we interpret that term to refer to a fair range of urban and rural rates both within a state's borders, and among states nationwide. We note that existing federal high cost loop support provides additional federal support to areas that have particularly high costs, and our recommendations herein continue that policy. It is proper to begin an inquiry by focusing on universal service issues closest to the consumer. Present rates are sufficient to cover the costs of serving most consumers across the nation. The costs of serving other consumers, however, are in excess of rates. To address these concerns, support mechanisms have been set up to offset these higher costs. The Joint Board acknowledges that, absent reform to these mechanisms, the forces of competition could erode certain of these support mechanisms and potentially have a negative impact on the provision of universal service.

16. The first step in dealing with this potential impact concerns the rates currently being charged to consumers, and the ability of the state to respond to competitive entry through its own ratemaking methods. This responsibility falls within the state's jurisdiction. To the extent the Commission determines that the totality of reasonable state efforts would not be sufficient to address universal service funding without violating the principles of reasonable comparability and affordability, the federal universal support mechanism should complete the effort. With this framework in mind, then, the Joint Board will set forth the method it recommends that the Commission use to size, calculate, and distribute federal support among the nation's non-rural carriers.

17. In formulating this *Second Recommended Decision*, our goal has been to ensure that rates in rural and high cost areas served by non-rural carriers are affordable and reasonably comparable through specific, predictable, and sufficient support mechanisms that are, to the extent possible, explicit.³¹ To do this, commenters proposed three possible ways in which universal service support could be used: (1) to provide support for high cost areas to enable the comparability of rates; (2) to make existing interstate support explicit; and (3) to make existing intrastate support explicit. In this section, we will address each of these three possible uses of support.

A. Enabling "Reasonably Comparable" Rates

18. The Act requires that consumers have access to rates and services "in rural, insular

³¹ 47 U.S.C. §§ 254(b)(1), (3), (5). *See also* H.R. Conf. Rep. No. 458, 104th Cong. 2nd Sess. at 279 (1996): "To the extent possible, the Conferees intend that any support mechanisms continued or created under new Section 254 should be explicit rather than implicit as many support mechanisms are today."

and high cost areas" that are "reasonably comparable" to rates and services in urban areas.³² While the Act does not define reasonable comparability, we interpret that term to refer to a fair range of urban/rural rates both within a state's borders, and among states nationwide. We note that existing federal high cost loop support provides additional federal support to areas that have particularly high costs, and we propose to continue that policy as we move to a forward-looking cost methodology for determining high cost support.

19. We recommend that federal support be available to non-rural carriers serving consumers in areas with costs significantly above the national average and whose average costs throughout its study area significantly exceed the national average. This support should be available where, considered in a consistent manner across all states, a state would find it particularly difficult to achieve reasonably comparable rates, absent such federal support. To the extent that additional federal high cost support to non-rural carriers, beyond the amount currently provided, is necessary to help meet the statutory goal of reasonably comparable rates, that additional federal support should be used to help ensure that intrastate rates are able to satisfy this statutory goal. The state commission has the authority to indicate which intrastate rates shall be affected to help ensure that the carrier does not double recover. Because rate setting methods and goals may vary across jurisdictions, we recommend, for purposes of determining federal high cost support, that the Commission use the *cost* of providing all supported services, rather than local rates. These costs are used in the methodology we describe below to calculate the level of federal support that will be available to help achieve reasonable comparability in rates across all states.

B. Making Interstate Support Explicit

20. In the *Universal Service Order* and the *Access Reform Order*, the Commission made several changes to its access charge rules, with the goal of reforming the mechanisms for recovery of subscriber loop costs to move from implicit to explicit federal universal service support mechanisms. In summary, the Commission decided that: (1) long term support (LTS) should be removed from interstate access charges and made part of explicit federal support mechanisms;³³ and (2) incumbent LECs should use any universal service support from the new support mechanisms to reduce support implicit in access charges, pending further reform.³⁴

21. The Commission concluded that universal service support implicit in rates cannot be sustained if competition emerges in the marketplace, and that removing implicit universal service

³² 47 U.S.C. § 254(b)(3).

³³ *Universal Service Order*, 12 FCC Rcd at 9169, paras. 769-71; *Access Reform Order*, 12 FCC Rcd at 16145-48, paras. 373-80.

³⁴ *Access Reform Order*, 12 FCC Rcd at 16148, para. 381.

support from interstate rates and replacing such support either with improved revenue recovery mechanisms or with explicit support should remain a goal of federal telecommunications reform.³⁵ The Commission also found that, unless implicit support is identified and eventually stripped from interstate access charges, those access charges could remain artificially high.

22. The Commission's efforts to remove implicit universal service support from interstate access charges will not affect intrastate rates directly. This issue is intertwined with the Commission's ongoing access reform proceeding, and the Commission should continue to synchronize the access reform and universal service proceedings with any action it takes to remove implicit universal service support from interstate access charges.

23. If the Commission determines that there is implicit universal service high cost support currently in interstate access rates, it is within the Commission's jurisdiction to determine what that implicit support is and what action the Commission should take to make that support explicit. Although we make no recommendation regarding whether the Commission should eliminate implicit support from interstate access rates, we recognize that it has the authority to do so. We do recommend, however, that, to the extent that the Commission determines that implicit support needs to be removed from interstate access charges and replaced with explicit universal service support, interstate access rates, such as the carrier common line charge (CCLC), presubscribed interexchange carrier charge (PICC), or subscriber line charge (SLC), be reduced dollar for dollar to reflect the corresponding explicit support. We further recommend that the Commission seek to ensure that any reductions in interstate access rates inure to the benefit of consumers. When considering such recommendations, the Commission should give due regard to the requirement that universal service shall bear no more than a reasonable share of joint and common costs. Moreover, the Commission should ensure that any efforts to replace implicit support in interstate access charges with explicit support do not jeopardize the reasonable comparability standard, or harm consumers generally, or any class of consumers in particular. Before taking any final action on removing this support from interstate access charges, the Commission should first consult with the Joint Board.

C. Making Intrastate Support Explicit

24. The Act requires that the Joint Board recommend changes to the Commission's rules that may be necessary to implement sections 214(e) and 254, "including the definition of the services that are supported by Federal universal service support mechanisms."³⁶ Section 254(b)(5) provides that there should be "specific, predictable and sufficient Federal and State

³⁵ *Universal Service Order*, 12 FCC Rcd at 8786-87, para. 17.

³⁶ 47 U.S.C. § 254(a)(1). *See also* 47 U.S.C. § 254(i).

mechanisms to preserve and advance universal service."³⁷ Thus, the Act envisions that both states and the federal government have authority and responsibility to ensure that universal service needs are met. The Act further allows the states in section 254(f) to create state universal service support mechanisms.³⁸ The Act clearly envisions the role of the Joint Board to be that of advising the Commission on matters related to federal support mechanisms, and preserves the ability of each state to design intrastate support mechanisms, although these state support mechanisms may not be inconsistent with the federal rules or burden the federal support mechanism.³⁹ In this *Second Recommended Decision*, we recommend a shared responsibility, but we also conclude, consistent with the statute, that the Commission may not mandate that a state establish an intrastate universal service fund.

25. Historically, intrastate rate design has helped promote universal service. While techniques such as rate averaging have served states well in the past, the onset of competition in local markets is likely to erode the ability of states to fund universal service through implicit support mechanisms. States possess the jurisdiction and responsibility to address these implicit support issues through appropriate rate design and other mechanisms within a state.

26. The same competitive forces that Congress anticipated would require making interstate universal service support explicit may militate for making intrastate universal service support explicit as well. The Act, however, did not mandate such an outcome. States should bear the responsibility for the design of intrastate funding mechanisms. The federal support mechanism should not be contingent upon, nor should it require, any particular action by the state.

IV. PROPOSED METHOD FOR ENSURING SUFFICIENT SUPPORT FOR AFFORDABLE AND REASONABLY COMPARABLE RATES

A. Basing Federal High Cost Support on Forward-Looking Economic Costs

27. In the *Universal Service Order*, the Commission adopted the Joint Board's recommendation that the revised universal service support mechanism would determine non-rural carriers' high cost support based on forward-looking economic costs, instead of the incumbent carrier's book costs, of providing supported services in order to "send the correct signals for

³⁷ 47 U.S.C. § 254(b)(5). *See also* 47 U.S.C. § 254(i).

³⁸ 47 U.S.C. § 254(f).

³⁹ 47 U.S.C. § 254(f).

entry, investment, and innovation in the long run.”⁴⁰ We continue to believe that federal high cost support should be based on forward-looking economic costs.⁴¹

28. Without a complete forward-looking economic cost model, it is not possible for the Joint Board to make a final recommendation as to the most reasonable forward-looking methodology to be used in distributing federal high cost support to the states and/or carriers. We note, however, that the vast majority of proposals on the record in this proceeding would use a model to estimate the forward-looking cost of providing the supported services. No party has suggested that there is a method preferable to a model to determine support based on forward-looking costs. We recommend, therefore, that the Commission continue to work with the Joint Board to select the input values to complete a forward-looking cost model and to finalize the methodology for distributing federal high cost support. We do recommend a framework, discussed in more detail below,⁴² that relates federal support to high average forward-looking costs and to states' ability to address their own universal service requirements.

29. Because the Commission's cost proxy model results are not complete, our recommendation on using a model to estimate forward-looking costs is a work in progress, and therefore tentative. We fully anticipate that the model results will furnish reasonable cost estimates for all regions of the country that can provide the basis for determining federal high cost support. Nevertheless, significant uncertainties need to be eliminated before a model can serve as the basis for federal support distributions. For example, a model must meet the openness criterion required of all model developers. At present the federal platform has been tested using geocoded customer location data that is treated as proprietary information by its supplier. We also understand that the Commission is seeking to identify alternative data sources at this time. We urge the Commission not to adopt those particular data as input values unless the Commission determines that such data are sufficiently open and available for testing and comment. Despite these uncertainties, we recommend that the states, the Commission, and the Joint Board continue their joint efforts to develop an accurate cost proxy model. In the event that the Commission has not defined all elements necessary to calculate support based on forward-looking costs in time for implementation by July 1, 1999, then the Joint Board recommends that the present method for determining support be continued for an interim period. In that event, we also recommend that

⁴⁰ *Universal Service Order*, 12 FCC Rcd at 8899, 8927, paras. 224 and 273. The Commission noted that use of forward-looking economic costs would preserve and advance universal service and encourage efficiency because support levels will be based on the costs of an efficient carrier. *Id.* at 8899, para. 225. The Commission adopted the Joint Board's recommendation that cost models be used because they were an "efficient method of determining forward-looking economic cost." *Id.* at 8903, para. 232.

⁴¹ We also wish to emphasize that a cost model's estimation of the forward-looking cost to provide the supported services does not alone determine the amount of support that will be needed in the aggregate or that any given carrier will receive. *Accord Platform Order* at para. 2.

⁴² *See infra* paras. 41-46.

the Commission make interim adjustments to the present rules to resolve any comparability issues in rural states primarily served by a large carrier, consistent with our general recommendation on comparability issues.

30. We emphasize, however, that, in recommending this framework for determining non-rural carriers' high cost support based on forward-looking cost, we do not intend for the Commission to create any precedent for any potential revisions to support mechanisms for rural carriers. The model platform that the Commission adopted in October was designed to estimate *non-rural carriers'* costs. Pursuant to the Joint Board's recommendation, the Commission has provided that the determination of the appropriate manner in which a model should be applied to rural carriers, if at all, will take into account the recommendation of this Joint Board, after the Joint Board receives a report from the Rural Task Force.⁴³ The Joint Board intends to look closely at these issues to ensure that rural carriers' unique situations and challenges are addressed in the separate proceedings examining their high cost support mechanisms.

31. We further recommend that the Commission reconsider its decision to allow state cost studies to be used in place of the federal model for non-rural companies.⁴⁴ We believe that it is more appropriate that the federal universal service support mechanisms be based upon a national yardstick for determining cost. Without such a national yardstick, it will be difficult to establish a consistent nationwide measurement of rate comparability. Although the Commission should fully evaluate any comments on this issue, we recommend that, absent a clear showing that basing federal support on a state cost study is necessary and appropriate to achieve statutory goals, the Commission base all federal support on a uniform methodology that derives from a single, national model. States may, of course, base any intrastate high cost support mechanisms on their own cost studies, rather than a federal model.

B. Size of Area Over Which Costs Are Averaged

32. In the *Universal Service Order*, the Commission adopted the Joint Board's recommendation that forward-looking economic costs be determined at the wire center level or below.⁴⁵ While we acknowledge the value of a cost model that is capable of estimating costs at that level of granularity, we now recommend that federal support initially be determined by measuring costs at the study area scale, a scale considerably larger than the wire center. In

⁴³ *Universal Service Order*, 12 FCC Rcd at 8917-18, paras 252-256.

⁴⁴ *Universal Service Order*, 12 FCC Rcd at 8912, para. 248.

⁴⁵ *Universal Service Order*, 12 FCC Rcd at 8884, para. 193; *see also Recommended Decision*, 12 FCC Rcd at 232-33, para. 277.

general, a study area is an area served by a local exchange carrier in a single state.⁴⁶ The existing high cost support program measures costs and distributes support at the study area level.

33. We recommend measuring costs at the study area level at this time because we believe that support calculated at this level will properly measure the support responsibility that ought to be borne by federal mechanisms given the current extent of local competition. We noted above that the primary purpose of federal support should be to ensure that rates remain affordable and reasonably comparable throughout the nation. By ensuring that cost disparities among study areas and among states are limited, we believe that federal support will be sufficient to maintain rate comparability and affordability.

34. We also recognize that, as competition develops within a study area, calculating costs using the aggregate characteristics of the study area may become less appropriate. Again, in light of the second goal of reforming universal service -- ensuring that support mechanisms are not eroded as competition develops⁴⁷ -- we recommend that the Commission consider the possible impacts of competition on federal universal service support mechanisms.

35. We have considered the use of statewide average cost (as opposed to study area costs) to determine the need for universal service support. While we agree that the states can be expected to participate as full partners in preserving universal service, a statewide approach could require states to create mechanisms to transfer support among non-rural carriers. At present, however, some states may lack such a mechanism. Given the short time to implement the new mechanism, we find it prudent to average costs at the study area level.

C. State Responsibility for Reasonably Comparable Rates

36. In this section, we conclude that the law gives the Commission an important role in universal service, but that the federal role is not exclusive. The states also bear part of the shared responsibility for universal service. States are free under the Act to establish or refrain from establishing explicit universal service support mechanisms. As we noted above, furthermore, federal support may not be made contingent upon any actions taken, or not taken, by the states. Federal support should not rely on a state's actions with respect to universal service but depend only upon the total support amount generated by the methodology described herein for calculating the amount of federal support for each state. The Joint Board believes therefore, that the level of

⁴⁶ Study area boundaries are fixed as of November 15, 1984. *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, *Decision and Order*, 50 Fed. Reg. 939 (adopting with minor modifications the Joint Board recommendations issued in MTS and WATS Market Structure, Amendment of the Commission's Rules and Establishment of a Joint Board, *Recommended Decision and Order*, 49 Fed. Reg. 48,325 (1984)).

⁴⁷ *See supra* para. 2.

federal support should reflect, in a consistent manner, each state's ability to use its own resources to address its universal service needs, regardless of whether that or any other amount of support is explicitly provided by the state.

37. While there is no mandate that a state create such an explicit fund, the state should have in place “specific, predictable and sufficient” mechanisms to preserve and advance universal service.⁴⁸ The federal support mechanism need not take into account the state's authority and ability actually to establish state universal service support mechanisms, since carriers may be required to recover more total support than the amount used exclusively for purposes of developing the federal fund. Such discretionary variations in support at the state level are left intentionally independent of the standard determinations of federal support levels, precisely in order to allow states to set their own levels of corresponding affordability and funding requirements. In contrast, federal funding requirements should be those amounts necessary to establish a standard of reasonable comparability of rates across states. Any state is then able to supplement, as desired, any amount of federal funds it may receive under this standard.

38. While we recommend a shared responsibility, we also conclude that, consistent with the statute, no state can or should be required by the Commission to establish an intrastate universal service fund. Each state is uniquely qualified to determine, based upon its own costs, rates and other circumstances, when and if it needs an explicit universal service support mechanism.

39. Implicit support in state rates is a matter intimately related to each state’s rate design. The success of these state efforts is demonstrated by the fact that rates today are generally affordable and subscribership is currently very high in most areas of the nation. This indicates a limited need for additional federal involvement. We believe it is consistent with the Act for the Commission to assume that the states will address issues regarding implicit intrastate support in a manner that is appropriate to local conditions. We also conclude that, under the Act, where states have the capacity today to accomplish this task, states are the most appropriate governmental level to address this issue.

40. Some states may face significant obstacles in maintaining reasonably comparable rates, and may find that solving this problem by state action alone is impossible or unreasonable in some instances. For this reason, we believe that additional federal support may be needed to ensure that rates are reasonably comparable, as required by section 254(b)(3).⁴⁹

D. Methodology for Federal Support of Reasonably Comparable Rates

⁴⁸ 47 U.S.C. § 254(b)(5).

⁴⁹ 47 U.S.C. § 254(b)(3).

41. We have considered numerous distribution options, including all those submitted by the parties. The methodology we propose incorporates elements from the various plans filed in this proceeding. Our methodology would average costs at a study area level.⁵⁰ Our methodology incorporates a reasonable "hold harmless" component, and is grounded in the principle that additional federal high cost support should be targeted to areas with the greatest need.⁵¹ Our recommended methodology includes a cost-based benchmark.⁵² Finally, as advocated by a number of parties, our methodology takes into account each state's ability to support its universal service needs internally.⁵³ The framework below addresses only the affordability and comparability goals of the Act. As indicated previously, we cannot at this time provide the details of a recommendation for a specific mechanism to distribute federal support to eligible carriers. We can, however, outline the basic elements that we believe should be considered in designing the distribution methodology.

42. We recommend that the distribution methodology contain two primary elements. First, study areas with average forward-looking per-line costs significantly in excess of the national average cost should be identified. Second, the state's ability to support its own universal service needs should be determined. Federal support should be provided only for costs that exceed both these thresholds.

43. In the first step of the process, identifying areas with high costs, we recommend that the Commission use the *cost* of providing supported services, rather than local rates, to evaluate rate comparability, because rate setting methods and goals may vary across jurisdictions. We recommend that federal support be available to non-rural carriers with average costs significantly above the national average. Specifically, we recommend that the Commission select a single national cost benchmark against which the forward-looking cost in a given study area would be compared to determine whether that study areas has costs that are significantly above the national average. We recommend that the Commission consider setting this national benchmark at a level somewhere between 115 and 150 percent of the national weighted average cost per line.

44. The second step in determining federal support should reflect that, for the reasons outlined above, federal support is only one portion of the shared federal-state responsibility established in section 254. Federal support should only be used to supplement a state's ability to address its own universal service needs. In order to accomplish this second step, it will be

⁵⁰ See AT&T comments at 7.

⁵¹ See Ad Hoc Proposal, US West Proposal, Colorado PUC Proposal.

⁵² See California PUC comments at 3, Bell Atlantic comments at 5, GTE comments at 18.

⁵³ See US West Proposal, Colorado PUC Proposal, South Dakota PUC Proposal; see also GTE comments at 6, Texas PUC comments at 7.

necessary to calculate a level of support that could equitably and reasonably be assumed to be provided by implicit or explicit state support. There are potentially several ways to estimate a state's ability to support its universal service needs. For example, the ratio of lines in a state with costs above a certain threshold could be determined, as a general indication of whether a state has a higher or lower percentage of high cost lines than other states. This ratio of high cost to low cost lines could then be factored into the support equation to reflect that states with a higher percentage of high cost lines will be less able to support their own universal service needs. Other approaches could set each state's presumed support responsibility at a given level, which might be expressed as a dollar value per line or as a percentage of intrastate revenue. The ratio of intrastate traffic volume to total traffic volume could also be used.

45. An example of how this system would work in practice would be an approach that calculated the state's ability to support its own universal service needs based on a percentage of intrastate revenues. Such a limit on a state's presumed responsibility, if adopted, could be between 3 and 6 percent of intrastate telecommunications revenues. Once the first step in the methodology has identified the amount by which costs in the study areas in the state exceed the cost benchmark, the percentage of intrastate revenues would be calculated that would be required to meet this high cost responsibility. If that amount exceeded the state revenue threshold, then the federal mechanism would provide support for the difference.

46. We urge the Commission to continue its deliberations with this Joint Board and to consult with Congress in order to specify further the proper parameters of these two variables as the study area costs are derived from the Commission's model and choice of inputs. It is our goal to recommend a plan that achieves the Act's goals of affordability and reasonable comparability without overburdening consumers across the nation.

V. SIZE OF THE FEDERAL SUPPORT MECHANISM

47. We described above the general outlines of a method for calculating federal support to high cost areas. Finalization of that method will determine the overall size of federal support for reasonably comparable rates. So long as the fund is for the purposes established in the Act, the Commission has discretion in providing remedies that are designed to "preserve and advance" universal service. Nevertheless, for several reasons we conclude that the federal high cost support fund should be only as large as necessary, consistent with other requirements of the law. This will ensure that there is balance between consumers who directly receive the benefits of universal service support and those consumers who must pay for the support through their rates.

48. Enabling reasonably comparable rates among states is a task that can likely be accomplished only with federal assistance. Federal support must be sufficient so that, when combined with a reasonable state effort, rates within service areas may be reasonably comparable both within and among states. Until we resolve several other pending policy decisions, as well as obtain more precise cost data, however, it is not possible to define, in dollars, the amount of

support required by the comparability standard.

49. We do not believe, however, that current circumstances warrant a high cost support mechanism that results in a significantly larger federal support amount than exists today. We recognize that some states currently may not receive support sufficient to enable reasonably comparable rates, and thus we believe the support level may rise somewhat.

50. These principles can be implemented through a plan that, at least initially, calculates support on a study area basis and allocates a reasonable and equitable share of responsibility for support to state universal service efforts. The plan can enable reasonably comparable rates if the combination of state and federal support can keep the net cost differences (after receipt of universal service support) between high cost and low-cost areas within reasonable bounds. We recognize that competition may develop in unpredictable ways. As competition threatens rate comparability or affordability in high cost areas served by non-rural carriers, it may be necessary to re-evaluate the appropriate level of federal support. Incumbent LECs to date have not demonstrated that implicit support has eroded as a result of competition.

VI. HOLD HARMLESS

51. When a new federal support mechanism is implemented, some carriers could receive more or less support than in the past. If substantial reductions were to occur in a single year, some consumers could experience rate shock. Both significant, sudden increases in the fund size overall, and significant decreases in the support that goes to a particular carrier, could have a notable impact on consumers' rates.

52. Rural companies have been assured by the Commission that their support systems will not be altered until January 1, 2001, at the earliest, and in no event before the Joint Board has completed further deliberations on high cost support mechanisms for rural carriers, in light of the recommendations received from the Joint Board-appointed Rural Task Force.⁵⁴ In addition, the Commission has stated to Congress that no state should receive less support than it currently receives.⁵⁵ The Puerto Rico Telephone Company has asked, notwithstanding its non-rural status, to continue to receive support at present levels, until the transition to a forward-looking high cost support mechanism is implemented for rural companies.

53. We support the Commission's commitment to continue to hold states harmless, so that no non-rural carrier, including the Puerto Rico Telephone Company, will receive less federal

⁵⁴ *Universal Service Order*, 12 FCC Rcd at 8917, paras. 252-253.

⁵⁵ *See Report to Congress*, 13 FCC Rcd at 11602, para. 219: "The Commission will work to ensure that states do not receive less funding as we implement the high cost support mechanisms under the 1996 Act. We find that no state should receive less federal high cost assistance than it currently receives."

high cost assistance than the amount it currently receives from explicit support mechanisms.⁵⁶ We recommend, depending on the final amounts of support estimated on a forward-looking basis, that the Commission consider a gradual phase-in of any increase in federal universal service high cost support for non-rural carriers.

VII. UNSERVED AREAS

54. The Arizona Corporation Commission (Arizona Commission) submitted a proposal to use a portion of federal support to address the problem of unserved areas and the inability of low-income residents to obtain telephone service because they cannot afford to pay the required line extension or construction charges.⁵⁷ The Arizona Commission's proposal is not intended to be a comprehensive alternative to the high cost fund distribution model, but rather is intended to address a discrete concern related to low-income residents in remote areas.⁵⁸

55. The framework created in the Act was designed to accelerate deployment of services to all Americans, and the universal service program plays an important role in that framework. The issue raised by the Arizona Commission is of interest to the Joint Board, even though it was not among those specifically referred to the Joint Board for further recommendation. States have generally addressed the "unserved household" concern through intrastate proceedings that establish reasonable rates for line extension agreements and encourage carriers to minimize unserved regions of the state.⁵⁹ We recognize that investments in line extensions have historically been an issue addressed by the states, and we believe they should continue to be dealt with by the states, to the extent that the states are able to do so. Unserved areas are not unique to Arizona; other states may also face this issue. Although historically a state issue, we recognize that there may be some circumstances which may warrant federal universal service support for line extensions to unserved areas. We recommend that the special needs of unserved areas be investigated and subject to a more comprehensive evaluation in a separate proceeding. The

⁵⁶ Of course, because support is portable, individual carriers' support may be reduced due to the loss of customers, though this will not affect the amount of support available in the study area.

⁵⁷ Proposal of the Arizona Corporation Commission For Distribution of Federal USF Funds to Establish Service to Low-Income Customers in Unserved Areas, or in the Alternative, for Amendment of the May 8, 1997 Report and Order to Provide for Federal USF Distribution for This Purpose; (*filed* April 27, 1998) (Arizona Proposal).

⁵⁸ Arizona Proposal at 2.

⁵⁹ *See, e.g.*, In re Competitive Provisions of Local Telecommunications Service in Areas Served by Local Telephone Companies with Less than 50,000 Subscribers, Dkt No. P-999/R-97-608, 1998 WL 317592 (Minn. P.U.C.) (May 12, 1998); In re Nebraska Universal Service Task Force, *Report and Recommendation*, 1997 WL 913331 (Neb. P.S.C.) (July 23, 1997); In re Anderson v. Citizens Communications Company of Nevada, Complaint Concerning the Lack of Telephone Service in the Adobe Heights Subdivision, *Compliance Order*, Dkt. No. 98-2010 (Nev. P.U.C.) (August 20, 1998). In addition, state and federal lifeline programs have been established to allow low-income residents to obtain services at reduced charges.

Commission should seek information on unserved areas throughout the nation and determine, in consultation with the Joint Board, whether such areas warrant any special federal universal service consideration.

VIII. MECHANISM FOR DISTRIBUTING SUPPORT

A. Portability of Support

56. We recommend that the Commission continue with the policy established in the *Universal Service Order* of making high cost support available to all eligible telecommunications carriers, whether they be an incumbent LEC or a competitive carrier, including wireless carriers.⁶⁰ We believe that portable support is consistent with the principle of competitive neutrality that we previously recommended and the Commission subsequently adopted in the *Universal Service Order*. We continue to support the use of competitive neutrality as a guiding principle of universal service reform and endorse the Commission's definition of this important principle in the *Universal Service Order*.⁶¹

B. Use of Support

57. One issue raised in comments was whether the Commission should condition the receipt of federal high cost support to ensure that support is used in a manner consistent with section 254. We recommend that the Commission require carriers to certify that they will apply federal high cost universal service support in a manner consistent with section 254.

58. We recognize that some states may lack the authority or the desire to impose constraints or conditions on the use of federal high cost support. We do not recommend, therefore, that the Commission require that states provide any certification, or require any other state action, as a condition for carriers to receive high cost support. At the same time, parties may have a legitimate concern that federal support should be used by carriers to further the goals of section 254. We further recognize that, even if costs are calculated at the study area level, high cost support should be targeted to consumers living in the highest cost areas of the study area. We therefore recommend that the Commission permit, but not require, states to certify that, in

⁶⁰ As recommended in the Joint Board's first Recommended Decision, which the Commission subsequently adopted in the *Universal Service Order*, however, a carrier that offers universal service solely through reselling another carrier's universal service package should not be eligible to receive universal service support. See *Universal Service Order*, 12 FCC Rcd. at 8861-62, paras. 151-152.

⁶¹ The Commission defined the principle of competitive neutrality as follows: "Universal service support mechanisms and rules should be competitively neutral. In this context, competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another." See *Universal Service Order*, 12 FCC Rcd at 8801, para. 47.

order to receive federal universal service high cost support, a carrier must use such funds in a manner consistent with section 254. For example, in order to provide efficient incentives for competitive entry, a state might require that federal support be targeted to those consumers living in the highest cost areas within a study area.

59. To the extent that the law permits, the Commission could reduce or eliminate federal high cost support if it finds that a carrier has not applied its federal universal service funds consistent with section 254, or if the state finds that the carrier has not adequately demonstrated that the federal support is being used in a manner consistent with section 254(e), which provides that carriers receiving universal service support "shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."⁶² We also clarify that this decision is intended only to affect the amount that carriers receive from the federal universal service high cost support mechanism. We recommend that the Commission clarify procedures by which a party, including a state, may initiate action against a carrier that fails to apply federal universal service support in an appropriate manner.

60. We do not believe that conditioning support on a demonstration that funds are being used for the advancement of universal service places any restrictions on the determination of a carrier's status as an eligible telecommunications carrier. As the *Universal Service Order* notes, "section 214(e)(2) does not permit the Commission or the states to adopt additional criteria for the designation as an eligible carrier."⁶³

61. One proposal recommends that the Commission distribute universal service funding directly to state commissions rather than to carriers.⁶⁴ We recognize that some state commissions may be able to ensure that high cost support is distributed to carriers and is used in a manner, consistent with federal rules, that best ensures that rates are just, reasonable, and affordable throughout that particular state. Nevertheless, we cannot recommend that the Commission adopt that mechanism, in light of the long-standing practice at the time that the 1996 Act became law of distributing federal universal service support to the carriers providing the supported services, and the absence of any affirmative evidence in the statute or legislative history that Congress intended such a fundamental shift to a state block grant distribution mechanism. In addition, distributing funding directly to state commissions is likely to create substantial administrative burdens for states currently lacking this ability, especially because there is very little time, prior to the July 1, 1999 implementation date, for the state to take the steps necessary to administer federal high cost support pursuant to the rules that Commission will be adopting in the spring.

⁶² We recognize that states may not use such certification processes in a manner inconsistent with section 253 of the Act.

⁶³ *Universal Service Order*, 12 FCC Rcd at 8851-52, para. 135.

⁶⁴ Ad Hoc Proposal at 13.

IX. ASSESSING CONTRIBUTIONS FROM CARRIERS

62. In the *Universal Service Order*, the Commission determined that assessment of contributions for the interstate portion of the high cost and low-income support mechanisms shall be based solely on end-user interstate telecommunications revenues, and assessment of universal service support for eligible schools, libraries and rural health care providers shall be based on interstate and intrastate end-user telecommunications revenues.⁶⁵ The Commission declined to assess both intrastate and interstate end-user revenues for the high cost and low-income support mechanisms because the states are currently reforming their own universal service programs, and it would have been premature to assess contributions on intrastate revenues before appropriate forward-looking mechanisms and revenue benchmarks are developed.⁶⁶ The Commission also concluded that carriers shall be permitted to recover their contributions to universal service support mechanisms only through rates for interstate services.⁶⁷

63. Pending the decision of the Fifth Circuit,⁶⁸ our recommendation on this issue is necessarily tentative. Continuing to assess contributions for high cost and low income support based solely on interstate revenues, as set forth in the *Universal Service Order*,⁶⁹ could have certain benefits. Under this approach, state commissions would have the greatest flexibility to tap into their intrastate revenue bases to advance universal service at the state level. Assessing only interstate revenues for federal high cost support also has some significant disadvantages, however. For instance, many carriers that do not routinely have to separate intrastate and interstate revenues for regulatory or business purposes now must do so solely for federal universal service purposes. This creates additional burdens on these carriers, and may create incentives for carriers to misclassify revenues between jurisdictions based on different assessment rates. A jurisdictional assessment base also makes it difficult for carriers to allocate the revenues associated with packages, or bundles, of services that include both intrastate and interstate components. Finally, a non-jurisdictional assessment base would enable both the state and federal mechanisms to tap broader revenue bases, thereby lowering the assessment rates needed. Thus, if the Fifth Circuit determines that the Commission may properly assess all revenues for universal service contributions, the Commission may wish to consider using that assessment methodology for high cost support. If the Commission determines that it may assess universal service contributions based on all revenues, the Commission should find that states may do the same for their state

⁶⁵ *Universal Service Order*, 12 FCC Rcd at 9197-05, paras. 824-41.

⁶⁶ *Universal Service Order*, 12 FCC Rcd at 9200-01, paras. 831-36.

⁶⁷ *Universal Service Order*, 12 FCC Rcd at 9198-00, paras. 825-30.

⁶⁸ *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir. 1997).

⁶⁹ *Universal Service Order*, 12 FCC Rcd at 9197-05, paras. 824-41.

universal service mechanisms. Alternatively, the Commission could consider assessing carriers high cost universal service contributions on a flat, per-line basis, which also addresses some of the difficulties of assessing only interstate revenues.

X. CARRIER RECOVERY OF UNIVERSAL SERVICE CONTRIBUTIONS FROM CONSUMERS

A. Introduction

64. The Commission concluded in the *Universal Service Order* that carriers would be permitted, but not required, to pass through their contributions towards the federal universal service programs to their interstate consumers.⁷⁰ The Commission noted that carriers recovering their contribution costs from their consumers "may not shift more than an equitable share of their contributions to any consumer or group of consumers."⁷¹ The Commission declined in the *Universal Service Order* to mandate that carriers recover their contributions through an end-user surcharge.⁷² The Commission reasoned that "[a] federally prescribed end-user surcharge would dictate how carriers recover their contribution obligations and would violate Congress's mandate and the wishes of the state members of the Joint Board."⁷³ The Commission agreed with state Joint Board members in the *Universal Service Order* that, in moving toward a competitive market, carriers should have the flexibility to decide how to recover their universal service contributions.⁷⁴

65. The Commission further determined in the *Universal Service Order* that carriers that pass through to consumers their universal service contribution obligations should include on the bills complete and truthful information regarding the contribution amount and an accurate description of the charge.⁷⁵ Specifically, the Commission stated that it would be misleading for a carrier to characterize its contribution as a surcharge, because carriers retain the flexibility to structure their recovery of the costs of universal service in many ways.⁷⁶

⁷⁰ *Universal Service Order*, 12 FCC Rcd at 9199, para. 829.

⁷¹ *Universal Service Order*, 12 FCC Rcd at 9199, para. 829.

⁷² *Universal Service Order*, 12 FCC Rcd at 9210, para. 853.

⁷³ *Universal Service Order*, 12 FCC Rcd at 9210, para. 853.

⁷⁴ *Universal Service Order*, 12 FCC Rcd at 9210-11, para. 853.

⁷⁵ *Universal Service Order*, 12 FCC Rcd at 9211, para. 855.

⁷⁶ *Universal Service Order*, 12 FCC Rcd at 9211-12, para. 855.

66. In the *Truth in Billing Notice* released on September 17, 1998, the Commission sought comment on how to ensure that consumers receive from their telecommunications carriers complete, accurate, and understandable bills.⁷⁷ The Commission noted that some long distance and CMRS providers have begun including on their consumers' bills line-item charges purportedly intended to recover the costs incurred in meeting their universal service contribution obligations.⁷⁸ The Commission further noted that both the Commission and state regulators have received numerous complaints and inquiries from consumers indicating widespread confusion about the nature of those charges.⁷⁹ Indeed, from January through September, 1998, more than 2,000 consumers filed informal complaints with the Commission. Furthermore, from January through May 1998, the Commission's National Call Center received approximately 10,000 calls per month from consumers with questions regarding charges on their bills.⁸⁰ Additionally, NARUC has stated that numerous interstate carriers that have implemented line-item charges to recover from consumers their universal service contributions have incorrectly indicated that these charges were mandated by the Commission or federal law.⁸¹ Consumer inquiries received by the Commission also indicate that these charges often are inaccurately identified and imply, or state directly, that they were mandated by federal law.⁸² The Commission pointed out in the *Truth-in-Billing Notice* that consumers may be less likely to engage in comparative service provider shopping if they are led to believe that certain rates or charges are federally mandated and may not vary from carrier to carrier.⁸³

67. The Commission also sought comment in the *Truth-in-Billing Notice* on the practice of some carriers to recover from a consumer more than the carrier's cost of contributing to universal service that is attributable to that consumer. The Commission sought comment on whether such a practice is misleading or unreasonable under section 201(b) of the Act.⁸⁴ The

⁷⁷ *Truth-in-Billing Format*, Notice of Proposed Rulemaking, CC Docket No. 98-170, FCC 98-232 (rel. Sept. 17, 1998) (*Truth-in-Billing Notice*).

⁷⁸ *Truth-in-Billing Notice* at paras. 25-26.

⁷⁹ *Truth-in-Billing Notice* at para. 25.

⁸⁰ *Truth-in-Billing Notice* at n.30.

⁸¹ National Association of Regulatory Utility Commissioners (NARUC), "Resolution Regarding End User Surcharges Instituted by Interstate Carriers," adopted March 4, 1998 (NARUC Resolution).

⁸² *Truth in Billing Notice* at para. 25.

⁸³ *Truth in Billing Notice* at para. 25.

⁸⁴ *Truth in Billing Notice* at para. 25. Section 201(b) provides, in part, that "[all charges, practices, classifications, and regulations for and in connection with" communication services "shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be

Commission also sought comment in the *Truth-in-Billing Notice* on whether carriers attributing line-item charges to government action should be required to disclose cost reductions, such as reductions in access charges, arising from government action.⁸⁵

B. Discussion

68. In this section, we recommend that the Commission provide to telecommunications carriers that contribute to universal service strict guidance regarding the extent to which they recover their universal service contributions from consumers. We also recommend that the Commission provide such carriers with express instructions regarding the manner in which carriers may depict on bills charges used to recover universal service contributions. Specifically, we recommend that, to the extent permitted by law, the Commission prohibit carriers from depicting such charges as a "tax" or as mandated by the Commission or the federal government by terms or placement on the bill. We note that, in truly competitive markets, firms recover a wide variety of costs in a wide variety of ways with no itemized notification of similar increases or decreases to individual consumers.

1. Recovery of Universal Service Contributions from Consumers

69. We reiterate that the choice of whether to collect universal service assessments from end users via a line-item charge on their bills should remain with the carriers, and that carriers are free to tell consumers that the carrier is required to pay to support universal service. Specifically, we recommend, that the Commission give careful consideration to a rule that provides that, for carriers that choose to pass through a line item charge to consumers, the line item assessment be no greater than the carrier's universal service assessment rate. Such a rule will help prevent consumers or classes of consumers from being charged excessively for a carrier's universal service contribution.⁸⁶ Some carriers may attempt to exercise market power and recover through universal service charges in a non-competitive fashion more than they are contributing to universal service, believing that they can describe those charges as mandated by the Commission or federal action. We are also concerned that some carriers may be allocating a disproportionate share of universal service costs to certain classes of consumers. Such practices might contravene section 201(b) of the Act. As noted above, consumers may be less likely to engage in comparative shopping for a carrier if they are led to believe that certain charges are fixed by the Commission or federal government.

unlawful" 47 U.S.C. § 201(b).

⁸⁵ *Truth in Billing Notice* at para. 31.

⁸⁶ The Commission sought comment on this idea in the *Truth and Billing Notice*. *Truth in Billing Notice* at para. 31.

2. Characterization of Universal Service Charges to Consumers

70. We believe that a carrier's billing and collection practices for communications services are subject to regulation as common carrier services under Title II of the Act.⁸⁷ We believe that inaccurately identifying or describing charges on bills that recover universal service contributions may violate section 201(b) of the Act.⁸⁸ For instance, it is important for consumers to understand that universal service support has long been implicit in the rates for various intrastate and interstate telecommunications services. We therefore recommend that the Commission take decisive action to ensure that consumers are not misled as to the nature of charges on bills identified as recovering universal service contributions. Specifically, we recommend that the Commission consider prohibiting carriers from identifying as a "tax" or as mandated by the Commission or federal government any charges to consumers used to recover universal service contributions. Similarly, we recommend that the Commission consider prohibiting carriers from incorrectly describing as mandatory or federally-approved any universal service line items on bills. This restriction would include both written descriptions of the charges and any oral descriptions from consumer service representatives as well as placement on the bill. While interstate telecommunications providers are required to contribute to the universal service support mechanisms, they are not required to impose such charges on consumer bills.

71. Cognizant of the First Amendment implications in regulating the manner in which carriers may convey information on consumers' bills, we note that the Supreme Court has held that the government may require a commercial message to "appear in such a form, or include such additional information, warnings, and disclaimers, as are necessary to prevent its being deceptive."⁸⁹ On the other hand, restrictions on speech that ban truthful, non-misleading commercial speech about a lawful product cannot withstand scrutiny under the First Amendment.⁹⁰ We believe that, pursuant to these Supreme Court rulings, it would not violate the First Amendment to specifically prohibit carriers from including on their bills untruthful or misleading statements regarding the nature of line items used to recover universal service

⁸⁷ See *Local Exchange Carrier Validation and Billing Information for Joint Use Calling Cards*, Report and Order, CC Docket No. 91-115, 7 FCC Rcd 3528 (1992), *clarified on reconsideration*, 12 FCC Rcd 1632, 1643 (1997); *Public Service Commission of Maryland*, Memorandum Opinion and Order, 4 FCC Rcd 4000, 4004 (1989), *aff'd*, *Public Service Commission of Maryland v. FCC*, 909 F.2d 1510 (D.C. Cir. 1990); *Detariffing of Billing and Collection Services*, Report and Order, 102 F.C.C.2d 1150, 1169-71 (1986) (*Detariffing Order*). We also note that a carrier that provides service to an end-user consumer remains responsible, and subject to regulation under Title II, for the accurate billing of its service even if that carrier chooses to have the actual billing and collection performed by another entity. *Truth-in-Billing Notice* at para. 12.

⁸⁸ 47 U.S.C. § 201(b).

⁸⁹ *Virginia Pharmacy Board v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 772, n.24 (1976).

⁹⁰ *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996).

contributions. We urge that the Commission carefully review the record in its proceeding before reaching any conclusion on these issues.

72. We also recommend that the Commission continue to explore, through its Truth-In-Billing proceeding, the possibility of establishing standard nomenclature that carriers could use on their bills to consumers regarding universal service charges. Such standardized language would represent the Commission's view of language that is accurate and not misleading. Standard nomenclature could benefit consumers by having common language across carriers so that consumers can easily identify the charge. We urge that the Commission consider using "Federal Carrier Universal Service Contribution" as standard nomenclature describing any universal service line item on consumer bills.⁹¹ The line item should be accompanied by an explanation that the carrier has chosen to separate its universal service contribution from its other costs of business, and to display the contribution as a line item on the consumer's bill.

73. Finally, we note that many state regulatory agencies either have in place or are considering establishing requirements that will curtail the practice of some carriers of mischaracterizing universal service line items on bills.⁹² In addition, other federal agencies, such as the Federal Trade Commission, may have jurisdiction that overlaps or is concurrent with that of the Commission or state regulatory agencies. We therefore recommend that the Commission work closely with these agencies to ensure that consumers are provided with complete and accurate information regarding the nature of universal service line items.

XI. PERIODIC REVIEW

74. The Act contemplates that universal service is an "evolving" level of service.⁹³ The Act further contemplates that the Joint Board may periodically make recommendations to the Commission regarding modifications in the definition of services supported by the federal universal service support mechanism.⁹⁴ Moreover, we recognize that the telecommunications industry is rapidly changing and that both competition and technological changes will affect universal service needs in rural, insular, and high cost areas of the nation. We therefore

⁹¹ We also urge, however, that the Commission recognize in its deliberations that it may also engender more confusion to use standard billing language where carriers have significant freedom in deciding how to set their own charges to consumers.

⁹² *See, e.g.*, In re Washington Utilities and Transportation Commission Approved for Official Comment Proposed Rules in (Proposed) Washington Administrative Code (WAC) 480-123-290, 300 (Fourth Draft) (Wash. U.T.C.) (November 23, 1998); *see also* California PUC, Decision 96-10-066 at 282, 286 (mimeo), Ordering Paragraphs 8, 15 (Cal P.U.C.) (October 25, 1996).

⁹³ 47 U.S.C. § 254(c)(1).

⁹⁴ 47 U.S.C. § 254(c)(2).

recommend that the Commission continue to consult with this Joint Board on matters addressed in this *Second Recommended Decision*. We also recommend that the Joint Board and the Commission broadly reexamine its high cost universal service mechanism no later than three years from July 1, 1999.

XII. RECOMMENDING CLAUSES

75. For the reasons discussed herein, this Federal-State Joint Board, pursuant to section 254(a)(1) and section 410(c) of the Communications Act of 1934, as amended, 47 U.S.C. sections 254(a)(1) and 410(c), recommends that the Federal Communications Commission adopt the proposals described above relating to high cost universal service support mechanisms for non-rural carriers.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

November 23, 1998

**Separate Statement
of
Commissioner Susan Ness**

Re: Federal State Joint Board on Universal Service (CC 96-45)

The Joint Board's recommendation today moves the universal service reform process a significant step closer to fulfillment of statutory requirements, with emerging majority positions on many difficult issues. The Joint Board is recommending a framework to "preserve and advance" universal service support for "consumers in rural, insular, and high-cost areas." This framework will provide "specific, predictable, and sufficient" support for rates that are "affordable" and "reasonably comparable to rates charged for similar services in urban areas," as required by the Act, without overburdening consumers all across the nation.

The Joint Board recommends that the Commission replace its prior 75-25 approach to universal service funding. Instead, it endorses the Commission's commitment to the Congress to hold the states harmless. Under this approach, no study area in any State would receive less support from the new high cost mechanism for non-rural carriers than it currently receives from explicit federal support mechanisms. In addition, the Joint Board further recognizes an additional need for the federal mechanism to supply any universal service support that States need but cannot reasonably be expected to fund from intrastate sources. It recommends that federal universal service support continue to be distributed to carriers, not to States. I support these recommendations without reservation.

The Joint Board majority reaffirms using a forward-looking economic cost approach for universal service, states that it anticipates the FCC's cost proxy model to provide reasonable cost estimates, and encourages the Commission to continue to work with the States through the selection of inputs to develop an accurate model. I support this recommendation as well. No economic model is perfect. But no one has proposed a better alternative for estimating forward-looking costs. A model is the only tool that has been identified to permit objective assessment of special needs that may require increased federal support to particular study areas. But we will not use this tool unless it has achieved a level of accuracy, predictability, and openness that earns it broad acceptance.

The Joint Board is also recommending a two-step methodology for determining and allocating federal high cost universal service need, which will be finalized as the FCC completes its work on the models. Federal support will be provided when a telephone company service area in a State has forward-looking costs significantly above the national average, and the State cannot

reasonably fund that need from intrastate sources. Key details remain to be formulated, but this general framework strikes me as logical and fair.

The Joint Board members generally agree that local competition is not yet developing quickly, and they detect no clear evidence that sources of implicit support have been undermined. This reduces the urgency and the magnitude of replacing implicit support with explicit support. But the FCC -- and the States -- cannot neglect our responsibilities. Both jurisdictions, in their respective spheres, must be prepared to provide whatever explicit support is needed as competition diminishes the availability of implicit support.

As provided by the law, universal service funds should be assessed and collected from carriers, not through mandatory new line-item charges on consumers. To the extent carriers choose to recover these costs through individualized assessments on consumers, they have a corresponding obligation to ensure that changes resulting from the Telecommunications Act are explained accurately to consumers, and not to use the restructuring of rates as a smokescreen for unjustified rate increases. I look forward to completing the Commission's "truth in billing" proceeding, where these issues are already under review.

Today's recommended decision is also important for what it does not do. It does *not* mean any reduction in the universal service support currently provided to non-rural carriers. It does *not* preordain any significant increase in explicit universal service funding *nor* create any colorable excuse for carriers to increase charges to consumers. It does *not* preordain any changes whatsoever in the universal service support currently provided to rural carriers.

Issues involving rural carriers are "off the table." Nothing that is done with respect to the large non-rural carriers will necessarily require corresponding changes in the regime for rural carriers. They will continue to operate under the status quo for the foreseeable future, pending recommendations from the Rural Task Force to the Joint Board.

The Joint Board process over the past several months has been a healthy and constructive dialogue between and among federal and State regulators with different perspectives on high cost universal service. Regulators who have to grapple with the problems of having high-cost service areas often have differing views from those who have a proportionately higher number of low-cost consumers.

Although there probably will always be differing opinions about how best to proceed, all sides have been listening to one another, and we have seen some very important breakthroughs. This is exactly how the process should work.

Most high-cost States now acknowledge the legitimacy of certain points previously stressed by the low-cost States. In particular, they generally agree that keeping telephone service affordable is a shared federal and State responsibility, that much of the problem has been managed and can

continue to be managed by the State public utility commissions; and that the federal responsibility should be based on the assumption that States will continue to shoulder their own responsibilities.

Conversely, many low-cost States now acknowledge the legitimacy of certain points previously stressed by the high-cost States. For instance, they generally recognize that some States may have such high costs in certain areas, and such a disproportionately small number of lower-cost lines, that they may require somewhat greater assistance than has historically been provided by the interstate jurisdiction.

Balancing the interests of the high-cost and low-cost States will continue to be a challenge, but I believe the framework recommended today represents a major milestone in the implementation of Section 254. I look forward to continuing the dialogue with the Joint Board members as partners in this proceeding, as the Commission continues with the next vital steps.

Joint Statement of Chairman Julia L. Johnson and Commissioner David Baker

We believe this Recommended Decision is an important step in a long process to bring traditional universal service goals in line with an increasingly competitive local marketplace. The framework outlined in this document will aid the transition to a more competitive arena, if it is properly implemented.

We are mindful of Congress' strong commitment to ensuring that rural, insular, and high cost customers are protected. Thus, we support the Commission's commitment to Congress to hold states harmless. Specifically, in this first step we have ensured that no company, thus customer, will receive less universal service support than it receives today. Although we have tentatively endorsed a forward-looking methodology, we have ensured that nonrural companies still have the safeguard provided by the existing method.

It is not without reservation, however, that we support this recommendation. While we are committed to ensuring that all citizens, both rural and urban, have fair, reasonable telephone rates, we are concerned that consumers from larger urban states not be overburdened with an unreasonably large high cost fund for nonrural carriers. Basic economic principles tell us that competition will develop primarily in the urban areas of urban states first.¹ These consumers will expect to see the benefits of competition through lower prices. Competitive benefits should not be completely eroded through high cost fund surcharges or other rate increases to customers.

While we believe that we can establish a system that will ensure fair and reasonable rates everywhere, we do not believe that regulations can establish, through a regulatory methodology, competition anywhere. Competition is now emerging in urban areas at a much faster pace than in rural areas. But even in the urban areas, growth has been modest.² We are very concerned that an improperly sized fund will overcompensate some areas, creating competition in rural areas not for customers, but for subsidies. Such a distortion of the market will serve as a barrier to true competition in both urban and rural areas.

We are pleased that the Recommended Decision anticipates a high cost fund at or near today's levels. Our endorsement of this recommendation is contingent on a commitment that the Commission will establish a high cost fund that is sufficient to provide for the needs of rural,

¹ As of July 10, 1998, there were 191 competitive local carriers certificated in Florida, 51 of which were providing basic local service to over 194,000 business and residential access lines. The vast majority of these customers were located in Ft. Lauderdale, Jacksonville, Miami and Orlando (1998 Status of Competition report to Florida Legislature).

² In the last year, competitive local carriers have increased their overall share of total access lines from 0.5% to 1.8%. Their percentage of total business lines grew from 1.4% to 4.3%; residential lines rose to 0.7%, compared to 0.2% in 1997 (1998 Status of Competition report to Florida Legislature).

insular, and high cost areas, but will not unnecessarily burden urban consumers from urban states.

Consistent with that commitment, we are troubled by the results to date of the Commission's platform model efforts. There are numerous issues to be resolved before a forward-looking model can be reasonably implemented, even for nonrural companies. Proprietary data, input values, and exorbitant results are but a few of the problems that must be overcome before July of next year. Although we are hopeful that these issues can be resolved, we must make it clear that unless the model produces consistent and rational results we will recommend that the existing system be maintained.

The Commission is investigating universal service and access charge reform concurrently; we expect a decision on both proceedings in time to implement them by July 1, 1999. We generally support the Commission's desire to remove implicit universal service support from interstate rates. We believe that, although universal service is predominantly funded through intrastate mechanisms, there is probably implicit universal service support in interstate access charges. It does not appear that, given today's marketplace, it is either simple or necessary to specifically identify the support at this time.

We see merit in industry plans that would remove "implicit universal service support" from interstate access charges. The difficulty, however, lies in quantifying those portions of interstate access charges that constitute universal service support. We believe it is possible to construct a system that will lower long distance rates for consumers without negating all of the benefits of the reductions through excessive surcharges. The Commission and Joint Board should continue to evaluate methods that benefit all classes of customers. To do so, the Commission should concentrate its efforts to ensure that all rate reductions are passed through to customers in an equitable manner so that all classes of customers benefit. Surcharges, if modest enough, could allow both low volume and high volume customers to benefit from the change in rate structure. Additionally, to ensure that customers continue to receive the benefits of access reform, *any* plan, whether through restructuring access rates or moving implicit universal service support into the universal service fund, should include an aggressive mechanism that would reduce rates or support over time, reflecting the continually declining costs of the telecommunications industry.

The Joint Board must continue our work with the Commission, even after the model platform becomes workable. Our support of this recommendation is contingent on an agreement that the Joint Board will have additional opportunities for input into the implementation of the forward-looking cost model, as well as any access charge reform issues that are directly related to universal service. We look forward to working with the Commission and its staff over the next six months and beyond.

Separate Statement of Public Counsel Martha Hogerty

The Joint Board's Recommended Decision issued today recognizes first and foremost that the Act requires consumers in rural and high cost areas have access to rates and services that are reasonably comparable to those in urban areas. Congress recognized that the competitive policies of the 1996 Act must not do damage to the longstanding policy of assuring universal service to all citizens. Competition will develop in the urban areas first, driving down those rates, thereby placing pressure on affordable and comparable rates in rural areas. Thus the focus of this Recommended Decision is to establish a framework to ensure reasonable comparability, a fair range of urban and rural rates, both within and among states.

We continue to support the use of a forward-looking model to calculate support, although we recognize that until a reliable model is developed, the current mechanism should continue on an interim basis. We specifically recommend that inputs to the model must not be proprietary, rather they must be fully open for testing and comment.

We have established a framework whereby total high cost support is developed using an average cost on a study area basis in conjunction with a nationwide average cost benchmark. Each state is expected to support its own high cost requirement up to a reasonable level. The remaining support constitutes the federal support to be distributed to the carriers in that state for intrastate purposes. I look forward to working with the commission to develop the final parameters for this framework that will ensure reasonable comparability.

We anticipate that the federal fund established to distribute high cost support to the state jurisdiction will be reasonably close to the current level. This is appropriate given the general absence of competition at the local level.

Further, the recommendation focuses on reasonable comparability and not on the elimination of implicit support. In my view, this approach is appropriate. Section 254 does not require that regulators take measures to identify and eliminate all "implicit support." Previously, universal service support, including LTS and DEM have been made explicit. It is my belief that no further actions are required of this kind. Competition will eliminate any "implicit support" that is implicit within rates. Regulators should not attempt to do this because they are unable to replicate the market, a market that does not exist and that they do not fully understand. Such an approach could make matters worse, creating perverse incentives and perhaps resulting in unnecessarily high rates. Competition holds the promise of lower, not higher rates.

Consistent with our view on implicit support, there is no recommendation that a state remove implicit support or that a state establish a universal service fund. Each state is free to address its own universal service requirements as it sees fit. Similarly with respect to the interstate jurisdiction, we do not recommend that the commission identify and eliminate implicit

support from interstate access rates. Competition for access at the federal level has not evolved any more than local competition at the state level. If the Commission decides to transfer some revenues that are now generated through access charges into the universal service fund, there is a danger that access rates now subject to price cap adjustments will be shielded and protected from appropriate reductions. Further, any consideration of access charge reductions should take into account the fact that the Commission's July, 1998 report, "Trends in Telephone Service," revealed that 68 percent of the total loop costs reflected in access revenues are borne by universal service. Since the loop has consistently been recognized as a joint and common cost, the current allocation does not appear to comply with section 254(k). That section provides that universal service shall bear no more than a reasonable share of joint and common costs. If the Commission moves some portion of access charges into the universal service fund, it should seriously consider making an offsetting reduction to the Subscriber Line Charge.

Finally, we recommend that carriers that recover their universal service contributions through a line item on the customer's bill should do so in a manner that is truthful and not misleading. Misleading and confusing consumer bills are a serious problem. Because of its urgency, the Commission should act promptly on this issue.

I look forward to continuing to work with the Commission on this most important issue of ensuring that all consumers have affordable and reasonably comparable rates and that the Act does what it was intended to do, protect consumers as the market develops.

November 23, 1998

**Separate Statement of
Commissioner Gloria Tristani,
Dissenting in Part**

Re: Federal-State Joint Board on Universal Service, Second Recommended Decision

I support today's recommendation by the Universal Service Joint Board. I believe that it fairly and responsibly balances the need to provide sufficient federal support to carriers serving high cost areas with the need to avoid creating an unreasonably large federal universal service fund.

It should be noted that the Recommended Decision expresses appropriate caution regarding the use of a cost proxy model to calculate federal support. Specifically, if the cost proxy model now under development would produce excessively high or low federal support amounts, the Joint Board recommends that the Commission retain the longstanding mechanisms for providing support. Whether the model will produce appropriate support levels will not be known until the Commission, in consultation with state members of the Joint Board, adopts the inputs to the model and makes the difficult policy decisions addressed in this Recommended Decision.

I am very pleased that the Recommended Decision also contemplates some circumstances in which carriers could use federal support to connect areas that are unserved today. Congress charged the Joint Board and the Commission with the preservation and advancement of universal service. I believe that connecting unserved areas is within our mandate under section 254 and should become a higher priority for the Commission. I look forward to a Commission proceeding to examine the nature and extent of the unserved areas problem.

While I support most of today's Recommended Decision, I am uncomfortable with its treatment of three discrete issues. Therefore, I respectfully dissent from those aspects of the Recommended Decision. The first issue is the Joint Board's recommendation regarding which carriers receive more explicit federal support than they receive today. The first step in that determination is to identify non-rural carriers whose costs, on a study-area basis, are "significantly above" the national average. The Recommended Decision determines that the appropriate cutoff for this first step is somewhere between 115 and 150 percent of the national average. That may turn out to be right, but it is not clear to me that we have a record to make this recommendation. We have no model to work with at this point because the Commission has not determined the model's inputs. Without a working model, I am unable to say that a cutoff in the 115-150 range

will permit the Commission to strike the right balance between providing sufficient support to high cost areas while minimizing the overall burden on consumers nationwide.

Second, I also note that the Recommended Decision appears to encourage the Commission to assess contributions for high cost support on intrastate revenues as well as interstate revenues. I believe a more neutral approach on this issue would have been prudent because the Commission's legal authority to assess intrastate revenues will be clarified by the courts in the near future. Moreover, I am not sure whether it would be desirable for the Commission to assess both interstate and intrastate revenues if it turns out that some state commissions are legally unable to do the same. For these reasons I would have reserved judgment on that issue.

Third, I would have preferred that the Recommended Decision take a less definite position regarding the proposal to distribute high cost support directly to state commissions rather than to carriers. I believe the current record does not provide a sufficient basis for the Joint Board's rejection of this idea. Even though my initial view of this proposal is that the current distribution mechanisms better serve our goals in this area, I believe the alternative distribution proposal merits further consideration.

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November 24, 1998

**DISSENTING STATEMENT OF COMMISSIONER
HAROLD FURCHTGOTT-ROTH**

*Re: Federal-State Joint Board on Universal Service, Second Recommended Decision;
(CC Docket No. 96-45).*

Nearly nine months ago, many States requested that the Federal Communications Commission refer several issues related to universal service in rural America to the Federal-State Joint Board on Universal Service. After several months of reflection, the Federal Communications Commission did refer several issues to the Joint Board, in part to better understand State perceptions of universal service in high-cost, rural America. The recommendations today are in response to that referral.

It has long been a fond hope of mine to be part of a unanimous or majority recommendation to the Commission on universal service. I have reviewed a series of draft items from the Common Carrier Bureau, and I have gone to great lengths to suggest edits. I have tried mightily to find common ground. It has, however, become increasingly difficult, and in the end, there is little that I can comfortably support in this recommendation. Indeed, there is much that causes me great discomfort as an economist, as a Federal Commissioner, as a former Congressional staffer who worked on universal service, and as a mere citizen who has listened to many of the universal service concerns of rural America.

Just a few of the concerns that I have with this item include: the adoption of a cost model for universal service support; the recommendation of a cost model without knowing results; the fact that this cost model may be used to reform access charges without knowing the results; the failure to hold all States harmless as to the total amount of federal support they currently receive; the refusal to ask to have issues referred back to the Joint Board after the inputs have been selected; and the indication that intrastate revenues could be assessed for the federal universal service program. In addition, I expressly note my agreement with many of the issues raised in Commissioner Schoenfelder's dissent. With such numerous concerns about both the specifics found in and the framework used in this recommendation, I must respectfully dissent from this item.

I. Federal Proxy Cost Models Should Not be Adopted to Distribute Universal Service Subsidies, Especially When the Results of the Model Are Not Even Known.

As an economist, I have spent much of my professional life building and evaluating economic models; I do not believe that a hypothetical proxy model can or should be used to determine the cost -- whether actual or forward-looking -- of providing service to every

individual, including those located in the remotest regions of our country. Moreover, I object to using such a model to determine the total federal universal subsidy that is now needed or to distribute that subsidy among the States.

A. Historic Struggle of Freedom Versus Excessive Regulation

One of the great intellectual struggles of the Twentieth Century has been between those who believe that the public is best served by the unencumbered activities of markets and those who believe that markets are often if not always flawed and that a relatively small but intelligent group of government employees can intervene in markets to better manage economies for the public benefit. Many eminently sensible arguments have been put forward for government intervention. Some have economic-sounding reasons such as market failure; some have social-sounding reasons such as income redistribution or industrial policy; and some have raw political-sounding reasons such as this or that group is too rich or too poor. Many clever people have argued on each side of this debate, but practically all empirical evidence tends to support the former approach as benefiting the masses in the public rather than the latter. The most extreme -- but by no means only -- form of the latter approach was of course communism.

Perhaps two of the most salient features of a market are the price and quality of a product or service. Prices and quality characteristics in unencumbered markets are set by the markets themselves and the interplay of consumer demand and business supply. Prices and quality characteristics in highly regulated markets are set by the government through the efforts of individual government employees. In modern economies with countless thousands of markets and countless thousands of prices and quality characteristics, the sheer enormity of setting prices and quality characteristics is a Herculean task. The brightest minds with the most sophisticated computers have been employed, and, in every instance, they perform far worse than an unencumbered market. The proper solution has never been to hire brighter people or build ever more sophisticated computers that can support ever more elaborate and detailed models. The proper solution is always to get rid of market regulation, and in the process, get rid of the price models and allow the brightest minds to find more gainful employment than regulating markets.

B. Economic Models Have Inherent Limitations and Change Over Time

Economic computer models have many valuable purposes. They can and do inform our understanding of the functioning of existing and past markets and the sensitivity of those markets to small perturbations. Models may mimic or approximate current or past markets, but they never exactly replicate them. Models are useful tools to expand our economic understanding, and they attract many of the finest minds in economics.

But models cannot predict the future. They are simply a reflection of what is known today. As technology changes and as markets change, economic models become obsolete. An

empirical finding based on a model today might reasonably change tomorrow. The instability of empirical economics cannot be overcome with ever better models; it is rather a property of using models themselves.

C. Economic Models Are Not Well Suited to Form the Basis of Price Regulation

It is widely accepted that economic models are not as efficient as actual market outcomes. Less familiar is that regulation of markets through models is also less equitable. There are at least three reasons. First, there is no easy appeal of model results. Few people understand how any model works; fewer still understand complex models; no one really understands models that produce no results. Models entail a certain degree of opacity in contrast to the transparency of markets and market outcomes, or even in contrast to simpler rules based on accounting information or even simpler information.

Second, models are more easily corrupted than markets. Markets have countless players, and competitive markets have countless more who want to play in the market. Ordinary individuals have many choices when unhappy with market outcomes: adapt, enter or leave markets, or -- to the extent legal rights are affected -- defend those rights in court. When a powerful and influential individual is unhappy with a market outcome, it is practically impossible for that individual to alter the market outcome in any manner different from that of an ordinary individual. Manipulation of outcomes as a powerful individual is impossible in competitive markets. This is simply because it is physically impossible to influence or corrupt everyone in a competitive market. Similarly, even an appeal of a regulatory rule based on accounting data cannot easily be manipulated. Accounting rules apply across many markets, not just one, and appeals are often heard and understood in courts of law.

Regulation, particularly by models, is different. It involves a finite -- often small -- number of individuals. They are not necessarily easily influenced, much less corrupted, but the temptation is certainly there. Moreover, regulation involves a process that may be hindered or delayed more easily by influential people than by ordinary citizens.

Third, models lead to inherent uncertainty and instability. The results of a model at one point in time can be arbitrarily helpful or harmful to one individual. The key word is "arbitrarily." Models can easily be changed, and often are. An apparent benefit one day can become a liability tomorrow. The net effect is unpredictability and uncertainty. Again, the instability of economic models cannot be overcome with ever better models; it is rather a property of using models themselves. As such, I do not believe that any economic cost model could meet the "specific and predictable" standard required of the federal universal service support mechanisms by the Act.¹

¹ 47 USCA section 254(b)(5).

Regulation based on accounting rules or even simpler rules may provide -- at any moment in time -- a less accurate portrayal of a competitive market than an economic cost model potentially could. Simpler rules such as accounting rules are far more transparent to the world, are not easily corrupted, are easily appealed, and provide a greater degree of market certainty and stability.

D. The Telecommunications Act of 1996

Most American markets in the 20th Century operated without substantial government encumbrance. Retail grocers could buy and sell groceries without substantial regulation of price or quality. Such a benign approach to markets could not be said for telecommunications. Throughout most of this century, little happened in telecommunications markets without explicit government approval, and such approval could often take years, if ever. Government officials, not consumers, determined which telecommunications services a consumer could potentially purchase and from which business a consumer could purchase those telecommunications services. Government officials, not competitive businesses, decided which customers a business could serve and which services the business could offer. The details changed over time, but the constant throughout was that government had substantial influence on how markets operated; indeed, government might have been said to manage American telecommunications markets.

The Telecommunications Act of 1996 was landmark legislation. Previously, telecommunications markets by federal and State statute were micromanaged by both federal and State regulation and were largely closed to competition, unconstrained by price movements and all too often innovative ideas. Throughout the Telecommunications Act's various statements of objectives, the concepts of *competition* and *deregulation* for telecommunications markets are often repeated. Balanced with these concepts is *universal service*, particularly in rural America as expressed in Section 254. Under the Act, competition and deregulation were not antithetical to universal service; indeed, competitive markets were the most likely and efficient way to ensure universal service.

It is not a gross exaggeration to say that Act was in part intended to end price modeling and regulation in competitive markets and to ensure that all statutory barriers to market entry have been reviewed. Simply stated, Congress expected some fairly *revolutionary* changes in opening up telecommunications markets by removing barriers to entry and removing restrictions on consumer choice. But Congress also wanted to preserve existing universal support and other support mechanisms. Congress wanted to be sure that no additional unnecessary uncertainty would be injected into rural markets. In the area of universal service, Congress expected *evolutionary*, not *revolutionary* change.

Sadly, it seems that we are in this Recommendation now headed in the opposite direction on universal service: more modeling, more price regulation, and more uncertainty in rural America.

E. Universal Service Is a Matter of Equity, Not Efficiency

It is popular at times to promote an idea in telecommunications regulation by claiming that it will lead to more "competition." For example, this item repeats the Commission's earlier claim that carriers should receive universal service support "based on the forward-looking cost of providing the supported services, because forward-looking costs provide the best measure of sufficient support that sends the correct signals for efficient entry and investment."² Sometimes these claims are true; sometimes not. Sometimes the purpose of a program or regulation is neither efficiency nor competition. Such is the case with universal service; its primary purpose is equity, not efficiency.

Universal service programs were not created to bring competition to rural America. They were designed rather to increase the mere likelihood of telecommunications service in rural America particularly by reducing financial uncertainty. They were designed for areas of the country in which the cost of service was likely to be above the willingness of most people to pay; in essence, universal service was designed to subsidize one service provider where otherwise none might exist.

Both this recommendation and the Commission's previous orders mistakenly believe that forward-looking economic costs should be used for universal service to promote competition. The language of Section 254, however, is also not about bringing competition to rural America. Universal service support may not go to anyone, but only to eligible telecommunications carriers as designated by States. States are never under any obligation to designate more than two eligible carriers, and in areas served by rural carriers, States are not even obligated to designate more than one carrier.

Bringing competition in telecommunications services to rural America is a noble goal, and one I fully support. It is, not however, the statutory obligation of the Commission under Section 254. In a perfectly competitive market, there would be no need for a universal service support program. While hundreds of carriers rush to serve low-cost, high-volume, urban business markets, competition has yet to appear in much of rural America. It may, and it will in good time.

The structure of the current universal service program is neither a clear attraction nor barrier to competition in rural markets. Modifying the current program would not likely result in any more or less competition in rural America, but such changes will lead to more confusion and

² Second Recommended Decision, at para. 9.

uncertainty in rural markets. Some people may like change for the sake of change even without tangible benefits; I do not.

Some have suggested that we change the current program and embellish the new program with fancy-sounding names like "forward-looking" and "pro-competitive" as if the use of attractive labels and wishful thinking will lead to more competition in rural America. I do not doubt the good intentions or motives of these efforts. But I do seriously doubt the effectiveness of these efforts. Indeed, I am not even sure whether the proposed changes will lead to more efficiency or not. And I have substantial doubts whether it will be more equitable.

There is something of an oxymoron in the phrase "efficient subsidies." Subsidies and transfer do not exist for the purpose of efficiency. Economic models that are truly based on efficiency cannot possibly be informative about subsidies. Models based on efficiency will always lead to zero subsidies; otherwise, they would not be perfectly efficient.

In a world of perfect competition -- the paradigm upon which forward-looking cost models are ultimately based -- the advance of technology and competition among firms for subsidies will drive those subsidies to zero. That may be the right answer in a world of economic theory, but it seems a far cry from the political reality of Congress. Moreover, it seems a far cry from the reality of rural America where competition is slim, with or without government subsidies. It makes little sense to consider what competitive prices might be in a hypothetical world, but it makes abundant sense to consider what is necessary to insure continued service in the real world.

At bottom, universal service is not about "economic efficiency;" it is about fairness. But fairness cannot be found in this or any model. Search as hard as you like, but no matter what any bureaucrat tells you no model can determine what is fair. Because ultimately, fairness is determined not based on some quantifiable "inputs" run through a computer "platform," but on intangible values that cannot be captured in a model.

F. Why We Do Not Need a Model for Universal Service.

I have explained on previous occasions why we do not need a cost model for universal service, and I incorporate those arguments by reference here.³ My primary arguments for not endorsing a model have been and are that: (1) we don't even know what the results of a federal model and inputs will be; (2) even if the models can play a helpful role in determining relative costs between high cost and low cost areas, they are an inappropriate tool for determining the absolute cost of service to any particular area; (3) the proposed model is designed to determine

³ Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, rel. October 22, 1998; Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding the Federal-State Joint Board Report to Congress, rel. April 10, 1998.

prices in a competitive market, but the purpose of universal service is to insure telephone service where competition is absent today; and (4) the adoption of the model along with the hold harmless provision results in a higher explicit universal service fund for these largest carriers.

II. The Standard for Determining When Costs Are Significantly Above the National Average Is Not Supported by the Record.

The recommended decision concludes that the standard for determining how much support a carrier should receive is whether or not their costs are "significantly above" the national average, which the Joint Board recommends be set at somewhere between 115 and 150 percent of the national cost. First, as anyone can see, such a range is unusually broad, and would encompass widely disparate results. But more importantly, I do not believe that the Joint Board had a sufficient record before it to make such a determination. As I have indicated elsewhere, the Commission has no model results before it because the inputs have not yet been selected. Without a working model or any final results, how can any member of the Joint Board guess as to what the appropriate cut-off will be for what costs are "significantly above" the national average, even within such a broad range? Moreover, the Joint Board recommends such a framework with no clear indication of how such a framework will actually impact the universal service subsidy system.

III. The Methodology For Distributing Support Presupposes a Universal Service Burden on the States, Establishing a De Facto Requirement of an Intrastate Universal Service Fund.

Again without the benefit of any federal model runs, the Joint Board seems almost arbitrarily to discuss a range of *possible* levels of State contributions "between 3 and 6 percent"⁴ as an example of what the Commission could assume States will provide. While not explicitly "mandated," the methodology for determining federal support includes calculating such a level of support that should then be assumed to be provided by the States. As an example, the Joint Board indicates that a State's "presumed responsibility [] could be between 3 and 6 percent of intrastate telecommunications revenues."⁵ But again, the Joint Board seems to discuss such a standard with little or no basis. Without a working model to determine fund size, how can any estimate be anything but arbitrary.

⁴ Second Recommended Decision, at para. 45.

⁵ Second Recommended Decision, at para. 45.

In addition, the fact that the Joint Board presupposes a State contribution level seems to conflict with other recommendations in the report. When discussing the methodology for determining federal support, the Joint Board determines that this step is "necessary" to determine the level of federal support as it "should only be used to *supplement* a state's ability to address its own universal service needs."⁶ But earlier in the recommendation, the Joint Board also concluded that:

The Federal Support Mechanism need not take into account the state's authority and ability actually to establish state universal service support mechanisms, since carriers may be required to recover more total support than the amount used exclusively for purposes of developing the federal fund. . . . Any state is then able to *supplement*, as desired, any amount of federal funds it may receive under this standard.⁷

The purpose of a State fund and the intention of these two statements seem inconsistent to me. I am unable to determine whether a State should be able to establish an intrastate fund to supplement federal support after some amount has been established that is necessary to achieve "reasonable comparability," or whether a State fund is assumed to be established as part of determining the appropriate level of federal support. Which fund is "supplementing" which fund? I suppose the answer is both. In any event, I do not support either an explicit or an implicit federal requirement that States establish intrastate universal service funds.

IV. The Federal Cost Proxy Model Should Not be Used For Access Reform.

I acknowledge that the distribution method recommended here does not address access charge reform, but that does not preclude the Commission from still using the model to determine the total size of subsidy needed now and thus "backing out" the amount of implicit support currently in access charges according to the model. Indeed, the item almost anticipates that the Commission will use the model for such a result.

I question whether a national cost model can or should be used for access charge reform or to make access charges explicit. First, as I indicate below, I believe that the Commission has made a commitment to hold all of the States harmless as to the total amount of support that they receive through explicit and implicit means today, with the expected reductions in the productivity factor. I agree with the sentiment expressed by some Joint Board members that there is a great deal of merit in recent proposals to make some portion (CCL and PICC) of access charges explicit. Indeed, I have advocated a similar approach. But I am also concerned with unilaterally

⁶ Second Recommended Decision, at para. 44.

⁷ Second Recommended Decision, at para. 37.

declaring that the recovery of these costs is universal service when such a determination may be more properly made in conjunction with the Separations Joint Board.

Moreover, I am concerned that such a determination at this time might endanger all of universal service. Current federal universal service support for non-rural carriers in high-cost areas is relatively small by national standards, but the adoption of the model will necessitate it getting bigger.⁸ Using the model to reform access for these carriers, however, would make the fund substantially larger. Regardless of the exact size of the increase in the universal service fund, I am concerned that it could threaten the viability of the entire universal service scheme. Any further increase in the universal service scheme will result in higher fees for customers, who already feel overburdened.

V. The Commission's Cost-Proxy Model Should Have Been Referred Back to the Joint Board After the Inputs Have Been Selected and Cost Estimates Can Be Provided.

As I have described above, I have serious reservations about the benefits of using a cost proxy model to size and distribute federal universal service support. And while everyone might not agree with all of these concerns, many members of the Joint Board have expressed some concern with recommending a framework when the Joint Board has not seen the ultimate results that such a framework would produce. I fear that the Joint Board may not be fulfilling its responsibilities when it endorses the use of a federal model without any formalized plan for recommendations regarding inputs or for a reevaluation of the framework after those inputs have been selected and final numbers are available. I advocated referring the issue back to the Joint Board after inputs have been selected and cost estimates can be provided. I note that the recommended decision does ask the Commission to continue to "consult" with the Joint Board. While such informal consultation is nice, it is the formal recommendation process that allows the States some degree of input into the decisions that affect them.

Moreover, even the recommendation acknowledges that the new universal service support system may need to be "gradual[ly] phase[d]-in."⁹ Thus, no one seems to be arguing that the model needs to be adopted now because of current market conditions. If that is so, and I would agree, I would prefer a shorter phase-in period, but an opportunity to review the results of the outputs of the model. These results must be only months away if the plan is to start using the

⁸ For the Fourth Quarter of 1998, these funds are projected to be \$253 million on an annualized basis, of which \$140 million are for Puerto Rico. Twenty-two States plus the District of Columbia, Guam, the Northern Mariana Islands, and the Virgin Islands receive no support. Of the twenty-eight States that receive support, only two--Alabama and North Carolina--receive more than \$10 million, and average support is much less than \$5 million annually.

⁹ Second Recommended Decision, at para. 53.

model anytime soon. Why can't the Joint Board see the results of the model and selected inputs prior to determining whether or not it should be used to distribute universal service support? Don't we need to see the results of the model and its inputs before we can make any judgement about the appropriate level of federal support or even a State ability to contribute?

The adoption of a model framework requires that the Commission determine a level of federal support. This 25/75 issue has been extremely controversial and an issue about which I believe the States need to have further input once the model results are known. I recognize, however, that it is difficult to discuss this issue in a vacuum. The Joint Board needs to be able to evaluate what costs the federal model will produce in order to evaluate the extent of federal support that will be needed. I advocated adopting a streamlined approach for the Joint Board to review the model and proposed input results. Such an expedited review could have occurred within a limited time-frame -- 90 days -- of being able to review the results of the selected platform and inputs on a State-by-State or carrier-by-carrier basis.

The most important message that we can send is not that universal service should be used to foster new competition or that the federal government has determined the exact cost of providing service to every customer in the country, but rather that the Joint Board will first and foremost make sure that no harm is done to current high-cost customers by either the development of competition to low-cost customers or by committing to a framework that requires us to change the current system before competition requires it thus resulting in harm to some telephone ratepayers through either a decrease in total federal support or an increase in the universal service subsidy. By endorsing this model framework without seeing the results, the Joint Board is going on blind faith that the universal service subsidy scheme will not be harmed.

VI. The Joint Board Should Have Agreed to Commit to Never Applying These Models to the Rural Carriers.

Models may approximate the costs of service for the majority of Americans, but approximate poorly for Americans living in unusual, low-density, geographic areas. Yet it is precisely the unusual circumstances that may most likely require universal service support. Models work least well where we have the least information about where people live; unfortunately, again it is the most rural and remote areas about which we have the least geocode information. Thus, even if the Joint Board were going to endorse a model framework, I would have been even more explicit in promising that such a model would never be applied to the small rural carriers. I appreciate the Joint Board's recommendation that this model do not create any binding "precedent," but I had advocated stronger language promising never to apply the model to the rural carries.

Moreover, it is not unanticipated that this model could be used for the small rural carriers. As they are an even larger piece of the universal service puzzle, we should at least have some idea of how this model would effect the overall level of support that those carriers would receive under the model.

Finally, I am concerned that we are addressing the needs of the non-rural carriers and providing them with additional support before we are addressing the rural carriers. As discussed elsewhere, the adoption of a model in combination with the hold-harmless pledge necessitates a larger universal service fund. If high-cost support is to increase, I am skeptical that a model that applies only to non-rural carriers is even practical. If universal service support is to increase, why should it increase only for non-rural, high-cost carriers? Why not rural telcos as well? Or why not low-income households? Thus, I would also have recommended a public commitment to increase the size of the rural high cost support by at least as much as we are increasing the size of the non-rural fund. Section 254 was primarily directed to provide support to carriers serving the most rural areas. After the adoption of a model and the increase in the amount of explicit universal service support to the largest non-rural carriers, we will have increased support for the new pieces of the universal service scheme (schools and libraries, rural health care), and we will have increased support for other existing recipients (large non-rural carriers, lifeline and link-up), while still failing to address those that the Section was primarily intended to benefit. I cannot support such an increase without a commitment to also increase the support to the rural carriers in a commensurate fashion.

VII. The Commission's Commitment to Hold Harmless the States and Carriers Should Have Applied to Both Explicit and Implicit Support.

Last April, the Commission indicated to Congress that, under new universal programs, we would hold States harmless. Specifically, the Commission indicated:

[W]e note that the pre-may 1997 regulatory scheme created a de facto allocation of responsibility between the Commission and State commissions with respect to support for service to rural and high cost areas. The allocation of responsibility was defined by the separations rules, which placed 25 percent of booked loop costs in the interstate jurisdiction for most of the loop plant used by the non-rural LECs. . . . [W]e conclude that a strict, across the board rule that provides 25% of unseparated high cost support to the larger LECs might provide some States with less total interstate universal service support than is currently provided through aggregate implicit and explicit federal subsidies. The Commission will work to ensure that states do not receive less funding as we implement the high

cost mechanisms under the 1996 Act. We find that no state should receive less federal high cost assistance than it currently receives.¹⁰

The plain language of this promise indicates that the Commission would ensure that States did not receive less in federal support than they do currently through explicit universal service funding and implicit support embedded in access charges. Thus, additionally allocating support using the model should allow States to choose the greater of what they would get under the model, or what they previously received through federal explicit and implicit support.

I object to the recommended decision's implication that all the Commission promised was to hold the States harmless as to the current *explicit* fund. Despite claims now to the contrary, I believe that the Commission promised Congress to hold the States harmless for their total level of support -- i.e. guarantee that the adoption of a new federal universal service subsidy scheme would not result in any State receiving "less total interstate universal service support than is currently provided through aggregate implicit and explicit federal subsidies."¹¹ I do not see how we will now claim that we were only talking about the current explicit fund, when the language quoted above goes farther.

My impression is that many carriers and States -- and indeed many Members of Congress - believe that universal service programs promulgated by the Commission will hold both carriers and States harmless. Indeed, the statute itself speaks of the "preservation" of universal service, not its reallocation, and I cannot support a recommendation that does not at least "preserve" the status quo.¹²

VIII. Block Grants to States Are a Viable Option that Should Have Merited Further Comment and Consideration.

I do not believe that block grants to the States, with the express requirement that they be given to eligible carriers, would violate the statute or contravene the legislative history. The recommended decision argues that "we cannot recommend that the Commission adopt that mechanism, in light of the long-standing practice at the time that the 1996 Act became law of distributing federal universal service support to the carriers providing the supported services, and the absence of any affirmative evidence in the statute or legislative history that Congress intended

¹⁰ *Federal State Joint Board on Universal Service*, CC Docket 96-45, April 10, 1998 Report to Congress, FCC 98-67, at para. 197.

¹¹ *Federal State Joint Board on Universal Service*, CC Docket 96-45, April 10, 1998 Report to Congress, FCC 98-67, at para. 197.

¹² 47 USCA section 254 ("preserve and advance" universal service).

such a fundamental shift to a State block grant distribution mechanism."¹³ I didn't realize that was the standard for determining whether a policy decision was allowed under the statute. More importantly, however, I do not see how adopting a "forward-looking cost model" would meet such a standard. Prior to the Act's passage, there was a "long-standing practice" of distributing support through a variety of other mechanisms based on embedded costs, and I can find no "affirmative evidence in the statute or legislative history that Congress intended such a fundamental shift" to forward-looking cost models. If Congress had intended that the Commission use models surely they would have at least mentioned them.

IX. The Federal Universal Service Fund Cannot and Should Not Assess Intrastate Revenues.

The recommended decision indicates that there are benefits to assessing on both inter- and intrastate revenues and encourages the Commission to consider so assessing if the Fifth Circuit determines the Commission may do so. As I have described on several occasions, I object to this federal agency assessing contributions based on intrastate revenues, I expressly incorporate my earlier statements here,¹⁴ and I would have preferred to acknowledge the legal difficulties with the federal government using intrastate rates to assess universal service contributions.

Section 2(b) of the Communications Act creates a system of dual federal-State regulation for telecommunications.¹⁵ In essence, the Act establishes federal authority over interstate communications services while protecting State jurisdiction over intrastate services. The legality of this agency assessing intrastate revenues for the purpose of calculating a universal service assessment is highly questionable. As I read the Communications Act, it does not permit the Commission to assess contributions for universal service support mechanisms based on intrastate revenues. Rather, the power to collect charges based on such revenues rests within the exclusive province of the States. Conversely, only the federal government and not the States can tax interstate revenues.

In addition, assessing intrastate revenues at the federal level but only allowing carriers to recover on their interstate rates violates the statutory requirement that the funding mechanisms for

¹³ Second Recommended Decision, at para. 61.

¹⁴ Separate Statement of Commissioner Harold Furchtgott-Roth Regarding the Second Quarter 1998 Universal Service Contribution Factors, rel. March 20, 1998; Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding the Federal-State Joint Board Report to Congress, rel. April 10, 1998.

¹⁵ Section 2(b) of the Act provides that "*nothing* in this Act shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." 47 U.S.C. section 152(b)(emphasis added).

universal service be equitable and nondiscriminatory. Section 254(b)(4) embodies the general principle that contributions to universal service must be equitable and nondiscriminatory. The recommended decision does not indicate that the FCC should permit carriers to recover these contributions through their intrastate rates, and it should not as the Commission has no authority over intrastate rates. But the federal assessment of intrastate revenues -- and particularly the inability to recover in the same jurisdiction -- creates a competitive disadvantage for interstate telecommunications carriers that provide intrastate services.

First, these carriers also compete, in local markets, against purely intrastate carriers. The interstate carriers, however, are forced to pay more in universal service fees because they have federal obligations that their intrastate competitors do not. As the dissenting State members of the First Joint Board explained, "a carrier with intrastate revenues of a billion dollars a year would be subject to no federal USF assessment at all, while a carrier with \$999,999,999.00 of intrastate revenue and one dollar of interstate revenue would be subject to assessment for the whole billion dollars of its revenue."¹⁶

In addition, the carriers that have both interstate and intrastate revenues are also at a competitive disadvantage vis-a-vis their purely interstate competitors. While the universal service contribution would be based on both interstate and intrastate revenues, a carrier would be limited to recovering the entire contribution through interstate rates. As it has no jurisdiction over intrastate rates, the Commission cannot ensure that carriers would be able to recover the intrastate portion of the contribution in their intrastate rates. Thus, a carrier is required to recover assessments on its intrastate revenues in its prices for interstate services.¹⁷ This recovery mechanism discriminates against carriers who derive a significant amount of their revenues from intrastate activities, as their recovery rates for interstate services would be higher than their purely interstate counterparts.

Thus, a scheme that contemplates assessment on one source of revenues but recovery on another must adversely effect the ability of some interstate providers of intrastate services to compete with purely intrastate providers and with purely interstate providers. Such disparities cannot meet the section 254 requirements that contributions to universal service be equitable and nondiscriminatory.

Finally, the assertion of federal authority over intrastate revenues could impinge upon the States' ability to establish their own universal service funds, which Congress expressly provided for in section 254(f) and envisioned in Section 254(h). As several others have questioned, assessing on both interstate and intrastate revenues at the federal level may be inequitable to the

¹⁶ Dissenting Statement of Commissioners Kenneth McClure, Missouri Public Service Commission and Laska Schoenfelder, South Dakota Public Utilities Commission, April 21, 1997.

¹⁷ Second Recommended Decision, at para. 62 and footnote 68.

extent that any States are legally precluded from assessing contributions to any State universal service fund based on interstate revenues.

I do find much merit to the recommended decision's alternative approach of assessing carriers on a flat, per-line basis.¹⁸ Such an approach addresses the problem of carriers who do not routinely classify their revenues as interstate or intrastate (e.g. wireless carriers) without encroaching on any States' jurisdiction.

Like members of many other professions, economists do not agree on everything, but most would agree on a few simple principles, among which are the following: regulation can lead to distortions in markets; setting prices too high in a market can lead to excessive supply; setting prices too low will lead to excess demand; and the most efficient way to redistribute income is never by distorting prices in an individual market but rather by collecting revenue through an unavoidable or "lump-sum" tax and then to distribute the revenues to targeted individuals.

X. Carrier Recovery of Universal Service Assessments.

In the Truth-in-Billing NPRM, I wrote separately to express my concerns with this agency's direct involvement in commercial billing issues and whether this exercise is a wise use of limited Commission resources. I continue to have deep reservations about the extent of the Commission's authority over the commercial relationship between carriers and their customers. I am not convinced that the Commission has specific statutory authority to regulate a bill's description of that commercial relationship or even the truthfulness of that correspondence. I am especially concerned, however, about regulation of billing when there is nothing factually inaccurate about the carrier's description but it does not reflect the government's preferred explanation. In this regard, I am concerned that the proposals discussed here not be used to pressure carriers, even indirectly, to remove or alter any current line items or charges; neither should these proposal be interpreted as suggesting that carriers have misrepresented any facts.

Indeed, as I have stated before, while the method of recovery is not required, the underlying contributions by the carriers are mandated by the government. "[N]o carrier should have its billing information restricted or limited by the Commission. The Commission has explicitly provided carriers with the flexibility to decide how to recover their payments, including

¹⁸ See, e.g., Separate Statement of Commissioner Harold Furchtgott-Roth Dissenting in Part, Order and Further Notice of Proposed Rulemaking Regarding Wireless Carrier Contributions to Universal Service, rel. October 26, 1998.

as charges on consumers bills, and I am concerned by implications that such charges are fraudulent or misrepresentations."¹⁹

Moreover, there are other federal agencies that may have overlapping or concurrent jurisdiction with regard to these billing issues. In particular, the Federal Trade Commission may have not only overlapping jurisdiction but more direct authority, as well as considerably more expertise in the area of consumer protection and fair advertising. As such, I am reluctant to devote what will be considerable FCC staff resources to these issues when another agency may have substantially more staff that specialize in consumer fraud issues.

Finally, I note that the Commission currently has a proceeding dealing with these issues before it, and look forward to working through these issues more thoroughly in that context.

¹⁹ Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding the Report to Congress in Response to Senate Bill 1768 and Conference Report on H.R. 3579, rel. May 8, 1998.

**SEPARATE STATEMENT OF
COMMISSIONER LASKA SCHOENFELDER
DISSENTING**

When the state members of the Joint Board asked the FCC to refer several issues to the Joint Board for further recommendation, I expected we would be able to arrive at definitive, well supported recommendations. It is with a great deal of disappointment and dissatisfaction that I write this dissent. I have always been skeptical of the use of a proxy model to determine and distribute the universal service support. The FCC, Joint Board and industry have spent thousand of hours and countless dollars attempting to develop a model to no avail. We still do not have any realistic results. We are being asked, however, in this recommended decision to accept the fact that eventually a model will produce reliable numbers for universal service funding and distribution that will be fair to all states and carriers and at the same time maintain a reasonable fund size. I can not in good conscience accept this premise on blind faith. I believe we should reject the use of a proxy model and continue to use the existing methodology based on embedded cost. I also believe the explicit fund size for non-rural LECs should remain at its present level until the Joint Board determines that competition has eroded implicit support for universal service.

At this time, we do not know what the results of the cost model will be. The Commission still must select the inputs to be used in the model. Without the opportunity to review the final results of the model, I do not believe we can make a determination that the model will provide a realistic estimate of the costs of providing the supported services. The model could either overstate or understate the costs. The model does not represent the actual cost incurred by the individual companies and is not tied to any verifiable cost incurred. Reliance on the cost model shifts the burden of proof that the level of universal support is sufficient from the companies that receive the support to the Commission.

A forward-looking cost model estimates the cost of the network built by an efficient provider in a totally competitive market. No one proposes that the carriers that receive the support build that network. The use of the model may ultimately reward companies that have not been aggressive in building or upgrading their networks and may penalize companies that have been diligent in constructing state of the art networks. The customers ultimately will carry the burden of the fund. If the resulting fund is either too large or too small, the resulting recovery mechanisms may hurt the very customers it was designed to help.

Today universal service high cost support is funded one hundred percent by federal funding. Any new universal service support mechanism should continue to be funded one hundred percent from the federal jurisdiction. The Telecommunications Act of 1996 states that services defined by the Commission are to be supported by the federal universal service support

mechanisms. Anything less than one hundred percent federal funding does not meet the sufficiency requirement of the Act.

Further, I can not agree with the recommended decision's proposed methodology containing two elements, one of which calculates a state's ability to support its own universal service needs.¹ This method will require a state to fund, implicit or explicitly, some percentage of the universal service support needed before the federal funding level for the state or carrier is determined. This approach is inconsistent with language contained in the recommended decision that federal support may not be made contingent upon any actions taken, or not taken, by the states. The proposed methodology of determining support calculates a state's contribution to be deducted from the determined level of needed universal support. This calculation in fact produces the same result as a specific requirement for state actions. The Act speaks to state responsibility, however, it is my belief that states need to implement that section of the law and do not need direction or mandates from the Joint Board or the Commission. In no way should a carrier's or state's receipt of universal service funds be contingent on any state action mandated by the FCC.

This recommendation can not make receipt of federal universal service support contingent, directly or indirectly, on states making intrastate subsidies explicit. Intrastate rate design is the sole jurisdiction of state regulators. The Commission has no authority to require states to establish a state universal service fund or rate rebalance. State regulators have the authority and the knowledge to design intrastate rates to best meet the conditions and needs of their states.

I do not believe that universal service support for the rural companies should be designed based on the results of the cost model. It must not be assumed in any way that the recommendation of the majority to use the cost model platform for the non-rural companies will set a precedent that will be applied to the rural companies. It is imperative that a cost model not be forced on rural companies. The Rural Task Force was created to address the rural carrier issues. The Task Force must have all solutions available to them to consider in determining how best to address the universal support for those companies. It must be clear that the recommendation to support the model for non-rural companies does not require that it will be used for rural companies. The rural companies currently receive the majority of the high cost fund based on actual costs they have incurred. Under the existing system these companies have been able to maintain affordable rates and provided the needed services.

I further dissent from the decision to apply any universal support to the interstate access charges. I do not believe that the Universal Service Joint Board possesses any jurisdiction over access charge reform. Access charges are a separations issue and should be addressed by the

¹ See the discussion of the approach to calculate the state's ability to support its own universal service needs in paragraph 46.

Separations Joint Board. Additionally, the Commission has an open docket on access charge reform. It has already implemented measures to change the recovery of the non-traffic sensitive costs in the carrier common line (CCL) rate from a usage sensitive basis to a flat rate basis by implementing the phase-in of the PICC charge. These charges are currently being passed on by some carriers directly to their customers as additional line charges. The level of these charges will increase over the next several years.

The Commission has not identified the amount of implicit subsidy they believe is in access charges and yet they want to allocate some hypothetical amount of subsidy from access charges to the universal service support mechanism and make it explicit. The Separations Joint Board will determine what allocation of network costs will be assigned to the federal jurisdiction for recovery. Federal access charge service must bear its fair share of the costs of the network. The courts have already decided that the network is a shared costs. That cost is a cost of doing business and should be recovered in the rates for the all services provided by that network. Additionally, no significant competition exists in the access market at this time to erode any implicit subsidies that may be embedded in access charges. Access charge reform is being addressed in two proceedings already; it does not need to be made a part of universal service as well.

I believe it is imperative that state regulators have the authority to ensure that universal service support is used for the purposes enumerated in the Act. Section 254(e) clearly states: A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.² The state regulators are in the best position to ensure that the support is applied to the rates, services and facilities that it was intended to support. Competition must not result in the deterioration of the quality of service for rural customers. State regulators must have the authority to ensure that the universal support is used to maintain and upgrade facilities to provide quality service in rural areas.

I do not believe that the FCC has the authority to assess intrastate revenues for universal service nor do I believe they have the authority to permit states to assess interstate revenues. My position has not changed from my position in the First Recommended Decision. (See attached Dissenting Statement of Commissioners Kenneth McClure and Laska Schoenfelder.)

I believe the Act explicitly recognized the need for universal service support to protect the customers in rural and high cost areas should effective competition develop and erode the current support that has maintained affordable rates. I do not believe the intent of Section 254 of the Act was to foster competition.

² Telecommunications Act of 1996.

For the most part I agree with the positions expressed by Commissioner Furchtgott-Roth in his separate statement.

I believe that any further actions concerning Universal Service by the Commission should not be taken until it has been referred to the Joint Board for consideration and recommendation.

ATTACHMENT:**DISSENTING STATEMENT OF COMMISSIONERS
KENNETH McCLURE, MISSOURI PUBLIC SERVICE COMMISSION
AND
LASKA SCHOENFELDER, SOUTH DAKOTA PUBLIC UTILITIES COMMISSION
TO FIRST RECOMMENDED DECISION (NOVEMBER 8, 1996)**

We respectfully dissent from the majority's recommendation that the Commission raise funds for the Federal USF program through an assessment on both the interstate and intrastate revenues of carriers providing at least some interstate services. The Commission should only assess the interstate revenue of such carriers. This view is supported by the language of Section 254, its legislative history, Section 152(b), and relevant case law.

Set out later in this statement are the reasons demonstrating that Congress, in dividing the overall USF program between the Federal fund assessed against interstate carriers and the State funds assessed against intrastate carriers, intended to limit the FCC to assessing interstate revenues only. In short, in setting up the new USF system, Congress followed traditional telecommunications principles and gave the FCC authority over interstate issues and the States authority over intrastate issues, indicating that the FCC's authority is limited to interstate revenues.

Section 152

The majority of this Joint Board recognized in the Recommended Decision of November 8, 1996, that "[w]hile Section 254(d) prescribes that every telecommunications carrier that provides interstate communications services shall contribute to the Commission's universal service

support mechanisms ... the statute does not expressly identify the assessment base for the calculation of the contribution." Recommended Decision, par. 820 (emphasis added). The crucial legal principle that the majority today has overlooked is that the lack of a plain statutory grant of authority to the FCC to take jurisdiction over intrastate revenues in and of itself mandates that Section 254 be construed so as to deny FCC jurisdiction to assess intrastate revenues.

What the FCC believes is the best rule or most efficient means of implementing Section 254 is not relevant. With certain exceptions that are not applicable in this case, Section 152(b) of the Communications Act simply forbids the FCC from using its interpretive powers to take jurisdiction over intrastate services:

Except as provided in sections 223 through 227 of this title, inclusive, and section 332 of this title, and subject to the provisions of section 301 of this title and subchapter V-A of this chapter, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service by wire or radio of any carrier ...

47 USC ' 152(b) (emphasis added).¹ In light of Section 152(b), the Commission cannot lawfully adopt rules under Section 254(d) permitting it to assess charges on intrastate telecommunications. Language in S. 652 as it passed both the House and Senate would have given the FCC such interpretive powers by adding Section 254 and neighboring provisions to the list of exceptions in

¹ Any argument that considering intrastate revenues in setting a carrier's assessment does not involve a charge on intrastate revenues or otherwise implicate Section 152(b) is misleading. If the assessment goes up with every additional intrastate dollar earned, the assessment is a charge on intrastate revenue, regardless of whether assessed on a bulk or per-call basis. Further, the broad language of Section 152(b) mandates that the "sphere of state authority which the statute" protects be broad rather than constrained. People of the State of California v. FCC, 905 F.2d 1217, 1240-41 (9th Cir. 1990).

the first clause of Section 152(b) quoted above. However, the Conferees deleted this language prior to the Bill's enactment as the Telecommunications Act of 1996.²

The Supreme Court, in rejecting a contention very similar to that accepted today by the majority, described Section 152 as a built-in rule of statutory construction:

While it is, no doubt, possible to find some support in the broad language of the section for [the FCC/LEC position that FCC depreciation rules apply to the intrastate as well as the interstate services of carriers subject to FCC jurisdiction], we do not find the meaning of the section so unambiguous or straightforward as to override the command of ' 152(b) that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction" over intrastate service.

Louisiana Public Service Commission v. FCC, 476 US 355, 377 (1986) (emphasis in original); id.

At 377, n. 5 (rule of statutory construction).³

A look at the statutory section at issue in Louisiana PSC, 47 U.S.C. ' 220, shows that the FCC had a basis for its argument that carriers doing at least some interstate business must use FCC depreciation rules for both their interstate and intrastate plant. That the FCC nonetheless lost shows just how tough it is to establish the existence of "unambiguous or straightforward" language. As with Section 254(d), Congress in Section 220 limited the FCC's jurisdiction by type

² See S. 652, 1st Sess., Section 101(c)(2) (as passed by Senate in June, 1995) and S. 652, Section 101(e)(1) (as passed by House in October, 1995, following amendment in nature of substitute). Both sought to add "part II of title II" to the exception list in Section 152(b).

³ In granting a stay of the portions of the Commission's interconnection order setting pricing rules for interconnection between CLECs and LECs, the Eighth Circuit relied in large part on its finding that there were "serious doubts" that Section 251 constituted a "straightforward or unambiguous grant of intrastate pricing authority to the FCC" sufficient to displace Section 152. Iowa v. FCC, ___ F.3d ___, 1996 WL 589204, Slip Op. At 4 (Eighth Cir., Nos. 96-3453 et al., October 15, 1996).

As an example of a sufficiently clear provision, the Eighth Circuit cited Section 251(3), providing that "[t]he Commission shall have exclusive jurisdiction over those portions of the North American Numbering Plan pertaining to the United States. Nothing in this paragraph shall preclude the Commission from delegating to State commissions or to other entities all or any portion of such jurisdiction."

of carrier, without distinguishing between the interstate and intrastate services of carriers subject to FCC jurisdiction:

(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this chapter ...

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property ...

Such carriers shall not ... after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than prescribed therefor by the Commission.

47 U.S.C. ' 220 (version in effect at time of Louisiana PSC decision, emphasis added). The

Supreme Court noted a number of important points supporting the FCC's reading of Section 220:

* The command that carriers subject to FCC jurisdiction follow FCC depreciation rules was not qualified by a limitation of it to those carriers' interstate services,

* There was no provision giving States authority to set depreciation rates (in fact, Congress deleted such a provision, which would have been analogous to Section 254(f), in passing the 1934 Act),

* The FCC could delegate its duties to set depreciation rates to States on a case-by-case basis, but was under no obligation to do so,

* The provision giving the States a right to "present their views" on depreciation to the FCC strongly implied the FCC was the decision-maker.

Louisiana PSC, 476 U.S. at 367 and 378, n. 6 (discussing sub-sections h and i and never-enacted sub-section j).

Despite all these indications (the last three of which are not present in the case of Section 254) the Supreme Court refused to find Congressional intent to override Section 152. Under Louisiana PSC, simply imposing an unqualified duty on carriers subject to the FCC's jurisdiction

to obey the FCC's rules does not mean that the FCC has the right to apply these rules to such carriers' intrastate services.

Most importantly, the Court affirmed a jurisdictional separation as the means of reconciling Section 152 with FCC authority, even though in the context of depreciation this required "depreciating one piece of property two ways", *id.* At 375, after splitting it into state-regulated and federal-regulated portions:

The Communications Act not only establishes dual state and federal regulation of telephone service; it also recognizes that jurisdictional tensions may arise as a result of the fact that interstate and intrastate services are provided by a single integrated system. ... Because the separations process literally separates costs such as taxes and operating expenses between the interstate and intrastate service, it facilitates the creation or recognition of distinct spheres of regulation. ... [I]t is certainly possible to apply different rates and methods of depreciation to plant once the correct allocation between interstate and intrastate use has been made.

Id. at 375. This result is fully consistent with the intent behind Section 152, which was intended by the 1934 Congress to "exempt the intrastate business of any carrier" from the FCC's jurisdiction.⁴ While Louisiana PSC illustrates the degree to which the Supreme Court is willing to go to preserve the principle of state regulation of intrastate telecommunications, universal service separations requires only an identification of interstate revenue, and does not require the splitting of property or any other regulatory-intensive process.

Of course part of the Louisiana PSC rule is that the FCC may regulate intrastate services where jurisdictional separation is not possible--as where separation would require a consumer to buy two phones, one for interstate and one for intrastate calls. Again, applying Section 152 in the

⁴ House Committee Report, Communications Act of 1934, Report No. 1850, 73rd Congress, 2nd Session (reprinted in Max C. Paglin, **A Legislative History of the Communications Act of 1934** (1989) at 726) (emphasis added).

case of universal service simply requires separating interstate from intrastate revenues. This has been done for years for purposes of comparing carriers interstate revenue to interstate costs (and intrastate revenue to intrastate costs) under the Commission's and the States' price cap and rate-of-return rules. It is also done in calculating carriers' payments to the Telecommunications Relay Service program, which is currently funded only by interstate revenue.⁵

For wireless carriers and other providers which do not use any separation procedure at the present time, call records should identify calling number and called numbers and so allow easy distinction between interstate intrastate calls. There is no requirement that the separations process be done with any particular precision,⁶ and it is well within the FCC's rulemaking power to accept projections based on samples of calls. Separating costs (other than perhaps payments to other carriers) would be unnecessary, as the USF assessment is on revenues. Mere "difficulty" in accomplishing separation, while grounds for assertion of FCC authority over intrastate matters prior to Louisiana PSC, is no longer reason to disregard Section 152.⁷ If there are any unusual carriers which cannot identify interstate revenue in an economically feasible manner, special arrangement (such as fixed allocation factors) can be used.⁸

⁵ 47 C.F.R. § 64.604(c)(4)(iii)(B)

⁶ Smith v. Illinois Bell Telephone Co., 282 U.S. 133, 150 (1930).

⁷ See Michael J. Zpevak, **Preemption after Louisiana PSC**, 45 Fed.Com.L.J. 185, 189, 206 (1993).

⁸ Some have suggested that carriers which market interstate and intrastate services to consumers in a bundled package will find it infeasible to separate their revenues. In this regard, keep in mind that bundling plans provide a way of pricing calls--a carrier would still ordinarily keep track of where calls begin and end, regardless of the pricing category for the call. In any event, if one piece of property can be broken into a federal and a state portion for depreciation purposes, a marketing plan can as well.

Finally, it cannot credibly be argued that confining the Federal USF to interstate revenues would negate the goals of Congress. Within the interstate jurisdiction, the FCC is free to use whatever assessment rate is necessary to fuel a "sufficient" support mechanism. Congress did not set a dollar target the FCC must meet for the Federal USF, or otherwise set specific goals that might make the Federal USF dependent on intrastate revenue. Instead, Congress contemplated that the States might wish to set up their own funds, to supplement the Federal USF if a State so desired. Section 152 in no way prevents Congress from getting what is sought -- a Federal fund supplemented by State funds in States desiring a higher service level than that possible with federal funding alone.

Section 254

For reasons other than Section 152, we are convinced that most persuasive reading of Section 254 is that the Federal USF is limited to interstate revenue. In Conference, the House receded to the Senate on the Universal Service section of the Bill, with substantial changes, particularly on the question of jurisdiction.⁹ These changes from the text of Senate Bill No. 652, as passed by the Senate, show an effort to distinguish the Federal USF from state universal service funds, and to tie the federal fund to interstate service and the state funds to intrastate services.

⁹ Joint Explanatory Statement of the Committee of Conference, House Conf. Rep. No. 104-458 at 130, 104th Congress, 2nd Session.

Senate Bill No. 652 as it passed the Senate contained only one provision as to contributions to support universal service, and treated intrastate, interstate, and foreign carriers in a unified manner:

Every telecommunications carrier engaged in intrastate, interstate, or foreign communications shall participate, on an equitable and nondiscriminatory basis, in the specific and predictable mechanisms established by the Commission and the States to preserve and advance universal service.

S. 652, Section 253(c). Under the Bill, one of the principles of universal service was to be "a coordinated Federal-State universal service system ..." S. 652, Section 253(a)(6). The subsection preserving state authority did not explicitly give the States authority to assess carriers providing intrastate services, and made no distinction between interstate and intrastate matters.¹⁰ Consistent with the approach of an all-encompassing universal service system run by the FCC, the Bill provided, without exempting carriers receiving moneys from State funds, that only "essential telecommunications carriers designated under Section 214(d) shall be eligible to receive support for the provision of universal service." S. 652, Section 253(e).

The language approved by the Conferees and enacted into law crystallized the distinction between the federal and state funds, and their sources of funding.

Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predicatble, and sufficient mechanisms established by the Commission to preserve and advance universal service. ...

¹⁰ A state may adopt regulations to carry out its responsibilities under this section, or to provide for additional definitions, mechanisms, and standards to preserve and advance universal service within that State, to the extent that such regulations do not conflict with the Commission's rules to implement this section. A state may only enforce additional definitions or standards to the extend that it adopts additional specific and predictable mechanisms to support such definitions or standards.

47 U.S.C. ' 254(d). The Conferees dropped language calling for "a coordinated Federal-State universal service system" from the list of universal service principles. See 47 U.S.C. ' 254(b). Moreover, the Conferees inserted in the section on state authority the requirement that carriers providing intrastate services contribute to state funds as directed by the states, thus (a) explicitly giving States assessment authority, and (b) limiting it to intrastate carriers.

A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

47 U.S.C. ' 254(f) (emphasis added). The Conferees also added language directing the States not to burden the newly distinguished "Federal" USF, and limited the requirement that carriers receiving USF funds be certified under Section 214(d) to carriers receiving Federal USF funds. See U.S.C. ' 254(e).

The overall effect of the Conferees' work was to take an amorphous general universal service concept and break it down into a fund controlled by the Commission and supported by interstate carriers and funds controlled by the States and supported by intrastate carriers. There would be little purpose in taking such effort to carve the Universal Service world into two spheres if the Federal USF fund was to have a first right to assess both interstate and intrastate revenues. If the Federal USF fund had such a right, any State USF fund making assessments on the same revenues would "rely on or burden" the Federal mechanism, potentially violating Section 254(f).

Moreover, if the majority were correct, it would have been unnecessary for Congress to expressly give States the duty to police against cross-subsidization of competitive intrastate services by carriers receiving USF subsidies, while giving the FCC the duty to police against cross-subsidization of competitive interstate services.¹¹ Drawing the line between the two types of services is the very step the majority seeks to avoid in recommending a combined intrastate/interstate Federal USF.

The majority's interpretation of Section 254 would result in violation of the Section's requirement that carriers be assessed in a non-discriminatory and equitable manner. Because only carriers doing some interstate business are subject to the terms of Section 254(d), a carrier could completely escape the Federal USF by becoming an intrastate only carrier. Thus, a carrier with intrastate revenues of a billion dollars a year would be subject to no federal USF assessment at all, while a carrier with \$999,999,999.00 of intrastate revenue and one dollar of interstate revenue would be subject to assessment for the whole billion dollars of its revenue.¹² The jurisdictionally-mixed carrier would carry a deadweight around with it as it tried to compete with the intrastate-only carrier. The majority's plan simply cannot satisfy the "competitively neutral" criteria of Section 254.

Just as there is an incentive to be an all intrastate carrier under the majority's reading, there is a reciprocal incentive to be an all-interstate carrier if States can assess the combined revenues of

¹¹ See 47 U.S.C. § 254(k).

¹² Under an approach limiting Federal USF assessments to interstate revenue, the later carrier would technically be subject to assessment for the Federal USF on the one dollar of interstate revenue, but would be excused under the de minimis rule of Section 254(d). Under the majority's approach, this carrier's contribution to the Federal USF from its one billion dollars of combined revenue would be substantial rather than de minimis.

carriers doing some intrastate business. Escaping State USF assessments would then give the all-interstate carrier a leg up on a competitor doing some intrastate business.

Because only jurisdictionally-mixed carriers would pay into both funds, the end result of the majority's recommendation would be to create powerful and wholly artificial incentives to turn down business on the basis of its intrastate or interstate nature, to create separate subsidiaries for intrastate in interstate business, and to take whatever steps are necessary to avoid assessment at both the Federal and State levels.

It is by no means clear that States will have the authority to assess interstate revenues to support their own funds. If they cannot, then intrastate revenue would be assessed at both the Federal and State level, while interstate revenue would be taxed only at the Federal level. This would give a competitive edge to carriers whose business is largely interstate. While caselaw interpreting Section 152, including a landmark Supreme Court opinion, holds that interstate communications is beyond the realm of the State's authority, the Supreme Court has upheld a State sales tax on end users for interstate calls against a challenge under the Commerce Clause, -- although there apparently was no claim that the tax was illegal under the Communications Act.¹³

If the litigation over this issue is resolved in favor of state authority to charge interstate calls, and states modify state-law restrictions confining their PUCs to intrastate matters, the next

¹³ Compare Smith v. Illinois Bell Tel Co., 282 U.S. 133, 148 (1930) (states have no authority over interstate rates -- interpreting predecessor Act to Communications Act); Ivy Broadcasting Co. V. AT&T, 391 F.2d 486, 491 (2d Cir. 1968) (often cited base broadly defining prohibition under Communications Act against state regulation of interstate communications); and AT&T Communications of the Mountain States, Inc. V. Public Service Comm'n, 625 F.Supp. 1204, 1208 (D.Wyo. 1985) (PSC exceeded its jurisdiction by including interstate call in base for calculating contribution for cost of local disconnect service); with Goldberg v. Sweet, 488 U.S. 252 (1989) (upholding Illinois sales tax on interstate and intrastate calls, no discussion of Communications Act).

issue will be the allocation of interstate revenue between states. How much of AT&T's interstate revenue would be accessible by the Mississippi USF, the Louisiana USF, the Massachusetts UFS, etc.? Simply permitting both the Federal and State USF programs to assess both interstate and intrastate revenue in no way eliminates allocation difficulties

Conclusion

Looking at just policy issues and the text of Section 254, the best interpretation of Section 254(d) is that the Federal USF program should be funded with only interstate revenues. Moreover, it cannot be credibly claimed that Section 254(d) so unambiguously or straightforwardly mandates the opposite result as to override Section 152's rule of construction against FCC jurisdiction over intrastate telecommunications. Because the majority is recommending a position which is bad policy, which extends the FCC's jurisdiction past its limit, and what will lead to years of litigation (most likely resulting in a reversal undoing years of hard work on the part of all concerned), we must respectfully dissent from the State Joing Board members' majority recommendation on this matter.