

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

In the Matter of)	
)	
Federal-State Joint Board on)	CC Docket No. 96-45
Universal Service)	
)	
Access Charge Reform)	CC Docket No. 96-262

**SEVENTH REPORT & ORDER AND
THIRTEENTH ORDER ON RECONSIDERATION IN CC DOCKET NO. 96-45
FOURTH REPORT & ORDER IN CC DOCKET NO. 96-262
AND FURTHER NOTICE OF PROPOSED RULEMAKING**

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By the Commission: Chairman Kennard approving in part and dissenting in part, and issuing a statement; Commissioner Ness approving in part and dissenting in part, and issuing a statement at a later date; Commissioner Furchtgott-Roth concurring in part and dissenting in part, and issuing a statement at a later date; Commissioner Powell issuing a statement.

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I. INTRODUCTION

1. The Telecommunications Act of 1996 (1996 Act) has fostered and accelerated the development of competition in local telecommunications markets across the nation.¹ The 1996 Act also, for the first time, wrote into law the Commission's long-standing policy of supporting universal service. In codifying this federal policy, Congress sought to ensure that universal service remains achievable and sustainable as local competition develops.

¹ The 1996 Act amended the Communications Act of 1934, 47 U.S.C. § 151, *et seq.* See Pub. L. No. 104-104, 110 Stat. 56 (1996).

2. In this Order, based on recommendations from the Federal-State Joint Board on Universal Service (Joint Board), we take action to achieve this Congressional goal and to ensure that mechanisms exist so that non-rural carriers' rates for services supported by universal service mechanisms remain affordable in all regions of the nation and reasonably comparable to those prevalent in urban areas.² In taking these steps, we are moving closer to bringing to fruition the work of the Joint Board and this Commission to render universal service support mechanisms explicit, sufficient, and sustainable as local competition develops.

3. In this Order, we adopt broad revisions to the federal support mechanisms, in light of the Joint Board's most recent recommendations, to permit rates to remain affordable and reasonably comparable across the nation, consistent with the 1996 Act and the competitive environment that it envisions. To accomplish these goals, as recommended by the Joint Board, we establish a methodology for determining non-rural carriers' support amounts, based on forward-looking costs estimated using a single, national model, and a national cost benchmark.³ We explicitly reconsider and repudiate any suggestion in the *First Report and Order*⁴ that federal support should be limited to 25 percent of the difference between the benchmark and forward-looking cost estimates, in favor of the more nuanced balancing of federal and state responsibilities outlined by the Joint Board. To the extent a state's resources are deemed inadequate to maintain affordable and reasonably comparable rates, the federal mechanism will provide the necessary support. We also adopt today the hold-harmless and portability principles recommended by the Joint Board.

4. Although we are adopting the principles of a federal support mechanism that conform to the *Second Recommended Decision*,⁵ we do not believe that an adequate record yet exists to make determinations regarding some of the specific elements of the support methodology. Accordingly, we also adopt the attached Further Notice of Proposed Rulemaking (FNPRM) seeking comment on several specific implementation issues. While we are resolving these implementation issues, we also are continuing to verify the operation of the cost model, including the input data elements. To complete this process, we issue separately an additional FNPRM on

² 47 U.S.C. §§ 254(b)(1), (3). Although the 1996 Act does not specifically define a non-rural carrier, it does define a rural telephone company as a local exchange carrier that provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines or that serves only very small communities as defined by the Act. 47 U.S.C. § 153(37)(C).

³ Although we adopt a cost benchmark for purposes of determining federal intrastate high-cost support, differing considerations will inform our selection of a cost-based benchmark, a revenue-based benchmark, or some other method for purposes of identifying universal service support implicit in interstate access charges. Accordingly, we may adopt a different approach in that context.

⁴ *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8801 (1997) (*First Report and Order*), as corrected by Errata, CC Docket No. 96-45 (rel. June 4, 1997), *appeal pending sub nom. Texas Office of Pub. Util. Counsel v. FCC*, No. 97-60421 (5th Cir. argued Dec. 1, 1998).

⁵ *Federal-State Joint Board on Universal Service*, Second Recommended Decision, 13 FCC Rcd 24744 (1998) (*Second Recommended Decision*).

the model input and operational issues.⁶ We encourage commenters to consider both of these FNPRMs together, and frame their comments to recognize the close relationship between the issues discussed in each.

5. We intend to resolve the remaining methodological issues identified in the attached FNPRM and verify the operation of the cost model, including the input data elements, on which comment is being sought in the companion *Inputs FNPRM*. We anticipate adoption this fall of an order resolving these remaining issues, so that support may be based on forward-looking costs of providing supported services beginning January 1, 2000. In conjunction with our actions to implement an explicit high-cost support mechanism based on forward-looking costs, we also take action today and seek comment on additional issues to permit us to identify implicit support remaining in interstate access charges by January 1, 2000.

II. OVERVIEW

6. One primary purpose of universal service support has always been to support telecommunications service in high-cost areas where such service would be relatively expensive. This has been accomplished by subsidizing carriers to enable them to serve high-cost consumers at below-cost rates. Several federal programs have long served this goal by providing explicit support for local loop and switching costs that significantly exceed the national average. State programs and state rate structures also have supported universal service. In the past, in addition to receiving explicit universal service support, monopoly local exchange carriers charged some customers, such as urban businesses and other low-cost customers, rates for local exchange and exchange access services that exceeded the cost of providing those services. Rates paid by these customers implicitly supported the rates for service provided by the same carrier to other, higher cost customers. This implicit support helped keep rates largely affordable by requiring monopoly local exchange carriers to develop rates using costs averaged over large geographic areas, to charge business customers rates that generally exceed those charged to residential customers, and to recover through usage-based charges some non-traffic sensitive costs of the local exchange network. In addition, support implicit in interstate access rates has in some cases inflated per-minute interstate toll charges.

7. Implicit universal service support is becoming less sustainable as competition increases, because a carrier charging rates significantly above cost to a class of customers may lose those customers to a competitor charging cost-based rates. As carriers lower their rates closer to their costs in urban areas, or lose low-cost customers to new entrants, the implicit support for below-cost rates in high-cost areas erodes. In addition, implicit support can promote potentially inefficient competition in low-cost, typically urban areas and for high-revenue, typically business customers. Implicit support can also delay or deny the benefits of competition to residential and high-cost consumers if a competitor finds that it is unable to compete against an incumbent's

⁶ *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, Further Notice of Proposed Rulemaking, CC Docket Nos. 96-45, 97-160, FCC 99-120 (rel. May 28, 1999) (*Inputs FNPRM*).

artificially low rates. For this reason, in tandem with our shift to explicit support based on forward-looking costs, we have taken steps toward identifying support implicit in interstate access rates.⁷

8. By contrast, explicit support⁸ based on contribution and support mechanisms that do not advantage or disadvantage any carrier that may seek to compete in the local market can preserve and protect universal service for all Americans. Efficient competition in local markets is most likely to occur when rates for services, after factoring in explicit universal service contributions or support, reflect the underlying cost of providing service. Accordingly, the 1996 Act requires all providers of interstate telecommunications services to contribute to universal service support mechanisms on an equitable and nondiscriminatory basis,⁹ and provides that universal service support should be explicit.¹⁰

9. Under the current system of federal support, potential new entrants to the local market in high-cost areas are at a competitive disadvantage relative to incumbents, which have access to much greater implicit support than new entrants. Converting such implicit support to explicit support that is portable among all eligible telecommunications carriers will significantly lessen this competitive advantage. Consequently, explicit mechanisms may encourage competitors to expand service beyond urban areas and business centers into all areas of the country and to all Americans, as envisioned by the 1996 Act.

10. The 1996 Act establishes as a principle, on which we must base our universal service policies, that high-quality supported services should be available across the nation at affordable and reasonably comparable rates.¹¹ In adopting a high-cost support mechanism, we must adhere to the universal service principles and requirements set forth by Congress. The support mechanism we adopt should, as far as possible, be explicit,¹² as well as specific, predictable, and sufficient to preserve and advance universal service.¹³ The support mechanism should also require all providers of telecommunications services to make an equitable and nondiscriminatory

⁷ See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing and End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, and 95-72, *First Report and Order*, 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*).

⁸ In discussing explicit support, we refer to support that is specifically identified as such in carriers' revenue streams.

⁹ 47 U.S.C. § 254(d).

¹⁰ 47 U.S.C. § 254(e).

¹¹ See 47 U.S.C. § 254(b).

¹² 47 U.S.C. § 254(e).

¹³ 47 U.S.C. § 254(b)(5).

contribution to the preservation and advancement of universal service.¹⁴ The support mechanism should neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.¹⁵ Any telecommunications carrier, using any technology, including wireless technology, is eligible to receive universal service support if it meets the criteria under section 214(e)(1).¹⁶

11. We agree with the Joint Board that we should use forward-looking costs as a starting point in determining support amounts. We believe that basing support levels on forward-looking costs will send the correct signals for investment, competitive entry, and innovation, and that a single, national cost model will be the most efficient way to estimate forward-looking cost levels. A cost model only estimates costs, however; it does not determine support. Therefore, we also adopt today the principles of a methodology for using the model's cost estimates to determine support amounts, as described in the *Second Recommended Decision*. We will use a national, cost-based benchmark set at a percentage of the national average forward-looking cost of providing the supported services as the first step in determining the amount of support to be provided. That is, federal mechanisms will support areas with per-line costs in excess of this benchmark unless, as the Joint Board recommended, an objective indicator of state resources reveals that the state possesses the ability to achieve reasonable rate comparability in the state without federal support.¹⁷ We conclude, consistent with the Joint Board's recommendation, that states should not be required to alter their existing substantial universal service support mechanisms, such as intrastate rate averaging, to receive federal support, but that states' ability to provide for their own universal service needs should be evaluated based upon the assumption that each line within the state is capable of bearing an intrastate support burden equal to a fixed dollar value assessment.¹⁸ The pool of revenue that could be raised from such an assessment is presumed to be available to the state for intrastate support efforts. We emphasize, however, that the use of a fixed per-line dollar value assessment to estimate states' abilities to support their universal service needs internally does not mandate the creation of state universal service funds for this purpose. Federal support will be available if this intrastate support is inadequate to enable reasonable comparability of rates.

12. Preserving and advancing high-cost universal service support, however, is not a task reserved solely to the Commission. On the contrary, consistent with the 1996 Act and the Joint Board's recommendations, and in recognition of the states' long history of acting to ensure universal service, joint federal and state responsibility is the cornerstone of the plan we adopt

¹⁴ 47 U.S.C. § 254(b)(4).

¹⁵ *First Report and Order*, 12 FCC Rcd at 8802, para. 49.

¹⁶ *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

¹⁷ *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 44.

¹⁸ *Second Recommended Decision*, 13 FCC Rcd at 24759-62, paras. 36-46.

today.¹⁹ The federal universal service methodology and principles we adopt today recognize the states' central role in providing intrastate support for high-cost areas, and reaffirm that the primary purpose of the federal support mechanism is to enable federal support to be available to ensure that states have the resources to maintain reasonably comparable rates in all areas of the nation. As competition develops, we agree with the Joint Board that states are likely to come under increasing pressure to render intrastate universal service support explicit. We recognize that the states are best positioned to evaluate their own intrastate needs, however, and we decline at this time to impose any conditions on a state's eligibility to receive federal high-cost support. Also in agreement with the Joint Board, we caution that federal support should not necessarily be available to replace eroding implicit intrastate support, absent a showing that the state is unable to maintain reasonable comparability of rates.

13. We emphasize that the methodology and principles we adopt today do not require any state to impose a per-line charge to support universal service and do not entitle carriers to recover any particular amount of support from new or explicit state mechanisms. As the Joint Board explained, this estimate of the state's ability to achieve reasonably comparable rates on a statewide basis establishes a level above which federal support, consisting of funds transferred from other jurisdictions, should be provided to assist the state in achieving rates that are reasonably comparable to those in other states. States largely are already making use of this ability by providing carriers with substantial universal service support, often through rate averaging and other rate design methodologies, and states are best positioned to determine how and whether these intrastate mechanisms need to be altered to ensure that carriers do not double-recover universal service support. Our estimate of a state's ability to support reasonably comparable rates internally is intended to ensure that federal support for this purpose is no greater than is necessary. In addition, by accounting for state resources that already are largely in use, we minimize the need for significant alterations in local rate structures to reflect federal support payments. We caution, however, that for carriers receiving significant increases in federal support for local rates, carrier and/or state commission action with regard to existing intrastate support, particularly that which is currently embedded in interstate rates, may be necessary to prevent double-recovery of universal service support at both the federal and state level.²⁰ We therefore seek comment on any actions that may be necessary to prevent such windfalls to carriers.

14. To ensure that our transition to a revised federal support mechanism does not cause sharp or sudden reductions in the level of support any individual carrier receives, we also adopt, as the Joint Board recommended, a hold-harmless principle.²¹ We agree with the Joint Board that this principle is an important transitional measure that will provide protection as we gain

¹⁹ Congress clearly intended that universal service reform be achieved through a combination of federal and state efforts. 47 U.S.C. § 254(a)(1); *see also* 47 U.S.C. § 254(b)(5) (stating that there "should be specific, predictable and sufficient *Federal and State* mechanisms to preserve and advance universal service") (emphasis added).

²⁰ *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

²¹ *Second Recommended Decision*, 13 FCC Rcd at 24763-64, paras. 51-53.

experience with the use of our new support mechanism.²² We also agree with the Joint Board, however, that we should revisit this issue no later than three years after implementation of the new support mechanism, *i.e.*, January 1, 2003, to reevaluate whether a hold-harmless provision remains necessary.²³

15. Today, in agreement with the Joint Board, we reaffirm our commitment to the principle that universal service support should be available to all eligible telecommunications carriers on an explicit *and portable* basis.²⁴ We also reaffirm that all carriers that provide the supported services, regardless of the technology used, are eligible for designation as an eligible telecommunications carrier. We believe that this transition to forward-looking explicit and portable support represents another critical step towards the development of efficient competition in all areas of the nation. As support becomes explicit and portable, we expect that competitors will find that they are increasingly able to compete for customers outside of the urban and business communities where we have seen more extensive competitive entry to date. Support will be available to competitors that win higher cost customers from an incumbent carrier. At the same time, if an incumbent local exchange carrier (LEC) begins to lose customers in high-cost areas, so will it lose the support associated with those customers.

16. While we provide hold-harmless protection in this Order, we are hesitant to provide sharp increases in current support levels, in the absence of clear evidence that, consistent with the development of efficient competition, such increases are necessary to preserve universal service or to protect affordable and reasonably comparable rates. In addition, because this is our first experience with support provided using forward-looking cost models, we conclude that we should implement a support mechanism based on forward-looking costs and gain experience with its operation before determining whether large increases are necessary. Accordingly, at this time we agree with the Joint Board that we should not increase the amount of explicit federal support significantly from current explicit levels.

17. We also agree with the Joint Board that many of the consumer issues raised in the *Second Recommended Decision*, such as how carriers recover their universal service contributions from consumers, are within the scope of the Commission's ongoing *Truth-in-Billing* proceeding.²⁵ We therefore conclude, consistent with the Joint Board's recommendation, that it is more appropriate to address those issues in the *Truth-in-Billing* proceeding, in light of the more complete record developed in that docket. Indeed, several of those issues have been resolved, or

²² *Second Recommended Decision*, 13 FCC Rcd at 24763-64, paras. 51-53.

²³ *Second Recommended Decision*, 13 FCC Rcd at 24773, para. 74.

²⁴ *Second Recommended Decision*, 13 FCC Rcd at 24765, para. 56.

²⁵ See *Truth-in-Billing and Billing Format*, First Report and Order and Further Notice of Proposed Rulemaking, FCC 99-72 (rel. May 11, 1999) (*Truth-in-Billing First Report and Order and FNPRM*).

are being resolved, in that proceeding.²⁶

18. Accordingly, in the attached FNPRM, we seek further comment on certain specific methodological issues, such as the precise level of the benchmark and the precise amount of the per-line state responsibility estimate. The FNPRM also seeks comment on other implementation issues, such as how exactly the hold-harmless mechanism should operate, and how best to ensure that support is used for the purposes for which it is intended, in the areas for which it is intended, as the Act requires,²⁷ particularly given state jurisdiction over local rate levels.²⁸

19. Because we are seeking further comment on implementation issues in the attached FNPRM, and because (as explained in this Order and the *Inputs FNPRM*)²⁹ further verification of the model's data input elements and results is necessary before its outputs can be used to determine support amounts, we defer implementation of the new forward-looking support mechanism for non-rural carriers until January 1, 2000.³⁰

III. BACKGROUND

20. This Order is part of an ongoing process intended to transform universal service mechanisms so that they are both sustainable as competition in local markets develops, and explicit in a manner that promotes the development of efficient competition across the nation. As required by the 1996 Act, the Commission convened the Joint Board,³¹ which produced its first set of recommendations to the Commission in November 1996.³² In light of those recommendations, the Commission, on May 8, 1997, released the *First Report and 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.³³

²⁶ See *Truth-in-Billing First Report and Order and FNPRM*, FCC 99-72.

²⁷ 47 U.S.C. § 254(e).

²⁸ 47 U.S.C. § 152(b).

²⁹ *Inputs FNPRM*, FCC 99-120.

³⁰ Accordingly, we amend our rules so that the present high-cost support mechanism remains in effect until January 1, 2000. See Appendix C.

³¹ *Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996).

³² Federal-State Joint Board on Universal Service, *Recommended Decision*, 12 FCC Rcd 87 (Jt. Bd. 1996) (*First Recommended Decision*).

³³ *First Report and Order*, 12 FCC Rcd 8776.

21. 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 sufficient support while sending the correct signals for efficient entry and investment.³⁴ 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 at least until January 1, 2001, pending further review by the Commission, the Joint Board, and a Joint Board-appointed Rural Task Force.³⁵ On October 28, 1998, the Commission released an order adopting a platform for a federal mechanism for determining non-rural carriers' forward-looking costs.³⁶ 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 costs of providing the supported services.³⁷ The model is used to estimate the forward-looking cost of providing the supported services, but does not itself determine federal support levels.

22. The Commission concluded in the *First Report and Order* that the share of support provided by the federal mechanism initially should be set at 25 percent, based on the need to avoid double-recovery by carriers pending reform of state rates and support mechanisms.³⁸ The Commission stated, however, that the federal share of support would be subject to review in light of state proceedings, the development of competition, and other relevant factors.³⁹

23. The Commission's determination relating to the federal share of support generated

³⁴ *First Report and Order*, 12 FCC Rcd at 8899-8900, paras. 224-26; *Recommended Decision*, 12 FCC Rcd at 232, para. 276.

³⁵ *First Report and Order*, 12 FCC Rcd at 8910, para. 254; 8917-18, paras. 252-56. The *First Report and 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. See *Federal-State Joint Board on Universal Service, Order and Order on Reconsideration*, 13 FCC Rcd 13749 (1998) (*Referral Order*). See also *Federal-State Joint Board on Universal Service Announces the Creation of a Rural Task Force; Solicits Nominations for Membership on Rural Task Force*, Public Notice, FCC 97J-1 (rel. Sept. 17, 1997).

³⁶ *Federal-State Joint Board on Universal Service, Fifth Report and Order*, 13 FCC Rcd 21323 (1998) (*Platform Order*).

³⁷ The input values will be determined in a separate order. See para. 4, *supra*; *Platform Order*, 13 FCC Rcd at 21324-25, para. 2; *Inputs FNPRM*.

³⁸ *First Report and Order*, 12 FCC Rcd at 8925, para. 269.

³⁹ See *First Report and Order*, 12 FCC Rcd at 8926, paras. 271-72. See also *Federal-State Joint Board on Universal Service, Report to Congress*, 13 FCC Rcd at 11602-09, paras. 219-234 (1998) (*April 1998 Report to Congress*).

several petitions for reconsideration⁴⁰ and significant comment.⁴¹ On March 11, 1998, the state members of the Joint Board filed a request that certain issues related to the determination of high-cost support, including issues regarding the share of federal high-cost support, be referred back to the Joint Board.⁴² Shortly after a March 1998 *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.⁴³ 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,⁴⁴ and sought proposals and comments on how to reform high-cost support for non-rural carriers.⁴⁵ In response, parties submitted a variety of proposals and comments, and provided input in a number of *en banc* hearings.⁴⁶

24. On July 17, 1998, the Commission referred the following issues to the Joint Board, to obtain its recommendations:⁴⁷

- (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 requested 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.

⁴⁰ See, e.g., Alaska Commission petition at 5-6; Arkansas Commission petition at 1-3; U S West petition at 6; Western Alliance petition at 18-19; Texas Commission petition at 2; Rural Telephone Coalition petition at 1-6.

⁴¹ See, e.g., *April 1998 Report to Congress*, 13 FCC Rcd at 11603-04, paras. 222-23 and associated notes.

⁴² 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.

⁴³ Letter from the State Members of the Joint Board to William Kennard, Chairman, FCC, CC Docket No. 96-45, filed June 18, 1998.

⁴⁴ *April 1998 Report to Congress*, 13 FCC Rcd at 11605, para. 224.

⁴⁵ *Common Carrier Bureau Seeks Comment on Proposals to Revise the Methodology for Determining Universal Service Support*, Public Notice, 13 FCC Rcd 7341 (Com. Car. Bur. 1998).

⁴⁶ In connection with the preparation of the *April 1998 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, which included the state Joint Board commissioners, to address options for revising the support mechanisms for non-rural carriers. On October 29, 1998, the Commission held an *en banc* hearing, which included the state Joint Board commissioners, to address the consumer billing and information issues that had been referred to the Joint Board.

⁴⁷ *Referral Order*, 13 FCC Rcd at 13751-52, para. 6.

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- (2) The extent to which federal universal service support should be applied to the intrastate jurisdiction. The Commission specifically requested the Joint Board's recommendation on the following topics:
- (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 requested 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 recognized that section 254(k) envisions separate state and federal measures related to the recovery of joint and common costs, but nevertheless indicated that it would welcome 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, it is reasonable for providers to recover universal service contributions through rates, surcharges, or other means.⁴⁸

25. On November 25, 1998, the Joint Board released its recommendations on these issues.⁴⁹ The Joint Board recommended that the Commission reconsider many aspects of the *First Report and Order's* approach to determining forward-looking support for non-rural carriers. The Joint Board began by considering the potential purposes of high-cost support, and concluded that enabling the reasonable comparability of rates should be a primary purpose. The Joint Board stated that the Commission has the authority to identify and make explicit any support that is

⁴⁸ *Referral Order*, 13 FCC Rcd at 13751-52, para. 6.

⁴⁹ *Second Recommended Decision*, 13 FCC Rcd 24744.

currently implicit in interstate rates, but found that making explicit any implicit intrastate support was within the jurisdiction of the individual states.

26. The Joint Board focused its recommendations on a mechanism for enabling the reasonable comparability of intrastate rates. To reach this goal, the Joint Board recommended that the Commission compute federal high-cost support through a two-step process: (1) the Commission should establish a national benchmark to determine the total amount of support needed in areas with costs in excess of that benchmark; and (2) for these high-cost areas, the Commission should consider, in a consistent manner across all states, each state's ability to support its own high-cost areas. The Joint Board recommended that federal support be provided to the extent that a state would be unable to support its high costs areas through its own reasonable efforts. The Joint Board also recommended that the mechanisms it had outlined be reviewed no later than three years from July 1, 1999. Finally, the Joint Board stated that, while it recommended a shared federal-state responsibility, no state can or should be required by the Commission to establish an intrastate universal service fund.

27. The Joint Board also expressed its support for the Commission's commitment to the concept of "hold-harmless" -- in other words, that current support levels should not decrease as part of the transition to support based on forward-looking costs. The Joint Board also made recommendations related to the revenue base on which carriers' universal service contributions are assessed, and how carriers should be permitted to recover those contributions from their customers. In this Order, we largely adopt the recommendations of the Joint Board on these referral issues.

IV. REPORT AND ORDER

A. The Purpose of Support

28. We agree with the Joint Board that a primary focus in reforming the federal high-cost universal service support mechanism is to enable intrastate rates to remain both affordable and reasonably comparable across high-cost and urban areas.⁵⁰ We also agree with the Joint Board that the Commission bears the responsibility to ensure that interstate rate structures comply with the Congressional mandates expressed in the Communications Act of 1934, as amended (the Act).⁵¹ In this section, we adopt the majority of the Joint Board's conclusions and recommendations concerning affordability, reasonable comparability, explicit interstate support, and explicit intrastate support. We have determined, however, that further comment is necessary on several implementation issues, as outlined in the FNPRM, and that more thorough verification of the model is necessary before a forward-looking support methodology can be implemented.⁵² Pending resolution of these issues, and pursuant to the Joint Board's recommendation, we are leaving the existing support mechanism in place for non-rural carriers for an additional six months. We anticipate adopting the permanent methodology for calculating and distributing support for non-rural carriers, based on forward-looking economic costs, this fall for implementation on January 1, 2000.

1. Enabling Reasonably Comparable Rates

a. Background

29. One of the guiding principles of the 1996 Act is that consumers in all regions of the nation should have access to rates and services that are reasonably comparable to rates and services in urban areas.⁵³ The 1996 Act does not define the term "reasonably comparable," nor does it specify the means to achieve this goal. In the *Second Recommended Decision*, the Joint Board interpreted the term "reasonably comparable" to refer to "a fair range of urban and rural rates both within a state's borders, and among states nationwide."⁵⁴ The Joint Board proposed to achieve reasonable comparability of rates using a two-step methodology that divides responsibility for this goal between the federal and state support mechanisms. In the first step, the federal support mechanism would identify study areas with costs greater than a federally determined

⁵⁰ *Second Recommended Decision*, 13 FCC Rcd at 24752-53, para. 14.

⁵¹ *Second Recommended Decision*, 13 FCC Rcd at 24752-53, para. 14.

⁵² See section V, *infra*.

⁵³ 47 U.S.C. § 254(b)(3).

⁵⁴ *Second Recommended Decision*, 13 FCC Rcd at 24753, para. 15.

national benchmark.⁵⁵ The second step would attempt to ensure that support is available where a state would "find it particularly difficult to achieve reasonably comparable rates, absent such federal support."⁵⁶ The federal support mechanism would then provide support for intrastate costs that exceed both the national benchmark and the individual state's ability to support those costs.⁵⁷

b. Discussion

30. We agree with the Joint Board that a central purpose of federal universal service support mechanisms is to enable rates in rural areas to remain reasonably comparable to rates in urban areas, and we adopt the Joint Board's interpretation of the reasonable comparability standard to refer to "a fair range of urban/rural rates both within a state's borders, and among states nationwide."⁵⁸ This does not mean, of course, that rate levels in all states, or in every area of every state, must be the same. In particular, as the local exchange market becomes more competitive, it would be unreasonable to expect rate levels not to vary to reflect the varying costs of serving different areas. The Joint Board and the Commission have concluded that current rate levels are affordable.⁵⁹ Therefore, we interpret the goal of maintaining a "fair range" of rates to mean that support levels must be sufficient to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels. When we use the term "reasonably comparable" throughout this Order and FNPRM, we are referring to this definition of the term.

31. We find that, once we have resolved several implementation issues outlined in the FNPRM, and further verified the forward-looking cost model, the Joint Board's recommended methodology largely will be an appropriate means for the federal mechanism to ensure that states have the ability to achieve reasonable comparability. Specifically, the Joint Board's proposed methodology will ensure that any state with per-line costs substantially above the nationwide average will receive federal support for those intrastate costs, unless the state has the ability to maintain reasonably comparable rates without such support. States, of course, retain primary responsibility for local rate design policy and, as such, bear the responsibility to marshal state and federal support resources to achieve reasonable comparability of rates.

⁵⁵ *Second Recommended Decision*, 13 FCC Rcd at 24754, 24761-62, paras. 19, 42-44. A study area is a geographical region generally composed of a telephone company's exchanges within a single state. See sections IV(B)(3)(1) and V(B)(1), *infra*, for discussion of the benchmark.

⁵⁶ *Second Recommended Decision*, 13 FCC Rcd at 24754, 24761-62, paras. 19, 42-44.

⁵⁷ *Second Recommended Decision*, 13 FCC Rcd at 24754, 24761-62, paras. 19, 42-44.

⁵⁸ *Second Recommended Decision*, 13 FCC Rcd at 24753-54, paras. 18-19.

⁵⁹ *First Recommended Decision*, 12 FCC Rcd at 154, para. 133; *First Report and Order*, 12 FCC Rcd at 8780, para. 2; *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3.

32. This approach does not consider rates directly. Instead, it uses costs as an indicator of a state's ability to maintain reasonable comparability of rates within the state and relative to other states.⁶⁰ We conclude that the underlying assumption in the Joint Board's recommendation - that a relationship exists between high costs and high rates -- is a sound one, because rates are generally based on costs.⁶¹ We adopt this approach, in part, because states possess broad discretion in developing local rate designs.⁶² State rate designs may reflect a broad array of policy choices that affect actual rates for local service, intrastate access, enhanced services, and other intrastate services. A state facing costs substantially in excess of the national average, however, may be unable through any reasonable combination of local rate design policy choices to achieve rates reasonably comparable to those that prevail nationally.⁶³ Through an examination of the underlying costs, instead of the resulting rates, we can evaluate the cost levels that must be supported in each state in order to develop reasonably comparable rates. Because responsibility for such support is shared at the federal and state levels, determining the federal portion based on costs rather than rates allows the federal jurisdiction to help accomplish the goal of rate comparability without having to evaluate states' policy choices affecting those rates.

33. By providing support for costs in any state that exceed a benchmark level, the Joint Board's recommended methodology ensures that the cost levels net of support that must be recovered through intrastate rates -- and, by analogy, its assumed rate levels -- must substantially exceed the national average. By taking account of the cost levels that must be supported in each state in order to enable reasonable comparability of rates, the Joint Board's methodology ensures that federal support is targeted to areas where it is necessary to achieve its intended purpose -- enabling reasonable comparability of rates -- and also that overall support levels are no higher than necessary to achieve this goal. We agree with the Joint Board that this methodology will result in federal support levels for each state that are appropriate to achieve the statutory principle of reasonable comparability of rates.

34. In the *First Report and Order*, the Commission concluded that the share of support provided by the federal mechanism should initially be set at 25 percent of the difference between the forward-looking cost of providing the supported services and a national benchmark.⁶⁴ In adopting the Joint Board's recommended methodology, we reconsider the Commission's

⁶⁰ See *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

⁶¹ Even under price cap rate regulation, initial rates generally are based on cost studies or rates prevailing when price caps are initiated.

⁶² 47 U.S.C. § 152(b).

⁶³ Another factor influencing a state's rate design choices, and its ability to achieve reasonably comparable rates, is the extent of cost variations between high-cost and low-cost areas of the state.

⁶⁴ *First Report and Order*, 12 FCC Rcd at 8925, para. 269.

conclusions in the *First Report and Order* regarding the federal share of support.⁶⁵ The Joint Board's recommended methodology for enabling reasonable comparability of rates will define the sharing of responsibility between the federal and state jurisdictions for high-cost intrastate universal service support in a way markedly different from the 25 percent federal share methodology adopted in the *First Report and Order*. Instead of allocating responsibility for universal service support based on fixed percentages, the Joint Board's recommended methodology recognizes the states' primary role in enabling reasonable comparability of rates. Under this recommendation, to the extent a state possesses the ability to support its high-cost areas wholly through internal means, the methodology we adopt recognizes that no federal support is required in that state to enable reasonably comparable local rates. Conversely, to the extent that a state faces larger rate comparability challenges than can be addressed internally, our forward-looking methodology places no artificial limits on the amount of federal support that is available, thus resulting in sufficient support as required by the 1996 Act.⁶⁶

35. We find that section 254(b)(3) supports the use of federal support to enable reasonable rate comparability among states. By specifying that "[c]onsumers in all regions of the Nation" should have rates and services reasonably comparable to rates and services in urban areas, we believe that Congress intended national, as opposed to state-by-state, comparisons. Some commenters dispute the Joint Board's interpretation of reasonable comparability. For example, the California Commission asserts that using federal universal service support to enable rate comparability among states would impermissibly expand the scope of section 254(b)(3), and that support should merely seek to enable the reasonable comparability of rates within each state.⁶⁷ Similarly, the Maryland Commission claims that the Joint Board's interpretation would lead to the comparison of rural rates in all states to some fictional national urban rate, with the potentially anomalous result that rural rates in a state could be lower than urban rates in that state.⁶⁸ The Joint Board's approach for enabling rate comparability relies not on a national urban rate, as the Maryland Commission asserts, but rather on a methodology that ensures that no state will face per-line costs that substantially exceed the costs faced by other states, taking into account the individual state's ability to support its own universal service needs. In this way, the Joint Board sought to ensure that every state has the means at its disposal to achieve reasonable comparability of rates in that state. We agree that the Joint Board's approach is an appropriate way for federal

⁶⁵ See *First Report and Order*, 12 FCC Rcd at 8925, para. 269.

⁶⁶ 47 U.S.C. § 254(e). See also 47 U.S.C. §§ 254(b)(5), (d).

⁶⁷ The California Commission relies in part on language taken out of context from the Commission's brief in a matter pending before the Court of Appeals for the Fifth Circuit. California Commission comments at 4 (quoting Brief of Respondent, *Texas Office of Pub. Util. Counsel v. FCC*, No. 97-60421, et al. (5th Cir. argued Dec. 1, 1998) (FCC Brief)). This reliance is misplaced. By stating that "[s]ection 254(b)(3) does not require the Commission to ensure that rural and urban rates in one State are no higher or lower than rural and urban rates in another State," the Commission was simply arguing that section 254(b)(3) allows for a range of comparable rates, rather than a single national rate. See FCC Brief at 101-03.

⁶⁸ Maryland Commission comments at 9.

support mechanisms to enable "consumers in all regions of the Nation" to have access to "reasonably comparable" rates.⁶⁹ We emphasize again, however, that, because states establish local rates, each state's policies will determine the level of urban rates relative to rural rates in that state.

2. Enabling Affordable Rates

a. Background

36. As discussed above, the 1996 Act specifies that telecommunications services should be affordable.⁷⁰ In its *First Recommended Decision*, the Joint Board concluded that telephone subscribership levels provide a general measure of affordability.⁷¹ Based on existing subscribership levels, the Joint Board determined that rates were generally affordable.⁷² The Joint Board also concluded, however, that additional factors, such as the size of the local calling area, consumer income levels, cost of living, population density, and other socio-economic indicators may affect affordability.⁷³ The Joint Board further concluded that a variety of factors affecting local rate design, including cost allocations and related charges, should be considered in determining affordability.⁷⁴ Because the characteristics of local jurisdictions vary, and because the states possess the expertise to evaluate the various factors affecting affordability, the Joint Board recommended that the states exercise the primary responsibility for determining the affordability of rates.⁷⁵ In the *First Report and Order*, the Commission adopted the Joint Board's conclusions regarding affordability, agreed with the Joint Board that the primary responsibility for determining affordability lies with the states, and rejected proposals for establishing a nationwide affordable rate.⁷⁶

37. In its *Second Recommended Decision*, the Joint Board reaffirmed that rates are generally affordable, and focused its efforts instead on the issue of reasonable comparability.⁷⁷ The District of Columbia (D.C.) Commission contends, however, that the Joint Board's proposed

⁶⁹ 47 U.S.C. § 254(b)(3).

⁷⁰ 47 U.S.C. § 254(b)(1).

⁷¹ *First Recommended Decision*, 12 FCC Rcd at 151-52, para. 127.

⁷² *First Recommended Decision*, 12 FCC Rcd at 154, para. 133.

⁷³ *First Recommended Decision*, 12 FCC Rcd at 151, para. 126.

⁷⁴ *First Recommended Decision*, 12 FCC Rcd at 153, para. 129A.

⁷⁵ *First Recommended Decision*, 12 FCC Rcd at 153-54, para. 131.

⁷⁶ *First Report and Order*, 12 FCC Rcd at 8837-38, paras. 110-11, 8842, para. 118.

⁷⁷ *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3.

federal high-cost support mechanism does not meet the affordability requirement of section 254(b)(1) because it fails to inquire whether the beneficiaries of high-cost support actually need the support.⁷⁸ According to the D.C. Commission, low-income consumers in low-cost states are required to support telephone service for consumers in high-cost states, regardless of how wealthy those consumers may be.⁷⁹ The D.C. Commission suggests that federal high-cost support be conditioned on states certifying that a carrier receiving federal high-cost support has implemented income-based "means testing" and is not earning a higher than average return on equity due to high-cost support.⁸⁰ Ad Hoc supports the D.C. Commission's position that high-income consumers in high-cost states should not receive support from the high-cost fund.⁸¹ Ad Hoc maintains that high-cost support should be limited to those areas in which consumers cannot afford to be connected to the network, and advocates a plan developed by Economics and Technology, Inc., under which high-cost support would be available in a particular state only to households with incomes below the 70th percentile of household income for that state.⁸²

b. Discussion

38. We decline to adopt the proposals suggested by the D.C. Commission and Ad Hoc. We continue to believe, consistent with the Joint Board's recommendation, that rates for local service are generally affordable.⁸³ Indeed, since March 1989, at least 93 percent of all households in the United States have had telephone service, and as of November 1998, the subscribership rate was 94.2 percent.⁸⁴ While affordability encompasses more than subscribership, the Joint Board and the Commission agree that the states are better equipped to determine which additional factors can and should be used to measure affordability.⁸⁵

39. The principle of ensuring reasonably comparable rates, set forth in section 254(b)(3),

⁷⁸ D.C. Commission comments at 8-9.

⁷⁹ D.C. Commission comments at 8-9.

⁸⁰ D.C. Commission comments at 10.

⁸¹ Ad Hoc reply comments at 3.

⁸² Ad Hoc reply comments at 3-5 (citing Economics and Technology, Inc., *Defining the Universal Service "Affordability" Requirement, A Proposal for Considering Community Income as a Factor in Universal Service Support*, originally submitted as an attachment to *Proposals to Revise the Methodology for Determining Universal Service Support*, CC Docket Nos. 96-45, 97-160, Comments Regarding Universal Service Methodology, Time Warner Communications Holdings, Inc. (filed April 27, 1998)).

⁸³ *See also* Bell Atlantic comments at 2.

⁸⁴ Report, *Telephone Subscribership in the United States*, Table 1 (Com.Car.Bur., rel. Feb. 18, 1999).

⁸⁵ *First Recommended Decision*, 12 FCC Rcd at 153-54, para. 131; *First Report and Order*, 12 FCC Rcd at 8842, para. 118.

does not specify an income component.⁸⁶ To the contrary, although affordability may vary with individual subscriber income, section 254(b)(3)'s statement that consumers in rural and high-cost areas of the country should have access to telecommunications services at rates that are reasonably comparable to rates in urban areas is not qualified. Therefore, we find no congressional mandate for the Commission to implement or to require that states implement means-testing in conjunction with mechanisms designed to provide support to high-cost areas and to enable reasonable comparability of rates nationwide. Affordability problems, as they relate to low-income consumers, raise many issues that are unrelated to the need for support in high-cost areas, and section 254(b)(3) reflects a legislative judgment that all Americans, regardless of income, should have access to the network at reasonably comparable rates. The specific affordability issues unique to low-income consumers, including all factors that may be relevant to means-testing or other need-based inquiries, are best addressed at the federal level through programs specifically designed for this purpose. Indeed, the Commission already has such programs in place, namely, the Lifeline and Link-Up programs, which provide assistance for low-income consumers to get connected and stay connected to the telecommunications network.⁸⁷ As discussed in the *First Report and Order*, we believe that the impact of household income on subscribership is more appropriately addressed through programs designed to help low income households obtain and retain telephone service, rather than as part of the federal high-cost support mechanism.⁸⁸

40. Moreover, forcing states to adopt means testing or limits on rates of return in order to receive federal high-cost support would be contrary to the Joint Board's recommendations.⁸⁹ Although it may be within the Commission's jurisdiction to condition federal support on specific state action,⁹⁰ the Joint Board recommended against our doing so in the high-cost context.⁹¹ Individual state commissions are in a position to evaluate specific affordability issues facing their respective states, and we believe that individual states should retain the primary responsibility to decide questions of affordability and to weigh the relative importance of factors such as consumer income and local rate design. Therefore, we decline to require means testing for federal high-cost support. An individual state, however, could voluntarily adopt an explicit support mechanism using means testing or other cost-of-living data, as suggested by the D.C. Commission and Ad Hoc. Although the states retain discretion to adopt such a mechanism, we will continue to monitor the issue of rate affordability, and we will take remedial action, to the extent we have

⁸⁶ 47 U.S.C. § 254(b)(1), (3).

⁸⁷ For background on the Lifeline and Link-Up programs, see *First Report and Order*, 12 FCC Rcd at 8952-94, paras. 326-409.

⁸⁸ *First Report and Order*, 12 FCC Rcd at 8844-45, para. 124.

⁸⁹ See *First Recommended Decision*, 12 FCC Rcd at 153-54, para. 131.

⁹⁰ GTE comments at 15 n.25.

⁹¹ *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

jurisdiction to do so, if it becomes necessary.

3. Making Interstate Support Explicit

a. Background

41. In section 254(e), Congress mandated that federal universal service support, as far as possible, "should be explicit."⁹² In the *First Report and Order* and the *Access Reform Order*, the Commission began the process of identifying and converting implicit interstate universal service support to explicit support.⁹³ The Commission determined that implicit support for universal service should be identified and removed from interstate access charges, and should be provided instead through explicit support mechanisms.⁹⁴ As initial steps toward achieving this task, the Commission directed that Long Term Support be removed from interstate access charges and be made part of explicit federal support mechanisms, and that incumbent local exchange carriers should use support received from new support mechanisms to reduce implicit support in interstate access charges.⁹⁵ The goal of converting support flows that may currently be implicit in interstate rates into explicit support, while also statutorily mandated, is distinct from the goal of assuring that federal support is available to ensure reasonably comparable intrastate rates. Thus, the support that we discuss in this section is different from the support that is described in sections IV(A)(1) and IV(B) of this Order.

42. In the *Second Recommended Decision*, the Joint Board recognized that the Commission has jurisdiction to determine whether interstate access rates contain implicit universal service high-cost support.⁹⁶ The Joint Board also recognized that, if implicit support does exist in interstate access rates, then the Commission has the authority to make such support explicit.⁹⁷ The Joint Board, however, made no finding as to whether implicit support exists in interstate access rates, or whether the Commission should make such support explicit if it does exist. In the event the Commission determines that implicit support exists in interstate access rates and that it should be removed, the Joint Board recommended several guidelines that the Commission should follow. First, as implicit support in interstate access rates is replaced with explicit support, there should be a corresponding dollar-for-dollar reduction in interstate access charges, such as the

⁹² 47 U.S.C. § 254(e). See Joint Explanatory Statement of the Committee of the Conference (H.R. Rep. No. 458, 104th Cong., 2d Sess.) at 131.

⁹³ *First Report and Order*, 12 FCC Rcd at 8782, para. 6; see generally *Access Charge Reform Order*, 12 FCC Rcd 15982.

⁹⁴ *First Report and Order*, 12 FCC Rcd at 8786, para. 15; *Access Charge Reform Order*, 12 FCC Rcd at 15986-87, paras. 5-9.

⁹⁵ *Access Charge Reform Order*, 12 FCC Rcd at 16148, para. 381.

⁹⁶ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

⁹⁷ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

carrier common line charge (CCLC), presubscribed interexchange carrier charge (PICC), or subscriber line charge (SLC).⁹⁸ Second, any reductions in interstate access rates should benefit consumers.⁹⁹ Third, universal service should bear no more than a reasonable share of joint and common costs.¹⁰⁰ Fourth, reasonable comparability should not be jeopardized, and neither consumers in general nor particular classes of consumers should be harmed.¹⁰¹ Fifth, the Commission should consult with the Joint Board before taking any final action on removing implicit support from interstate access charges.¹⁰²

b. Discussion

43. We agree with the Joint Board that the Commission has the jurisdiction and responsibility to identify support for universal service that is implicit in interstate access charges. Moreover, we agree with the Joint Board that it is part of our statutory mandate that any such support, to the extent possible, be made explicit. In this proceeding and in our pending *Access Charge Reform* proceeding, we are endeavoring to identify the types of implicit support in interstate access charges and the amount of that support. As we move forward with our efforts to reform interstate access charges, we will develop additional information on the costs of interstate access necessary to evaluate the Joint Board's recommendations in this area and the associated record. The overwhelming majority of commenters addressing the Joint Board's recommendations, however, agree that interstate access rates contain implicit support that should be made explicit.¹⁰³ These commenters differ only as to the amount of their estimate of implicit support presently in access rates and the method for making it explicit.¹⁰⁴ We anticipate taking action in the fall of 1999 to resolve the issue of making interstate support explicit, and we will address the Joint Board's recommendations at that time. Although, as explained above, the statutory goal of making explicit the support that is currently implicit in interstate access charges

⁹⁸ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

⁹⁹ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

¹⁰⁰ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23. *See also* 47 U.S.C. 254(k).

¹⁰¹ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

¹⁰² *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

¹⁰³ BellSouth comments at 3; California Commission comments at 5; Comptel comments at 3; GTE comments at 4-7; MCI WorldCom comments at 3-9; RTC comments at 25; SBC comments at 3; TRA comments at 4; USTA comments at 2-5; US West comments at 10-12; Western Wireless comments at 6. *See also* CWA reply comments at 6. *But see* Colorado Commission comments at 4 (stating that the Colorado Commission "disagrees with any notion that support received from federal high-cost support mechanisms be used to lower interstate access charges").

¹⁰⁴ *See, e.g.*, California Commission comments at 5 (stating that the Commission should proceed cautiously in removing implicit support from interstate access rates); BellSouth comments at 3 (stating that the Commission should move quickly to address implicit support in interstate access rates).

is distinct from the statutory goal of ensuring reasonably comparable intrastate rates,¹⁰⁵ we nevertheless recognize the close relationship between the implementation of the permanent revised support mechanism on January 1, 2000 and the *Access Charge Reform* proceeding. We therefore intend to move ahead with access reform in tandem with the implementation of the revised methodology. In the FNPRM, we seek comment on how, once we determine the amount of implicit support, we should target any reductions in interstate access charges to account for increased high-cost support.¹⁰⁶

4. Making Intrastate Support Explicit

a. Background

44. As discussed above, Congress envisioned that the Commission and the states would share responsibility for implementing universal service reform, and it gave the states specific authority to create intrastate universal service support mechanisms.¹⁰⁷ In the *Second Recommended Decision*, the Joint Board found that this shared responsibility demonstrated Congress's intent to preserve the states' historical jurisdiction and responsibility to address issues of implicit support through rate design and other state mechanisms.¹⁰⁸ The Joint Board concluded that the federal support mechanism should not be contingent on, nor require, any particular action by the states.¹⁰⁹ Based on this conclusion, the Joint Board determined that the Commission should not require a state to establish an explicit intrastate universal service support mechanism.¹¹⁰ The Joint Board acknowledged, however, that the competitive forces that prompted Congress to favor explicit interstate support may also lead states to establish explicit intrastate support mechanisms, although the Joint Board found no requirement in the 1996 Act that states do so.¹¹¹

b. Discussion

45. Historically, states have ensured universal service principally through implicit support mechanisms, such as geographic rate averaging and above-cost pricing of vertical services, such

¹⁰⁵ Our approach to making federal support available to help ensure reasonably comparable intrastate rates is discussed in sections IV(A)(1) and IV(B) of this Order.

¹⁰⁶ See section V(E), *infra*.

¹⁰⁷ See 47 U.S.C. § 254(f).

¹⁰⁸ *Second Recommended Decision*, 13 FCC Rcd at 24755-56, paras. 24-26.

¹⁰⁹ *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

¹¹⁰ *Second Recommended Decision*, 13 FCC Rcd at 24755-56, para. 24.

¹¹¹ *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

as call waiting, voice mail, and caller ID.¹¹² We agree with the Joint Board that the 1996 Act does not require states to adopt explicit universal service support mechanisms.¹¹³ Section 254(e) does not specifically mention state support mechanisms. Section 254(b)(5) declares that "[t]here *should* be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."¹¹⁴ Section 254(f) provides that states "*may* adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service."¹¹⁵ The permissive language in both of these sections demonstrates that Congress did not require states to establish explicit universal service support mechanisms. Accordingly, our actions today are consistent with the directives of the 1996 Act.

46. As the Joint Board acknowledged, however, the development of competition in local markets is likely to erode states' ability to support universal service through implicit mechanisms. We agree with the Joint Board that the erosion of intrastate implicit support does not mean that federal support must be provided to replace implicit intrastate support that is eroded by competition. Indeed, it would be unfair to expect the federal support mechanism, which by its very nature operates by transferring funds among jurisdictions, to bear the support burden that has historically been borne within a state by intrastate, implicit support mechanisms. The Joint Board stated that states "possess the jurisdiction and responsibility to address these implicit support issues through appropriate rate design and other mechanisms within a state,"¹¹⁶ and it concluded that states "should bear the responsibility for the design of intrastate funding mechanisms."¹¹⁷ The Joint Board's position is consistent with the methodology that it recommended for determining federal support levels. That methodology does not mandate any particular state action, but assumes that states will take some action, whether through rate design or through an explicit support mechanism, to support universal service within the state, and provides for federal support where such state efforts would be insufficient to achieve reasonable comparability of rates.¹¹⁸ We will continue to monitor state efforts at eliminating implicit support and will consider additional measures should state efforts be insufficient in this regard.

B. Methodology for Estimating Costs and Computing Support

47. We are adopting the majority of the Joint Board's recommendations for a revised

¹¹² *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 25.

¹¹³ *See also* GTE comments at 15; New York Commission comments at 4; Sprint comments at 5.

¹¹⁴ 47 U.S.C. § 254(b)(5) (emphasis added).

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

¹¹⁶ *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 25.

¹¹⁷ *Second Recommended Decision*, 13 FCC Rcd at 24756, para. 26.

¹¹⁸ *Second Recommended Decision*, 13 FCC Rcd at 24760-62, paras. 37, 42-44.

methodology for estimating costs and calculating federal support levels to enable reasonably comparable local rates for non-rural carriers. We are seeking further comment, however, on specific implementation issues in the attached FNPRM.¹¹⁹ We conclude that the revised universal service high-cost support mechanism shall take effect on January 1, 2000. We anticipate that by January 1, 2000, the Commission will have made final determinations on all outstanding issues raised in the FNPRM, and all verification of the cost model that will be used to estimate the forward-looking costs of providing supported services will have been completed.

48. Specifically, we adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services.¹²⁰ We also adopt the Joint Board's general recommendation that the methodology should rely primarily on states to achieve reasonably comparable rates within their borders, while providing support for above-average costs to the extent that such costs prevent the state from enabling reasonable comparability of rates.¹²¹ We further adopt the Joint Board's recommendations that this explicit federal support mechanism should not be significantly larger than the current explicit federal mechanism.¹²² Finally, while we endorse the concept of a hold-harmless provision in this Order, we are seeking more specific comment in the FNPRM on how a hold-harmless provision should be implemented.¹²³ We are also seeking comment in the FNPRM on certain recommendations of the Joint Board, including its recommendation that support be calculated at the study area level and its recommended ranges for a cost-based benchmark.¹²⁴

1. Forward-Looking Economic Costs

a. Background

49. In both *Recommended Decisions*, the Joint Board recommended that the Commission calculate federal high-cost support for non-rural carriers based on forward-looking economic costs, instead of on incumbent carriers' book costs of providing the supported services.¹²⁵ The

¹¹⁹ See section V, *infra*.

¹²⁰ *Second Recommended Decision*, 13 FCC Rcd at 24757, para. 28.

¹²¹ *Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 41-46.

¹²² *Second Recommended Decision*, 13 FCC Rcd at 24762-64, paras. 47-50.

¹²³ See section V(D), *infra*.

¹²⁴ See sections (V)(B)(1), (2), *infra*.

¹²⁵ *First Recommended Decision*, 12 FCC Rcd at 184, para. 184; *Second Recommended Decision*, 13 FCC Rcd at 24756-58, paras. 27-30. The Joint Board noted, however, that a proxy cost model's determination of forward-looking costs to provide the supported services does not determine the amount of support that will be needed in the aggregate or that any given carrier will receive. *Second Recommended Decision*, 13 FCC Rcd at 24757, para. 28 n.41 (citing *Platform Order*, 13 FCC Rcd at 21324-25, para. 2).

Joint Board further encouraged the states and the Commission to work with the Joint Board to develop an accurate cost model for estimating forward-looking costs, in recognition of the fact that the cost model was not yet finalized at the time of the *Second Recommended Decision*.¹²⁶ The Joint Board also recommended that the Commission reconsider its decision in the *First Report and Order* to allow state cost studies to be used in place of the federal model for non-rural carriers.¹²⁷

b. Discussion

50. We adopt the Joint Board's recommendation that support calculations be based on forward-looking costs, and that those costs be estimated using a single national model. As we stated in the *First Report and Order*, a methodology based on forward-looking economic costs will "send the correct signals for entry, investment, and innovation in the long run."¹²⁸ Many commenters support the use of forward-looking economic costs as the basis for estimating the costs of providing the supported services,¹²⁹ because the use of forward-looking economic costs will encourage efficient entry and investment. The use of a carrier's book costs, by contrast, would not allocate support in a competitively neutral manner among potentially competing carriers.¹³⁰ Instead, such a system would tend to distort support payments because current book costs are influenced by a variety of carrier-specific factors, such as the age of the plant, depreciation rates, efficiency of design, and other factors. Support based on forward-looking models will ensure that support payments remain specific, predictable, and sufficient, as required by section 254, particularly as competition develops.¹³¹ To achieve universal service in a competitive market, support should be based on the costs that drive market decisions, and those costs are forward-looking costs.

51. Although we believe that forward-looking costs will set support levels most efficiently, we decline to adopt a suggestion of the Ohio Consumers' Counsel that carriers should receive the lesser of either current amounts of high-cost support or a forward-looking economic

¹²⁶ *Second Recommended Decision*, 13 FCC Rcd at 24757-58, para. 29.

¹²⁷ *Second Recommended Decision*, 13 FCC Rcd at 24758, para. 31. *See First Report and Order*, 12 FCC Rcd at 8912, para. 248.

¹²⁸ *See First Report and Order*, 12 FCC Rcd at 8899, 8927, paras. 224, 273.

¹²⁹ AT&T comments at 3; District of Columbia Commission comments at 7; GSA comments at 7; MCI WorldCom comments at 11; Ohio Consumers' Counsel comments at 5; TRA comments at 3-4; Wyoming comments at 3. *But see, e.g.* Bell Atlantic comments at 6; Colorado Commission comments at 1; Harris Skrivan & Associates comments at 1.

¹³⁰ *See, e.g.*, AT&T comments at 3.

¹³¹ *See* 47 U.S.C. § 254(b)(5).

cost model-based amount.¹³² The hold-harmless provision set forth in section IV(B)(4) of this Order is intended to prevent dislocation and rate shocks as we make the transition to a support system based on forward-looking costs.¹³³ As noted below in section IV(F), we intend for the Joint Board and the Commission to re-evaluate non-rural carriers' support mechanisms, including the hold-harmless provision, three years from the date that the revised mechanism is implemented.¹³⁴

52. Although some commenters have expressed concerns about the accuracy of the outputs of the cost model,¹³⁵ we agree with the Joint Board that a national forward-looking model will provide a more consistent approach by which to develop a method for measuring rate comparability than would individual state cost studies. We believe state cost studies could rely on differing forward-looking cost methodologies, including differing assumptions or input data elements that would prevent meaningful comparisons of the resulting forward-looking cost estimates, and thus would provide a less accurate and consistent picture by which we could evaluate the cost levels that must be supported in each state to develop reasonably comparable rates. Therefore, we reject the use of state cost studies for the purpose of developing our method for rate comparability. States, of course, retain the flexibility to design state-level support mechanisms using other indicators of cost.

53. At this time, however, there has not been adequate time to verify the results of the cost model and to verify that certain input data elements are accurate. Thus, we cannot implement immediately a revised high-cost support mechanism based on forward-looking economic costs. We anticipate that the model and the input data will be verified and ready for use by January 1, 2000.

54. The Joint Board recommended that, if the Commission did not implement a forward-looking support mechanism on July 1, 1999 to enable the reasonable comparability of non-rural carriers' rates, the Commission should provide interim relief to high-cost states served primarily by non-rural carriers.¹³⁶ In formulating this Order, we have continued to consult with the state Joint Board members, and they recently filed a letter stating that the Commission should not adopt an interim mechanism, given the brevity of the implementation delay that we adopt today.¹³⁷ The

¹³² Ohio Consumers' Counsel comments at 5.

¹³³ See section IV(B)(4), *infra*.

¹³⁴ See section IV(F), *infra*.

¹³⁵ The Illinois Commission disagrees with the Joint Board's recommendations that a federal proxy model be used, and raises concerns about the accuracy of the proxy models, particularly while the Commission has not yet determined the input values. Illinois Commission comments at 2-3.

¹³⁶ *Second Recommended Decision*, 13 FCC Rcd at 24757-58, para. 29.

¹³⁷ See Letter of State Joint Board Members to William E. Kennard, Chairman, FCC, dated May 14, 1999.

state Joint Board members state that they have been unable to develop a workable interim solution, and that the administrative complexity of overlaying changes in collection and disbursement onto the existing system for only six months does not appear prudent. In light of the state members' position on this issue, and the reasons they present in their letter, we conclude that we should not adopt an interim support mechanism at this time.

2. Shared Federal-State Responsibility for Reasonably Comparable Rates

a. Background

55. The Joint Board recognized in the *Second Recommended Decision* that states bear part of the responsibility for universal service. The Joint Board further stressed that implicit support in state rates is "intimately related to each state's rate design," and that the Commission may assume that states will address issues regarding implicit intrastate support in an appropriate manner.¹³⁸ To the extent that states face great burdens or obstacles in maintaining rates reasonably comparable to those prevalent nationally, the Joint Board explained that federal support could be applied to achieve such reasonable comparability.¹³⁹

56. The Joint Board recommended that federal support should be available where a state cannot meet its own universal service burden to achieve rates that are reasonably comparable, but that federal support should not be conditioned on a state's actions with respect to universal service.¹⁴⁰ Specifically, the Joint Board recommended that federal support should be provided in a manner consistent with each state's ability to use its resources to address its universal service needs.¹⁴¹

b. Discussion

57. We agree with the Joint Board that the states share responsibility for universal service, and that states should have "specific, predictable, and sufficient" mechanisms in place to maintain and advance universal service.¹⁴² We further agree with the Joint Board that, because rates are generally affordable, and subscribership is high in most parts of the country, federal involvement may be limited to instances where states face significant obstacles in maintaining

¹³⁸ *Second Recommended Decision*, 13 FCC Rcd at 24760, para. 39.

¹³⁹ *Second Recommended Decision*, 13 FCC Rcd at 24760-61, para. 40.

¹⁴⁰ *Second Recommended Decision*, 13 FCC Rcd at 24759-60, para. 36.

¹⁴¹ *Second Recommended Decision*, 13 FCC Rcd at 24759-60, para. 36.

¹⁴² *Second Recommended Decision*, 13 FCC Rcd at 24759-60, paras. 36-38.

reasonably comparable rates.¹⁴³ Because affordability is closely tied to local rate levels, established and regulated by the states, we conclude that states are well-positioned to adopt local rate structures and intrastate universal service support mechanisms that maintain affordable and reasonably comparable rates on a statewide basis. Federal mechanisms, in contrast, will assure that these goals are met nationally by providing support to those states where the cost of providing the supported services substantially exceed the national average. We find that the appropriate balance of responsibility for enabling reasonably comparable local rates can be struck through the methodology recommended by the Joint Board. Accordingly, as explained more fully in paragraph 34, above, we reconsider and reject the decision in the *First Report and Order* that the federal share of support should be limited to 25 percent of the difference between the forward-looking cost of providing the supported services and a national benchmark, and directed only to the interstate jurisdiction.¹⁴⁴

3. Determination of Federal Support Amounts

a. Background

58. The Joint Board recognized that some states may face significant difficulty in maintaining reasonably comparable rates, and therefore indicated that federal support would be necessary to enable states to achieve reasonably comparable rates, as required by section 254(b)(3) of the Act.¹⁴⁵ Accordingly, the Joint Board considered various options and concluded that the methodology for determining federal support should: (1) use a cost-based benchmark; and (2) consider each state's ability to support its universal service needs.¹⁴⁶ Specifically, in the *Second Recommended Decision*, the Joint Board recommended that the support methodology should identify: (1) study areas with average forward-looking per-line costs significantly in excess of the national average forward-looking cost (cost-based benchmark),¹⁴⁷ and (2) a state's ability to support its universal service needs internally.¹⁴⁸ Federal support would then be provided only to the extent that a state could not internally support its costs exceeding the benchmark.¹⁴⁹

¹⁴³ *Second Recommended Decision*, 13 FCC Rcd at 24760-61, para. 40.

¹⁴⁴ *See First Report and Order*, 12 FCC Rcd at 8925, para. 269.

¹⁴⁵ *Second Recommended Decision*, 13 FCC Rcd at 24760-61, para. 40.

¹⁴⁶ *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 41.

¹⁴⁷ In the *First Report and Order*, the Commission adopted the Joint Board's initial recommendation that, in determining high-cost support for non-rural carriers, the nationwide average revenue per line is a reasonable benchmark to use. *See First Report and Order*, 12 FCC Rcd at 8919-22, paras. 257-64. In this Order, we reconsider the use of a revenue-based benchmark, and decide instead to adopt a cost-based benchmark, consistent with the Joint Board's recommendations. *See Second Recommended Decision*, 13 FCC Rcd at 24761, para. 41.

¹⁴⁸ *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 42.

¹⁴⁹ *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 42.

59. With respect to the first step of the methodology, the Joint Board recommended that the Commission consider setting the national benchmark at a level between 115 and 150 percent of the national average cost per line.¹⁵⁰ The Joint Board supported using a cost-based benchmark, as opposed to one based on revenues, in evaluating rate comparability because state jurisdictions vary in how they set local rates.¹⁵¹ The Joint Board explained that such a cost benchmark could be used to identify study areas in which costs significantly exceed the national average.¹⁵²

60. In the second step of the methodology, the Joint Board concluded that federal support should be available to the extent that the state is not able to achieve reasonable comparability of rates using its own resources. The Joint Board discussed various potential ways to estimate a state's internal ability to achieve rate comparability, including calculating the ratio of high-cost to low-cost lines, or the ratio of intrastate traffic volume to total traffic volume.¹⁵³ In the alternative, the Joint Board stated that the Commission could determine the state's support responsibility as a certain percentage of intrastate revenues, or as a fixed amount per line.¹⁵⁴ Finally, the Joint Board recognized that it could not recommend specific details of the methodology because the model's cost estimates were not yet finalized.¹⁵⁵

b. Discussion

(1) Determining the National Benchmark

61. We adopt the Joint Board's recommendation that federal high-cost intrastate support should be determined using a cost-based benchmark and should be provided where states are unable to provide sufficient intrastate universal service support to non-rural carriers with costs that exceed a national benchmark. In so doing, we reconsider and reject the determination in the *First Report and Order* that federal support for rate comparability should be determined using a

¹⁵⁰ See *Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

¹⁵¹ See *Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

¹⁵² See *Second Recommended Decision*, 13 FCC Rcd at 24761-62, para. 43.

¹⁵³ *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 44.

¹⁵⁴ *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 44. For example, if the Commission were to determine a limit on a state's presumed responsibility at between three and six percent of intrastate telecommunications revenues, the Joint Board noted that, once the first step in the methodology had estimated 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. *Id.* at para. 45. Federal support would be provided for the amount exceeding the state revenue threshold.

¹⁵⁵ See *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 46. The Joint Board recommended that the Commission continue to consult with it and with Congress in order to specify the parameters of the methodology, as the amount of study area costs is derived from the Commission's model and choice of inputs. *Id.*

revenue-based benchmark.¹⁵⁶ Given the focus of the *Second Recommended Decision* on rate comparability, and its recommendation that the Commission should rely on the cost of providing the supported services when determining support amounts, rather than local rates, we believe that a cost-based benchmark is more appropriate.¹⁵⁷ We agree with the Joint Board's re-examination of this issue and its departure in the *Second Recommended Decision* from its original recommendation that a cost-based benchmark should not be used. We have continued to coordinate with the Joint Board in developing specific details of the methodology for determining high-cost support for non-rural carriers.

62. In the first step of the revised support methodology, areas will be identified where the forward-looking cost of providing the supported services exceeds the benchmark amount. We agree with the Joint Board that a cost-based benchmark provides a better gauge with which to identify areas in need of support to enable reasonably comparable rates than would a revenue benchmark. Contrary to the assertions of some commenters,¹⁵⁸ revenues may not accurately reflect the level of need for support to enable reasonably comparable rates because states have varying rate-setting methods and goals.¹⁵⁹ At this time, however, we are seeking further comment in the attached FNPRM on the specific level at which the cost-based benchmark should be set when the revised support mechanism goes into effect on January 1, 2000.¹⁶⁰

(2) Determining a State's Ability to Support its High-Cost Areas

63. We further agree with the Joint Board that federal support should be available to enable local rate comparability if the state cannot do so on its own, and thus that federal support

¹⁵⁶ *First Report and Order*, 12 FCC Rcd at 8919-24, paras. 257-267.

¹⁵⁷ *See Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19. In the *First Report and Order*, the Commission reasoned that a revenue benchmark was appropriate because, among other things, a revenue benchmark would also include revenues from discretionary (non-supported) services, and these revenues should, and do, contribute to the joint and common costs of providing the supported services. *First Report and Order*, 12 FCC Rcd at 8920-21, paras. 260-262. We now believe, however, that the use of a revenue benchmark is becoming an administratively unworkable approach, given that carriers may now be bundling the supported services with services that are not provided on the supported network, such as long distance services, wireless services, and Internet access services.

¹⁵⁸ *See, e.g.*, BellSouth comments at 7-8 (arguing that use of cost benchmark with analysis of a state's ability to fund its own universal service needs is contrary to intent of Section 254); Kentucky Commission comments at 3 (asserting that the Joint Board has not provided explanations as to why a cost-based benchmark is preferable to a revenue-based benchmark); MCI WorldCom comments at 11-12 (asserting that the only meaningful benchmark to use is the projected revenue that would be generated if rates were set at affordable and reasonably comparable levels).

¹⁵⁹ *See Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19; Bell Atlantic comments at 4; ITCs comments at 3-4; Sprint comments at 11-13.

¹⁶⁰ *See* section V(B)(1), *infra*.

for this purpose should be determined based, in part, on a state's ability to support its universal service needs internally.¹⁶¹ Given the difficulties in determining a state's ability to support its high-cost areas, and after extensive consultation with the Joint Board, we have concluded that a set dollar amount per line is an appropriate method by which to ascertain a state's internal ability to achieve rate comparability. We agree with the Maine Commission that a fixed dollar amount per line is a reasonably specific and certain method by which to determine a state's share of responsibility for universal service support.¹⁶² We also believe that using a fixed dollar amount per line is an administratively simple methodology that can be applied in a consistent manner to all states. In this Order, however, we have not set a specific per-line dollar amount. Rather, we seek further comment on the set dollar amount that should be used to define a state's responsibility in the FNPRM.¹⁶³

64. We agree in principle with those commenters that assert that using a fixed percentage of each state's intrastate revenues as the level of the state's responsibility for its universal service needs could unduly burden high-cost states that also have high intrastate revenues because they currently have high rates due to high costs.¹⁶⁴ However a state chooses to bear its universal service burden (*i.e.*, through existing, implicit rate designs or through an explicit support mechanism), the ability to spread the burden over a larger number of lines will make the burden easier for a state to bear. In contrast, using the ratio of high-cost to low-cost lines, one method suggested by the Joint Board, may not be as predictable as using a fixed dollar amount per line, because the number of high-cost to low-cost lines may fluctuate over time. Using the ratio of high-cost to low-cost lines also would be an administratively difficult method of determining a state's internal ability to achieve rate comparability, given the fact that supporting data would need to be obtained from a variety of sources in each state. Finally, the Joint Board's recommendation that intrastate support be calculated as a percentage of intrastate telecommunications revenues was based in part on its judgment that intrastate telecommunications revenues provide a rough measure of the funds available to support intrastate mechanisms. Because we have decided to adopt a cost-based benchmark rather than a benchmark that is based on revenues, we do not believe that a percentage-based cap on intrastate responsibility would in every case provide a meaningful measure of a state's ability to fund intrastate support.

65. We emphasize that states are not, through the adoption of this approach, required to impose a per-line charge to support universal service, nor are carriers necessarily entitled to recover this amount from new or explicit state mechanisms. As the Joint Board explained, this amount reflects a reasonable estimate of the state's ability to achieve reasonably comparable rates on a statewide basis and establishes a level above which federal support, consisting of funds

¹⁶¹ See *Second Recommended Decision*, 13 FCC Rcd at 24761-62, paras. 42, 44.

¹⁶² See Maine Commission *et al.* comments at 6.

¹⁶³ See section V(B)(3), *infra*.

¹⁶⁴ See, *e.g.*, Iowa Commission comments at 8-9; Maine Commission *et al.* comments at 6.

transferred from other jurisdictions, should be provided to assist the state in achieving rates that are reasonably comparable to those in other states. States largely are already making use of this ability by providing carriers with substantial universal service support, often through rate averaging and other rate design methodologies, and states are best positioned to determine how and whether these mechanisms need to be altered to ensure that carriers do not double-recover universal service support. Given the substantial amounts of universal service support already built into state rate designs, we agree with the Joint Board that providing the full amount of support determined by the federal methodology from federal mechanisms, without any estimate of state support, is likely to lead to carrier double-recovery.¹⁶⁵

66. Thus, in the second step of the revised support methodology, an assessment will be made as to whether the perceived support need, as established in the first step of the methodology, exceeds the state's ability to achieve reasonable comparability of rates. The state's ability will be estimated by multiplying a dollar figure by the number of lines served by non-rural carriers in the state. Any needed support that exceeds this estimate of the state's ability to support its own high-cost areas will be provided by the federal mechanism. In this way, the mechanism will ensure that every state will have adequate resources to ensure reasonably comparable rates.

4. Size of the Federal Support Mechanism and Hold-Harmless

a. Background

67. The Joint Board concluded in the *Second Recommended Decision* that federal high-cost support mechanisms should be only as large as necessary, consistent with other requirements of the law.¹⁶⁶ Specifically, the Joint Board observed that, although federal support must be sufficient to enable reasonable comparability of rates, it did not believe that current conditions required a significantly larger federal support mechanism than currently exists to meet these ends.¹⁶⁷ The Joint Board recommended that the Commission consider a "phase-in" of any increase in federal support intended to enable reasonable comparability of local rates for non-rural carriers, depending on the final amounts that are estimated on a forward-looking basis.¹⁶⁸ At the same time, the Joint Board expressed in the *Second Recommended Decision* its support for "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 high-cost assistance than the amount it currently receives from explicit support mechanisms."¹⁶⁹

¹⁶⁵ *Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19.

¹⁶⁶ *Second Recommended Decision*, 13 FCC Rcd at 24762-63, para. 47.

¹⁶⁷ *Second Recommended Decision*, 13 FCC Rcd at 24763, para. 49.

¹⁶⁸ *Second Recommended Decision*, 13 FCC Rcd at 24764, para. 53.

¹⁶⁹ *Second Recommended Decision*, 13 FCC Rcd at 24764, para. 53.

b. Discussion

68. In this Order, we adopt the recommendation of the Joint Board that a hold-harmless provision should be implemented to prevent substantial reductions of federal support and potentially significant rate increases.¹⁷⁰ Adoption of a hold-harmless provision will both serve to avoid any potential rate shock when the new federal support mechanism goes into effect, and to prevent undue disruption of state rate designs that may have been constructed upon, and thus are dependent upon, current federal high-cost support flows. We agree with the Joint Board that the hold-harmless amounts should be provided in lieu of the amounts computed by the two-step forward-looking methodology described in section IV(B)(3), above, whenever the hold-harmless amount exceeds the amount indicated by the forward-looking methodology. While we generally agree that a hold-harmless mechanism should be adopted, we are seeking further comment on specific implementation issues associated with the hold-harmless provisions in the FNPRM, and in particular, whether the hold-harmless mechanism should ensure that states as a whole, or carriers in particular, do not experience reductions in federal support.¹⁷¹

69. In determining the size of the new federal mechanism to enable reasonably comparable local rates, we must fulfill our statutory obligation to assure sufficient, specific, and predictable universal service support without imposing an undue burden on carriers and, potentially, consumers to fund any increases in federal support. Because increased federal support would result in increased contributions and could increase rates for some consumers, we are hesitant to mandate large increases in explicit federal support for local rates in the absence of clear evidence that such increases are necessary either to preserve universal service, or to protect affordable and reasonably comparable rates, consistent with the development of efficient competition.¹⁷² Rather, we agree with the Joint Board that current conditions do not necessitate substantial increases in federal support for local rates. We believe that limiting the amount of new support that each state receives under the new mechanism is consistent with the Joint Board's recommendation that the amount of such federal support should not increase significantly.¹⁷³

¹⁷⁰ *Second Recommended Decision*, 13 FCC Rcd at 24763, para. 51. Many commenters support the Joint Board's recommendation. *See, e.g.*, GTE comments at 22-23 (supporting hold-harmless and suggesting that a frozen per-line amount of support be the floor for the average per-line support provided in non-rural areas); Puerto Rico Telephone Company comments at 3 (stating that the hold-harmless pledge is particularly important to Puerto Rico, given its low penetration rates); RTC comments at 10 (asserting that hold-harmless will provide a reasonable level of support to states and carriers and will prevent rate shock); SBC comments at 6 (supporting holding states harmless so that no non-rural carrier receives less federal high-cost support than the amount it currently receives from explicit support mechanisms); Vitelco comments at 4 (supporting hold-harmless so that subscribers in the U.S. Virgin Islands will not experience drastic rate increases).

¹⁷¹ *See* section V(D), *infra*.

¹⁷² *See* D.C. Commission comments at 3-4. *See also* Ameritech comments at 6-7; Maryland Commission *et al.* comments at 5-6; New York Commission comments at 3; Ohio Consumers' Counsel comments at 2-3.

¹⁷³ *Second Recommended Decision*, 13 FCC Rcd at 24762-63, para. 47.

70. The Joint Board initially recommended that having the federal mechanism calculate support using study-area average costs would be one way roughly to maintain the current size of the federal mechanism.¹⁷⁴ Indeed, the current system calculates costs using study area-averaged costs. While we agree with the Joint Board that there is no current need for large increases in the size of the federal support mechanism for local rates, we are seeking further comment in the FNPRM on whether it is equally important, even at this early stage in the development of local competition, to provide support that is calculated at a more granular level.¹⁷⁵ Given that telephone service currently is largely affordable, and any significant increase in the size of federal support for local rates appears unnecessary,¹⁷⁶ we conclude that we should limit the size of the federal mechanism, as recommended by the Joint Board. We seek further comment in the FNPRM, however, on how we can best achieve this goal.¹⁷⁷

5. Portability of Support

71. In the *Second Recommended Decision*, the Joint Board recommended that the Commission maintain the policy established in the *First Report and Order* of making high-cost support available to all eligible telecommunications carriers, whether they be incumbent LECs, competitive carriers, or wireless carriers.¹⁷⁸ The Joint Board stated that portable support is consistent with the principle of competitive neutrality, and expressed its continued support for competitive neutrality as a guiding principle of universal service reform.¹⁷⁹ GTE and USTA expressed general support for this recommendation.¹⁸⁰

72. We conclude, consistent with the Joint Board's recommendation, that the policy the Commission established in the *First Report and Order* of making support available to all eligible telecommunications carriers should continue.¹⁸¹ All carriers, including commercial mobile radio service (CMRS) carriers, that provide the supported services, regardless of the technology used,

¹⁷⁴ *Second Recommended Decision*, 13 FCC Rcd at 24763, para. 50.

¹⁷⁵ See section V(B)(2), *infra*.

¹⁷⁶ See Maryland Commission *et al.* comments at 5-6.

¹⁷⁷ See section V(B)(2), *infra*.

¹⁷⁸ *Second Recommended Decision*, 13 FCC Rcd at 24765-66, para. 56. The Joint Board also reaffirmed the policy that a carrier offering universal service solely through reselling another carrier's universal service package should not be eligible to receive universal service support. *Id.* at 24765, n.60 (citing *First Report and Order*, 12 FCC Rcd at 8861-62, paras. 151-152).

¹⁷⁹ *Second Recommended Decision*, 13 FCC Rcd at 24765-66, para. 56.

¹⁸⁰ GTE comments at 28; USTA comments at 9.

¹⁸¹ See *First Report and Order*, 12 FCC Rcd at 8861-62, paras. 151-52.

are eligible for ETC status under section 214(e)(1).¹⁸² We reiterate that the plain language of section 214(e)(1) prohibits the Commission or the states from adopting additional eligibility criteria beyond those enumerated in section 214(e)(1).¹⁸³ We also reaffirm that under section 214(e), a state commission must designate a common carrier, including carriers that use wireless technologies, as an eligible carrier if it determines that the carrier has met the requirements of section 214(e)(1).¹⁸⁴ We re-emphasize that the limitation on a state's ability to regulate rates and entry by wireless service carriers under section 332(c)(3) does not allow the states to deny wireless carriers ETC status.¹⁸⁵

73. We agree with the Joint Board that competitive neutrality is a fundamental principle of universal service reform, and that portability of support is necessary to ensure that universal service support is distributed in a competitively neutral manner. We also agree with US West that "portability" of support should not be used to divert federal funds from high-cost areas to other areas.¹⁸⁶ For this very reason, we conclude in section IV(B)(6), below, that all carriers, both incumbent LECs and competitive LECs, must use high-cost support in a manner consistent with section 254, and we seek comment in the FNPRM on ways in which to target portable support amounts to high-cost wire centers within each incumbent's study area.¹⁸⁷

74. Although we adopt a hold-harmless provision in section IV(B)(4), above, we do not believe that the Joint Board intended incumbent LECs to be held harmless for federal high-cost support amounts that they lose when a customer elects to switch carriers and begins taking service from a competitive LEC. Such a conclusion would contravene the Joint Board's desire that competitive neutrality be a driving force behind universal service reform. Moreover, it would eviscerate the concept of "portable" support if the loss of customers to a competitor did not change the incumbent's support amounts. We conclude, therefore, that incumbent LECs will not be held harmless for reductions in their federal high-cost support amounts that result from competitive LECs capturing that incumbent LEC's customers. In addition, a competitive LEC or other carrier that gains an incumbent LEC's customers, and hence any high-cost support that the incumbent LEC had received for those customers, may only use that support in a manner consistent with section 254.¹⁸⁸ We seek comment in the FNPRM on how and whether any hold-

¹⁸² *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

¹⁸³ *First Report and Order*, 12 FCC Rcd at 8847, para. 127.

¹⁸⁴ *First Report and Order*, 12 FCC Rcd at 8851-52, para. 135.

¹⁸⁵ *First Report and Order*, 12 FCC Rcd at 8858-59, para. 145.

¹⁸⁶ US West comments at 12.

¹⁸⁷ See section (V)(C), *infra*.

¹⁸⁸ See section IV(B)(6), *infra*, for a discussion of the appropriate use of high-cost support.

harmless support should be ported.¹⁸⁹

6. Use of Support

a. Background

75. Section 254(e) of the 1996 Act requires 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."¹⁹⁰ In the *Second Recommended Decision*, the Joint Board recommended that the Commission require carriers to certify that they will apply federal high-cost support in a manner consistent with section 254.¹⁹¹ The Joint Board also recommended that the Commission should not require states to provide any certification as a "condition" on their carriers' receipt of high-cost support, but that the Commission should permit states to certify that, in order to receive federal universal service support, a carrier must use such funds in a manner consistent with section 254.¹⁹² The Joint Board stated that, to the extent permitted by law, the Commission could reduce or eliminate federal high-cost support if the Commission or a state finds that a carrier has not applied its federal universal service funds in a manner consistent with section 254.¹⁹³ The Joint Board also recommended that the Commission clarify the 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.¹⁹⁴

76. The Joint Board expressed its belief that conditioning support on a demonstration that funds are being used for the advancement of universal service does not place any restrictions on the determination of a carrier's status as an eligible telecommunications carrier.¹⁹⁵ Finally, the Joint Board recommended that universal service support should continue to be distributed directly to carriers, rather than to state commissions. The Joint Board arrived at this recommendation based upon: (1) the long-standing policy prior to the 1996 Act of distributing support to carriers providing the supported services; (2) the absence of any affirmative evidence in the statute or legislative history that Congress intended a "fundamental shift" to a mechanism that would distribute funds to state commissions; (3) concerns about imposing substantial administrative burdens on states; and (4) concerns that there is very little time, prior to July 1, 1999, for states to

¹⁸⁹ See section V(D), *infra*.

¹⁹⁰ 47 U.S.C. § 254(e).

¹⁹¹ *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 57.

¹⁹² *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 58.

¹⁹³ *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 59 (citing 47 U.S.C. § 254(e)).

¹⁹⁴ *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 59.

¹⁹⁵ *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 60.

take the steps necessary to administer the support mechanisms.¹⁹⁶

b. Discussion

77. We conclude that carriers must apply federal high-cost universal service support in a manner consistent with section 254. Specifically, section 254(e) requires carriers to use universal service support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."¹⁹⁷ We are seeking further comment in the FNPRM, however, on how, in concrete terms, we can best implement the Joint Board's recommendation that we ensure that carriers will use universal service support in a manner consistent with section 254.

78. We also conclude that, if we find that a carrier has not applied its universal service high-cost support in a manner consistent with section 254, we have the authority to take appropriate enforcement actions. States or other parties may petition the Commission, pursuant to section 208 of the Act, if such parties believe that a common carrier has misapplied its high-cost universal service support.¹⁹⁸ States or other parties should avail themselves of the Commission's formal complaint procedures if they believe that a common carrier is not using its federal universal service high-cost support in accordance with the directions we have set forth in this Order.¹⁹⁹ Because the Commission's statutory authority under section 208 extends to violations of the Act by all common carriers, we conclude that all potential recipients of high-cost support would be subject to our enforcement jurisdiction.²⁰⁰ Depending on the nature of the complaint, furthermore, a complaint filed by a party against a common carrier alleging misapplication of universal service high-cost support could qualify for resolution under the Commission's "accelerated docket" procedures.²⁰¹

C. Carrier Recovery of Universal Service Contributions from Consumers

¹⁹⁶ *Second Recommended Decision*, 13 FCC Rcd at 24767, para. 61.

¹⁹⁷ 47 U.S.C. § 254(e).

¹⁹⁸ 47 U.S.C. § 208. Section 208 provides, *inter alia*, that "any person, any body politic or municipal organization, or State commission, complaining of anything done or omitted to be done by any common carrier subject to this Act, in contravention of the provisions thereof, may apply to said Commission by petition. . . ."

¹⁹⁹ The Commission's procedures for complaints involving common carriers are codified at 47 C.F.R. § 1.720, *et seq.*

²⁰⁰ *See generally Implementation of the Telecommunications Act of 1996, Amendment of Rules Governing Procedures to Be Followed When Formal Complaints Are Filed Against Common Carriers*, Report & Order, CC Dkt. No. 96-238, 12 FCC Rcd 22497 (1997). Standing is not an issue for parties seeking redress for violations of the Act.

²⁰¹ *See Implementation of the Telecommunications Act of 1996, Amendment of Rules Governing Procedures to be Followed when Formal Complaints are Filed against Common Carriers*, Second Report and Order, CC Docket No.96-238, 13 FCC Rcd 17018 (1998).

1. Background

79. In the *First Report and Order*, the Commission concluded that, in a dynamic telecommunications marketplace where pricing flexibility is an important competitive tool, carriers will need the ability to decide how they should recover their contributions to the federal universal service support mechanisms.²⁰² The Commission found that, as telecommunications carriers and providers begin combining various telecommunications products into single packages, they will be likely to offer bundled services and new pricing options, such as local and long distance service for a package price.²⁰³ Therefore, the Commission decided to permit, but not to require, incumbent LECs whose interstate rates are under the Commission's jurisdiction to recover their contributions to the universal service support mechanisms from their interstate access and interexchange customers.²⁰⁴ In doing so, the Commission declined to require that carriers recover their contributions from consumers through a mandatory end-user surcharge.²⁰⁵ Instead, consistent with the Joint Board's recommendations, the Commission allowed interexchange carriers, wireless carriers, and competitive LECs to decide for themselves whether, and how, to recover their contributions from their customers.²⁰⁶

80. In the event that carriers decided to recover their contributions from their customers, the Commission required carriers to provide complete and truthful information on customer bills regarding the contribution amount.²⁰⁷ The Commission stated that characterizing universal service charges on customer bills as a federally mandated surcharge would be misleading because carriers retain the flexibility to structure their recovery of the costs of universal service in many ways.²⁰⁸ Carriers choosing to recover universal service costs from consumers were instructed to convey information about such charges in a manner that does not mislead by omission and that accurately describes the nature of the charge.²⁰⁹

81. On September 17, 1998, the Commission released the *Truth-in-Billing NPRM*, seeking comment on how to ensure that consumers receive thorough, accurate, and

²⁰² *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

²⁰³ *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

²⁰⁴ *First Report and Order*, 12 FCC Rcd at 9199, para. 829.

²⁰⁵ *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

²⁰⁶ *First Report and Order*, 12 FCC Rcd at 9210-11, para. 853.

²⁰⁷ *First Report and Order*, 12 FCC Rcd at 9211-12, para. 855.

²⁰⁸ *First Report and Order*, 12 FCC Rcd at 9211-12, para. 855.

²⁰⁹ *First Report and Order*, 12 FCC Rcd at 9211-12, para. 855.

understandable bills from their telecommunications carriers.²¹⁰ In response to evidence suggesting widespread confusion among consumers in this area, the Commission sought comment in the *Truth-in-Billing NPRM* on whether carriers were providing complete, accurate, and understandable information regarding the amounts of, and the reasons for, the new charges on customer bills.²¹¹ The Commission asked commenters to address whether it should prescribe "safe harbor" language that carriers could include on their bills to ensure that they are meeting their obligations to provide truthful and accurate information concerning the recovery of universal service charges.²¹² The Commission also sought comment on whether charging a customer more than a proportionate share of the carrier's universal service costs attributable to that customer would violate section 201(b) of the Act.²¹³ The Commission recognized that it had recently referred to the Joint Board the issue of whether it is reasonable for telecommunications providers to recover universal service contributions through rates, surcharges, or other means, and that nothing in the *Truth-in-Billing NPRM* was intended to supersede or interfere with the Joint Board's evaluation.²¹⁴ Instead, the Commission indicated that the Joint Board's recommendations would inform the Commission's judgment in the *Truth-in-Billing* proceeding.²¹⁵

82. In the *Second Recommended Decision*, the Joint Board reaffirmed that interexchange carriers, wireless carriers, and competitive LECs should have the choice of whether to collect universal service assessments from end users through a line-item charge on their bills.²¹⁶ Based on its concerns that consumers were not receiving accurate and truthful information from carriers, however, the Joint Board recommended that the Commission provide carriers with strict guidance about the extent to which they can recover their universal service contributions from consumers.²¹⁷ Specifically, the Joint Board recommended that the Commission carefully consider adopting a rule that limits the line-item universal service charge on a consumer's bill to an amount

²¹⁰ *Truth-in-Billing and Billing Format*, Notice of Proposed Rulemaking, 13 FCC Rcd 18176 (1998) (*Truth-in-Billing NPRM*).

²¹¹ *Truth-in-Billing NPRM*, 13 FCC Rcd at 18189, para. 26.

²¹² *Truth-in-Billing NPRM*, 13 FCC Rcd at 18189-90, paras. 27-30.

²¹³ *Truth-in-Billing NPRM*, 13 FCC Rcd at 18190, para. 31; *see also* 47 U.S.C. § 201(b) (stating that all charges and practices regarding communications services shall be just and reasonable).

²¹⁴ *Truth-in-Billing NPRM*, 13 FCC Rcd at 18189, para. 26 n.55.

²¹⁵ *Truth-in-Billing NPRM*, 13 FCC Rcd at 18189, para. 26 n.55.

²¹⁶ *Second Recommended Decision*, 13 FCC Rcd at 24771, para. 69. Incumbent LECs subject to price cap regulation made exogenous increases in price cap indices for baskets containing end-user revenues, to permit recovery of their universal service contribution obligations. *See Access Charge Reform Order*, 12 FCC Rcd at 16147-48.

²¹⁷ *Second Recommended Decision*, 13 FCC Rcd at 24770, para. 68.

no greater than the carrier's universal service assessment rate.²¹⁸ The Joint Board also recommended that the Commission prohibit carriers from identifying universal service charges as a "tax" or as being mandated by the Commission or federal government, either on written bills or through oral descriptions from customer service representatives.²¹⁹ The Joint Board further recommended that the Commission explore in the *Truth-in-Billing* proceeding the possibility of establishing standard nomenclature that carriers could use on their bills regarding universal service charges.²²⁰ The Joint Board suggested using the term "Federal Carrier Universal Service Contribution" as standard language on consumer bills, 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.²²¹ Finally, the Joint Board recommended that the Commission work with other federal and state regulatory agencies charged with consumer protection to ensure that consumers are provided with complete and accurate information regarding universal service charges.²²²

83. The Commission received a broad range of comments in response to the proposals in the *Second Recommended Decision*.²²³ Several commenters pointed out, however, that the issues addressed by the Joint Board concerning the recovery of universal service contributions from consumers are already pending in the *Truth-in-Billing* proceeding.²²⁴ These commenters suggest that it would be more appropriate for the Commission to consolidate its handling of the recovery issues in the *Truth-in-Billing* proceeding.²²⁵

84. On May 11, 1999, the Commission released the *Truth-in-Billing First Report and*

²¹⁸ *Second Recommended Decision*, 13 FCC Rcd at 24771, para. 69.

²¹⁹ *Second Recommended Decision*, 13 FCC Rcd at 24771-72, para. 70.

²²⁰ *Second Recommended Decision*, 13 FCC Rcd at 24772, para. 72.

²²¹ *Second Recommended Decision*, 13 FCC Rcd at 24772, para. 72.

²²² *Second Recommended Decision*, 13 FCC Rcd at 24773, para. 73.

²²³ See, e.g., AT&T comments at 8-9; Airtouch comments at 2-7; Ameritech comments at 10-11; BellSouth comments at 9; Boston University comments at 1-2; CompTel comments at 7; Dobson comments at 2-9; GSA comments at 14-17; GTE comments at 32; Illinois Commission comments at 4; MCI WorldCom comments at 18-22; Ohio Commission comments at 9-10; PCIA comments at 2-5; RTC comments at 24-25; Sprint comments at 16-22; TRA comments 2-8; USTA comments at 11-13; US West comments at 13-17; Wyoming Commission comments at 7; AT&T reply comments at 12-15; GSA reply comments at 16-20; GTE reply comments at 22-28; MCI WorldCom reply comments at 8-11; Sprint reply comments at 4-5; Western Wireless reply comments at 16-17.

²²⁴ PCIA comments at 2; Sprint comments at 16-17; AT&T reply comments at 14-15.

²²⁵ PCIA comments at 2; Sprint comments at 16-17; AT&T reply comments at 14-15.

Order and FNPRM.²²⁶ In the *Truth-in-Billing First Report and Order*, the Commission adopted basic principles mandating that consumer telephone bills must be clearly organized, must contain full and non-misleading descriptions of charges, and must clearly and conspicuously disclose any information the consumer may need to contest charges on the bill.²²⁷ In addition, based in part on the Joint Board's *Second Recommended Decision* and the comments in response to it, the Commission made specific findings regarding carrier recovery of universal service contributions.

85. First, the Commission declined to require that contributions be recovered through an end-user surcharge.²²⁸ Instead, the Commission reaffirmed its commitment to allowing carriers the flexibility to decide whether, how, and how much of their costs they choose to recover from consumers.²²⁹ Second, the Commission declined to adopt a specific rule restricting a carrier from charging a line-item assessment amount greater than the carrier's universal service assessment rate, or a specific rule prohibiting a carrier from charging a customer more than the customer's *pro rata* share of the carrier's universal service contribution.²³⁰ The Commission noted that contributions may depend on variables not known to the carrier at the time the carrier issues a bill.²³¹ The Commission decided to evaluate allegedly unjust or unreasonable line-item charges on a case-by-case basis under its section 201(b) authority.²³² Finally, the Commission concluded that line-item charges associated with federal regulatory action should be identified on bills through a standard industry-wide label.²³³ So long as carriers include the standard label, they would be free to elaborate on the nature and origin of the universal service charge through a full, accurate, and non-misleading description framed in language of their own choosing.²³⁴ In the *Truth-in-Billing FNPRM*, the Commission tentatively concluded that the standard label to describe universal service charges should be "Federal Universal Service," and sought comment on alternative nomenclature.²³⁵

2. Discussion

²²⁶ *Truth-in-Billing First Report and Order and FNPRM*, FCC 99-72.

²²⁷ *Truth-in-Billing First Report and Order* at para. 5.

²²⁸ *Truth-in-Billing First Report and Order* at para. 55.

²²⁹ *Truth-in-Billing First Report and Order* at para. 55.

²³⁰ *Truth-in-Billing First Report and Order* at para. 56.

²³¹ *Truth-in-Billing First Report and Order* at para. 56.

²³² *Truth-in-Billing First Report and Order* at para. 56.

²³³ *Truth-in-Billing First Report and Order* at para. 49.

²³⁴ *Truth-in-Billing First Report and Order* at para. 55.

²³⁵ *Truth-in-Billing First Report and Order* at para. 67.

86. Because we have resolved, or are resolving, all of the carrier recovery issues in the *Truth-in-Billing* proceeding, we need not revisit them here. We continue to believe that the ongoing *Truth-in-Billing* proceeding, with the detailed record being developed there, is the correct forum to resolve these issues. We wish to emphasize, however, that prior to the adoption in the *Truth-in-Billing* proceeding of any final standardized label for universal service charges on consumer bills, we will not hesitate to take enforcement action against carriers who engage in unjust or unreasonable practices in violation of section 201(b).²³⁶

D. Assessing Contributions from Carriers

1. Background

87. In the *First Report and Order*, the Commission concluded that contributions to federal high-cost and low-income support mechanisms would be assessed based solely on end-user interstate telecommunications revenues, while universal service support for eligible schools, libraries and rural health care providers would be assessed based on interstate and intrastate end-user telecommunications revenues.²³⁷ The Commission declined to assess both interstate and intrastate end-user revenues for the high-cost and low-income support mechanisms because the states are currently reforming their own universal service support mechanisms, and it would have been premature to assess contributions on intrastate revenues before appropriate forward-looking mechanisms and revenue benchmarks are developed.²³⁸ The Commission also concluded that carriers shall be permitted to recover their contributions to universal service support mechanisms only through rates for interstate services.²³⁹

88. The Joint Board's recommendations regarding the revenue base on which universal service contributions should be assessed were tentative, pending the Fifth Circuit's decision in *Texas Public Utility Counsel v. FCC*.²⁴⁰ The Joint Board recognized that the current method of basing contributions solely on interstate end-user revenues gives the states the most flexibility to tap into their intrastate revenue bases to advance universal service.²⁴¹ The Joint Board also recognized, however, that assessing only interstate end-user revenues may create burdens for carriers that do not routinely have to separate revenues on a jurisdictional basis for regulatory or

²³⁶ 47 U.S.C. § 201(b).

²³⁷ *First Report and Order*, 12 FCC Rcd at 9197-05, paras. 824-41.

²³⁸ *First Report and Order*, 12 FCC Rcd at 9200-01, paras. 831-36.

²³⁹ *First Report and Order*, 12 FCC Rcd at 9198-00, paras. 825-30.

²⁴⁰ *Second Recommended Decision*, 13 FCC Rcd at 24767-68, para. 63 (citing *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir. argued Dec. 1, 1998)).

²⁴¹ *Second Recommended Decision*, 13 FCC Rcd at 24767-68, para. 63.

business purposes, such as wireless carriers and competitive LECs.²⁴² The Joint Board observed that a jurisdictional assessment base makes it difficult for carriers to allocate revenues associated with bundled services, and stated that a non-jurisdictional assessment base would enable state and federal mechanisms to tap broader revenue bases, thereby lowering the assessment rate.²⁴³ The Joint Board recommended that, 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 adopts such an assessment methodology, it should also permit states to do the same for their state universal service contributions.²⁴⁴ In the alternative, the Joint Board also indicated that the Commission could consider assessing high-cost universal service contributions on a flat, per-line basis.²⁴⁵

89. There is a lack of consensus among the parties as to the appropriate basis for contributions to the high-cost universal service support mechanisms. While some commenters support assessing contributions to the high-cost universal service support mechanisms based on both intrastate and interstate end-user revenues²⁴⁶ some commenters assert that contributions should continue to be based solely upon interstate end-user revenues.²⁴⁷

2. Discussion

90. The Fifth Circuit has not yet issued a decision in *Texas Public Utility Counsel v. FCC*. While we acknowledge the Joint Board's observation that changing the assessment base to include both interstate and intrastate end-user telecommunications revenues would ease burdens on carriers that would not otherwise have to separate revenues on a jurisdictional basis and that a broader revenue base would result in a lower assessment rate, these recommendations are contingent upon the Fifth Circuit's decision in *Texas Public Utility Counsel v. FCC*. Accordingly, pending further resolution of this matter by the Fifth Circuit, the assessment base and the recovery base for contributions to the high-cost and low-income universal service support mechanism that we adopted in the *First Report and Order* shall remain in effect.

E. Unserved Areas

²⁴² *Second Recommended Decision*, 13 FCC Rcd at 24767-68, para. 63.

²⁴³ *Second Recommended Decision*, 13 FCC Rcd at 24767-68, para. 63.

²⁴⁴ *Second Recommended Decision*, 13 FCC Rcd at 24767-68, para. 63.

²⁴⁵ *Second Recommended Decision*, 13 FCC Rcd at 24767-68, para. 63.

²⁴⁶ See AT&T comments at 6; GSA comments at 6; GTE comments at 31; Bell South comments at 9.

²⁴⁷ See, e.g., Ameritech comments at 10; Bell Atlantic comments at 7; California Commission comments at 7-8, 10-11; Illinois Commission comments at 5; Ohio Consumers' Counsel comments at 8; Sprint comments at 14-15.

91. During the proceedings that led to the *Second Recommended Decision*, the Arizona Corporation 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 line extension or construction charges.²⁴⁸ In the *Second Recommended Decision*, the Joint Board expressed its interest in ensuring that telephone service is provided to unserved areas, and recognized that states other than Arizona may have unserved areas that may need to be examined.²⁴⁹ Because providing service to unserved areas has historically been addressed by the states, the Joint Board concluded that the states should continue to address unserved area problems, to the extent they are able to do so.²⁵⁰ The Joint Board recognized, however, that there may be some circumstances that warrant federal universal service support for line extensions to unserved areas. The Joint Board recommended that the Commission investigate the question of unserved areas in a separate proceeding and determine, in consultation with the Joint Board, whether there are unserved areas that warrant any federal universal service consideration.²⁵¹

92. We agree with the Joint Board that, while the states have historically addressed the issue of providing service to unserved areas, there may be unserved areas, or inadequately-served areas characterized by extremely low density, low penetration, and high costs that warrant additional federal universal service support.²⁵² Commenters who addressed this issue agree with the Joint Board that the Commission should investigate this issue further.²⁵³ Bringing service to these areas is clearly within the goal of the 1996 Act to accelerate deployment of services to "all Americans."²⁵⁴ In accordance with the Joint Board's recommendations, therefore, we will initiate a separate proceeding in July of 1999 to more fully develop the record on this issue, and investigate the nature and extent of the "unserved area" issue in the nation. We anticipate that, as a result of this separate proceeding, and in consultation with the Joint Board, we will be better

²⁴⁸ 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).

²⁴⁹ *Second Recommended Decision*, 13 FCC Rcd. at 24764-65, para. 55.

²⁵⁰ *Second Recommended Decision*, 13 FCC Rcd. at 24764-65, para. 55.

²⁵¹ *Second Recommended Decision*, 13 FCC Rcd. at 24764-65, para. 55.

²⁵² For example, such areas may encompass portions of Alaska, certain Native American lands, and other similar areas. We recognize "the distinctive obligation of trust incumbent upon the Government in its dealings with [Native Americans]," *Seminole Nation v. United States*, 316 U.S. 286, 296 (1942), and we are committed to fulfilling this obligation in the area of telecommunications. See also *Ramah Navajo Chapter v. Lujan*, 112 F.3d 1455, 1462 (10th Cir. 1997) (the federal government has a unique trust relationship with Native Americans).

²⁵³ See NECA Comments at 3-4, US West Comments at 21-22.

²⁵⁴ Indeed, the 1996 Act added section 214(e)(3), which provides a mechanism by which state commissions, with respect to intrastate services, may require a carrier to extend service into unserved areas. 47 C.F.R. § 214(e)(3).

able to determine whether any of these unserved areas should receive federal universal service support.

F. Periodic Review

93. In the *Second Recommended Decision*, the Joint Board noted that the 1996 Act 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.²⁵⁵ In addition to recommending that the Commission continue to consult with the Joint Board on matters addressed in the *Second Recommended Decision*, the Joint Board specifically recommended that the Joint Board and the Commission broadly reexamine the high cost universal service mechanism no later than three years from the implementation date of the revised universal service high-cost mechanism.²⁵⁶

94. We affirm our commitment to consulting with the Joint Board on an ongoing basis on issues addressed in this Order. We agree with the Joint Board that ongoing and periodic review is necessary in light of the fact that the telecommunications industry is rapidly changing, and both competition and technological change may affect universal service needs in rural, insular, and high cost areas. We conclude that, in addition to ongoing consultation with the Joint Board, the Commission and the Joint Board shall, on or before January 1, 2003, comprehensively examine the operation of the high-cost universal service mechanism implemented in this Order, including the hold-harmless mechanism.

²⁵⁵ *Second Recommended Decision*, 13 FCC Rcd at 24773, para. 74 (citing 47 U.S.C. § 254(c)(2)).

²⁵⁶ *Second Recommended Decision*, 13 FCC Rcd at 24773, para. 74.

V. FURTHER NOTICE OF PROPOSED RULEMAKING

A. Introduction

95. In the foregoing Order, we have adopted a framework to be used in estimating costs and computing federal support to enable reasonable comparability of rates for non-rural carriers. In this FNPRM, we provide an additional opportunity for interested parties to comment on specific implementation issues now that they are able to work with the cost model. We encourage all commenters to frame their comments in light of the companion *Inputs FNPRM* and to make those comments as specific as possible.²⁵⁷

B. Methodology Issues

1. National Benchmark

96. In its *Second Recommended Decision*, the Joint Board supported using a cost-based benchmark, as opposed to one based on revenues, in evaluating rate comparability because state jurisdictions vary in how they set local rates.²⁵⁸ The Joint Board explained that forward-looking cost estimates for a given area could be compared against the single national cost benchmark in order to determine whether the area has costs that are significantly above the national average.²⁵⁹ As discussed above in section IV(B)(3)(1), we adopted the Joint Board's recommendation to employ a cost-based benchmark.

97. In setting the level of the national benchmark, the Joint Board recommended that the Commission consider using a range between 115 and 150 percent of the national weighted average cost per line.²⁶⁰ Although several commenters support the use of a national benchmark, many were reluctant to comment on the range proposed by the Joint Board in the absence of a finalized cost model.²⁶¹ For that reason, we seek further comment on the specific cost benchmark that we should adopt, and we seek comment on whether the national benchmark should fall within the Joint Board's recommended range.

²⁵⁷ *Inputs FNPRM*, FCC 99-120.

²⁵⁸ See *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 43.

²⁵⁹ See *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 43.

²⁶⁰ See *Second Recommended Decision*, 13 FCC Rcd at 24761, para. 43.

²⁶¹ Maine Commission *et al.* comments at 3; Maryland Commission *et al.* comments at 10; Ohio Commission comments at 3-4; Sprint comments at 11-13; USTA comments at 5-6; Wyoming Commission comments at 6-8.

98. The current high-cost mechanism for large carriers²⁶² provides increasing amounts of support based on the amount by which a carrier's loop costs exceed the national average, beginning with loop costs between 115 percent and 160 percent of the national average. In particular, the current federal support mechanism provides 10 percent support (in addition to the 25 percent allocation of all loop costs to the interstate jurisdiction) for large incumbent LECs with more than 200,000 working loops for book loop costs above 115 percent of the national average, and provides gradually more support for the portion of these carriers' book loop costs exceeding 160 percent of the national average.²⁶³ The following chart summarizes the levels of support provided by the current high-cost mechanism for large carriers:²⁶⁴

Loop Cost as a % of the National Average	Amount of Intrastate Loop Cost Supported
greater than 115%, but not greater than 160%	10%
greater than 160%, but not greater than 200%	30%
greater than 200%, but not greater than 250%	60%
greater than 250%	75%

While the existing mechanism provides support for loop costs beginning at 115 percent of the national average, it considers only loop costs, while the forward-looking cost model estimates the forward-looking cost of all components of the network necessary to provide the supported services.

99. Although we have not yet completed our work verifying the results of the forward-looking cost model, the cost model is now operational and, in the foregoing Order, we have adopted the framework of our methodology for its use. The model currently suggests that, using this methodology, a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals. In addition to general comments on the Joint Board's recommended range for the cost benchmark, we also seek specific comment on the level at which we should set the national benchmark, including comment on what additional factors and considerations we should take into

²⁶² Pursuant to section 36.631 of the Commission's rules, the current high-cost mechanism provides greater levels of support for study areas reporting 200,000 or fewer working loops than for study areas reporting more than 200,000 working loops. *See* 47 C.F.R. § 36.631(c), (d).

²⁶³ 47 C.F.R. § 36.631(d). Although the 1996 Act does not specifically define a non-rural carrier, it does define a rural telephone company as a local exchange carrier that provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines or that serves only very small communities as defined by the Act. 47 U.S.C. § 153(37)(C).

²⁶⁴ 47 C.F.R. § 36.631(d).

account before selecting a final national benchmark level.²⁶⁵ We encourage commenters to use updated model outputs in formulating their comments.

100. To ensure that there are no sudden withdrawals or reallocations of federal support to cover costs between the cost benchmark range that we ultimately adopt, we also seek comment today on the Joint Board's recommendation that the new forward-looking mechanism incorporate a hold-harmless provision.²⁶⁶ In section V(D), below, we seek comment on the specific operation of such a provision. We encourage commenters to consider and discuss the interaction between specific cost benchmark levels and the precise operation of the hold-harmless provision.

2. Area Over Which Costs Should Be Averaged

a. Background

101. In the *First Report and Order*, the Commission adopted the Joint Board's original recommendation that forward-looking economic costs be determined at either the wire center level or below.²⁶⁷ In the *Second Recommended Decision*, the Joint Board reconsidered its original recommendation, and recommended instead that federal support be determined initially by measuring forward-looking costs on a study area basis, a considerably larger area than the wire center.²⁶⁸ The Joint Board decided that, although determining costs at the wire center level allows for measurement of support at more granular levels, support calculated at a study area level is more appropriate at this time, because the latter method will properly measure the amount of support that is required of the federal mechanism in light of the current level of local competition.²⁶⁹ The Joint Board acknowledged, however, that calculating costs at the study area level may be less appropriate as competition continues to develop.²⁷⁰

b. Discussion

102. After further consultation with the Joint Board, we seek further comment on whether the federal support mechanism should calculate support levels by comparing the forward-looking costs of providing supported services to the benchmark at either (1) the wire center level;

²⁶⁵ We have also requested comment on whether we should adopt incremental funding levels, similar to the current mechanism, above a graduated series of benchmarks. See section V(B)(2), *infra*, at para. 109.

²⁶⁶ We reiterate that comparison of the two mechanisms is difficult because the existing mechanism looks at book loop costs, while the new mechanism will consider the forward-looking cost of the entire network infrastructure necessary to provide the supported services.

²⁶⁷ *First Report and Order*, 12 FCC Rcd at 8884, para. 193.

²⁶⁸ *Second Recommended Decision*, 13 FCC Rcd at 24758, para. 32.

²⁶⁹ *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 33.

²⁷⁰ *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 34.

(2) the unbundled network element (UNE) cost zone level; or (3) the study area level.

103. A number of commenters have expressed support for calculating costs at the wire center level.²⁷¹ As we strive to bring competition to local telephone markets while keeping rates for local service affordable and reasonably comparable in all regions of the country, we recognize two major benefits of such explicit deaveraged high-cost support. As competition places downward pressure on rates charged to urban, business, and other low-cost subscribers, we believe that support deaveraged to the wire center level or below may ensure that adequate support is provided specifically to the subscribers most in need of support, because the support reflects the costs of specific areas. In addition, deaveraged explicit support that is portable among all eligible telecommunications carriers and targeted in a granular manner to support high-cost subscribers could encourage efficient competitive entry in all areas, not just in urban or other low-cost areas. By permitting the incumbent's rates to reflect actual costs in all areas, subject to explicit support assessments or portable support payments, explicit deaveraged support may provide incentives to competitors to expand service beyond urban areas and business centers into all areas of the country and to all Americans, as envisioned by the 1996 Act. We seek comment on this analysis.

104. As an alternative to computing costs at the wire center level, we seek comment on whether we should compare costs to the benchmark at the level of UNE cost zones instead. Under this proposal, each wire center within a UNE cost zone would receive the same amount of support. Thus, support would still be targeted to the general areas that need it most, but upward pressure on the size of the federal fund would be lessened compared to the wire center approach. This approach would also coincide with the rules on the pricing of UNEs.²⁷² Under our deaveraging rules, state commissions must establish different rates for elements in at least three defined geographical areas within the state to reflect geographic cost differences, and may use existing density-related zone pricing plans, or other cost-related zone plans established pursuant

²⁷¹ See Iowa Commission comments at 2; MCI-WorldCom comments at 4-5; RTC comments at 5; SBC comments at 4-5; Sprint comments at 8-10; USTA comments at 7; US West comments at 8-9; Western Wireless comments at 6-10; Wyoming Commission comments at 4-5.

²⁷² *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 (1996), *aff'd in part and vacated in part sub nom. Iowa Utilities Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utilities Bd.*, 119 S.Ct. 721 (1999) (*Local Competition Order*). Although the Supreme Court has reinstated our UNE deaveraging rules, *see* 47 C.F.R. § 51.507(f), those rules are currently stayed. *See In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deaveraged Rate Zones for Unbundled Network Elements*, Stay Order, CC Docket No. 96-98, FCC 99-86 (rel. May 7, 1999) (*Stay Order*). Pursuant to the *Stay Order*, the stay shall remain in effect until six months after the Commission issues an order in CC Docket No. 96-45 finalizing, and ordering implementation of, high-cost universal service support for non-rural LECs under section 254 of the 1996 Act. *Stay Order*, FCC 99-86 at para. 1. We expect to issue an order this fall that will finalize, and order the implementation of, a new high-cost support mechanism for non-rural LECs. Notwithstanding the stay, some states have already adopted deaveraged UNE rates and we have in the past recognized the benefits to competition of deaveraged UNE rates.

to state law.²⁷³ Using UNE zones may avoid opportunities for arbitrage,²⁷⁴ and because states are responsible for developing UNE zones, states will be able to develop zone boundaries based upon local conditions, including cost characteristics and the status of competition. We generally do not foresee any difficulty using the cost model to mirror state UNE zones, provided that state UNE zones correspond to wire center boundaries. We seek comment, however, on how state UNE zones that potentially do not correspond to wire center boundaries can be effectively used in the cost model. We encourage commenters to use updated model outputs in formulating their comments on this proposal. Finally, we ask commenters to propose any other cost zones, other than UNE zones, that may be an appropriate basis for computing costs.

105. We also seek comment on whether we should calculate costs at the study area level. In recommending that the federal support mechanism calculate costs at the study area level, the Joint Board suggested that the level of competition today has not eroded implicit support flows to such an extent as to threaten universal service.²⁷⁵ In addition, compared to calculating costs at the level of wire centers or UNE zones, calculating costs at the larger study area level may be more likely to prevent substantial increases in the size of the high-cost support mechanism because high-cost areas within the study area are averaged with lower-cost areas within the study area. In addition, we seek comment on whether comparing costs to the benchmark at the study area level is more consistent with a vision of a federal mechanism for reasonable rate comparability that focuses on support flows *among* states rather than *within* states, and whether such a vision is more consistent with the Joint Board's *Second Recommended Decision*.²⁷⁶ We seek specific comment, however, on the extent to which competition is likely to place steadily increasing pressure on implicit support flows from low-cost areas and the extent to which this pressure suggests that we should deaverage support in the implementation of our new mechanism. We urge commenters to use updated model outputs when responding to this analysis.

106. We seek specific comment on the impact of using study-area averaged costs in a study area where UNEs are available. In the *Local Competition Order*,²⁷⁷ the Commission determined that UNEs would be priced in a minimum of three rate zones within a state. If high-cost support is provided using study-area averaged costs, then all lines within the study area would be eligible for the same amount of support even though the UNE rates for those same lines would vary among rate zones within the state.²⁷⁸ We seek comment on whether this disparity

²⁷³ 47 U.S.C. § 51.507(f). See note 272, *supra*.

²⁷⁴ See para. 106, *infra*.

²⁷⁵ *Second Recommended Decision*, 13 FCC Rcd at 24759, para. 33.

²⁷⁶ See generally *Second Recommended Decision*, 13 FCC Rcd at 24752-56, paras. 14-26.

²⁷⁷ See *Local Competition Order*, 11 FCC Rcd 15499.

²⁷⁸ As discussed in note 272 above, although states are not now required to deaverage UNE rates, some states have done so and we have expressed our support in the past for deaveraging of UNE rates.

between support amounts and UNE rates among different rate zones may create incentives for carriers to engage in arbitrage or other uneconomic activities unrelated to the purpose of high-cost support.

107. In recommending that costs be calculated at the study area level, the Joint Board was driven by concerns that the amount of federal high-cost universal service support be "properly measured" in light of the current state of local competition. Comparing costs to a benchmark when averaged over a smaller area is bound to produce higher support calculations, however, because high costs in one area are less likely to be diluted by low costs in another area when the area under consideration is smaller. As discussed above, we agree with the Joint Board that federal support to enable reasonably comparable local rates for non-rural carriers should not increase significantly from current levels. We seek comment, however, on ways to resolve the tension between the goal of preventing the fund from increasing significantly above current levels, and the goal of ensuring that support is, to the extent possible, directly targeted to high-cost areas within study areas. In addition, we seek specific comment below on four proposals to resolve this tension.

108. First, we propose, if we were to determine total support amounts in each study area by running the model to estimate costs at the study area level, to distribute support by running the model again at the wire center level in order to target support to high-cost wire centers within the study area. This approach would not significantly increase the size of the fund, but would ensure that support is distributed to areas that need it most. As a second alternative, we could determine support based on costs averaged at a level more granular than the study area, such as UNE zones or wire centers, but provide only a uniform percentage of the support so indicated. Such an approach would be consistent with the Joint Board's findings that rates are presently affordable and that competition has not yet eroded support to high-cost customers.²⁷⁹

109. As a third alternative, we could determine support based on costs averaged at a level more granular than the study area, such as UNE zones or wire centers, but cap the amount of support available to any particular state to a fixed percentage of the overall fund. As a fourth alternative, if we were to determine support based on costs averaged at the UNE zone or wire center level, we could limit the size of the fund either by raising the cost benchmark appropriately or adopting incremental funding levels for costs above the selected benchmark similar to the existing high-cost loop support mechanism. As an example of incremental funding levels, were we to adopt a cost benchmark of 135 percent of the national weighted average cost per line, we could fund 10 percent of the costs that are between 135 percent and 160 percent of the national average, 30 percent of the costs that are between 160 percent and 200 percent of the national average, and so forth. We seek comment on each of these proposals, including comment on how each meets the statutory requirement that support should be "sufficient."²⁸⁰ We also ask commenters to suggest additional methods for preventing the size of the fund from growing

²⁷⁹ *Second Recommended Decision*, 13 FCC Rcd at 24746, para. 3, 24760, para. 39, 24763, para. 50.

²⁸⁰ 47 U.S.C. § 254(b)(5).

significantly.

3. Determining a State's Ability to Support High-Cost Areas

110. As discussed above in section IV(B)(3)(2), we agree with the Joint Board that federal support to enable reasonably comparable local rates for non-rural carriers should be determined based, in part, on a state's ability to support its universal service needs internally and that such federal support should be available to the extent the state is unable to achieve reasonably comparable rates using its own resources.²⁸¹ We concluded that a fixed dollar amount per line is a reasonably certain and specific means of assessing a state's ability to enable reasonable comparability of rates using its own resources.²⁸²

111. In this FNPRM, we now seek comment on the fixed per-line dollar amount that should be set to estimate a state's ability to internally support its high-cost areas, and how the amount should be determined. As one option, we observe that in the *First Report and Order*, the Commission suggested a revenue benchmark of approximately \$31.²⁸³ In the *Second Recommended Decision*, the Joint Board considered establishing a state's responsibility based on a percentage of revenues, specifically, a range between three and six percent of intrastate telecommunications revenues.²⁸⁴ We seek comment on whether the per-line amount should be set so that it amounts to between three and six percent of this original \$31 revenue benchmark, in order to roughly equal, in absolute dollar terms, the amount that a state could reasonably have anticipated if measured on a revenue percentage basis. For example, a \$2.00 per line figure would reflect roughly six percent of \$31. Under this fixed dollar amount per line approach, the perceived need for support in the state is first calculated by comparing costs to the benchmark. The state's ability to enable reasonably comparable rates in the face of this perceived need would then be estimated by multiplying the per-line figure by the total number of non-rural carrier lines in the state. If the perceived support need exceeds this estimate of the state's own resources, federal support would support the difference in accordance with the benchmark methodology described above in section IV(B)(3). We seek comment on this proposal.

²⁸¹ See *Second Recommended Decision*, 13 FCC Rcd at 24761-62, paras. 42, 44. See also Ameritech comments at 10 (stating that the Commission should not adopt a mechanism that requires it to become involved in an analysis of state universal service efforts); Iowa Commission comments at 8-9 (using a percentage of intrastate revenues does not measure a state's ability to support its high cost areas, and would penalize states that have begun rate rebalancing structures); Maine Commission *et al.* comments at 6 (noting that use of a fixed percentage of intrastate revenues would unduly burden high cost states that also have high intrastate revenues); Maryland Commission *et al.* comments at 12-13 (noting that the Commission should consider factors other than a state's ability to support its high cost areas internally, including the greater ability of high-income households to pay for basic local exchange service).

²⁸² We reiterate that, as discussed above in section IV(A)(4), the federal mechanism is neither contingent upon, nor requires, any particular action by the state.

²⁸³ *First Report and Order*, 12 FCC Rcd at 8924, para. 267.

²⁸⁴ *Second Recommended Decision*, 13 FCC Rcd at 24762, para. 45.

112. We also seek comment on whether wireless lines should be included in the calculation of a state's ability to support universal service. If commenters believe that wireless lines should be included, we seek comment on whether there should be a distinction between wireless lines of an ETC and wireless lines of a non-ETC.²⁸⁵ Finally, we emphasize that the use of a fixed per-line dollar value assessment to estimate states' abilities to support their universal service needs internally does not mandate the creation of state universal service funds for this purpose.

C. Distribution and Application of Support

113. As discussed above in section IV(B)(6), we have concluded that, consistent with section 254, carriers should be required to use support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."²⁸⁶ We seek comment on what specific restrictions, if any, are necessary to achieve this statutory requirement. Specifically, in the event that the Commission ultimately decides to average costs over an area larger than the wire center in determining support levels, we seek comment on how this application of support should be accomplished given our tentative conclusion to require carriers to apply federal high-cost support to the wire centers that triggered the need for support.

114. Although the Commission has the responsibility to ensure that support is sufficient to enable reasonable comparability of rates, the states establish specific rate levels. Therefore, we seek comment on whether making federal support available as carrier revenue, to be accounted for by the state in the rate setting process, will sufficiently fulfill the section 254(e)'s requirement that federal support shall be used "only for the provision, maintenance, or upgrading of facilities and services for which the support was intended."²⁸⁷ We tentatively conclude that making support available as part of the state rate-setting process would empower state regulators to achieve reasonable comparability of rates within their states.²⁸⁸ For example, we expect that states that have adopted price cap regulation could require exogenous price cap adjustments to reflect the increased support for high-cost areas and that states that retain rate of return regulation would count the new support towards carriers' revenue requirements. In either case, the state would be able to use federal support targeted to high-cost wire centers to enable reasonable comparability of local rates, if it so chose. We seek comment on this proposal. Specifically, we seek comment on whether all state commissions possess the jurisdiction and resources to take the actions this approach would require. We also seek comment on whether, under this proposal, carriers should be required to notify high-cost subscribers that their lines have been identified as high-cost lines and that federal high-cost support is being provided to the carrier to assist in keeping rates

²⁸⁵ Only ETCs, as defined under the 1996 Act and the Commission's rules, are eligible to receive federal universal service support. See 47 U.S.C. §§ 214(e), 254(e); 47 C.F.R. § 54.201.

²⁸⁶ 47 U.S.C. § 254(e).

²⁸⁷ 47 U.S.C. § 254(e).

²⁸⁸ See *Second Recommended Decision*, 13 FCC Rcd at 24755-56, paras. 24-26, 24759-61, paras. 36-40.

affordable in those subscribers' area.

115. In addition, we seek comment on what further restrictions, if any, we should impose on the use of federal support to ensure that recipient carriers use the support in a manner consistent with section 254. The Joint Board recommended that the Commission require carriers to certify that they will apply federal high-cost support in accordance with the statute.²⁸⁹ The Joint Board also recommended that the Commission should not require states to provide any certification as a "condition" for carriers in the state to receive high cost support, but the Commission should instead permit states to certify that, in order to receive federal universal service support, a carrier must use such funds in a manner consistent with section 254.²⁹⁰ We seek comment on whether state authority over local rates in a manner cognizant of federal support levels will adequately enforce the requirements of section 254(e), making additional federal regulation unnecessary. Because some states may lack either the authority or the desire to impose conditions on the use of high-cost support, we tentatively conclude that such state oversight, while valuable and potentially sufficient, may not in every case ensure that section 254(e)'s goals are met. Therefore, we seek comment on whether it would be appropriate to condition the receipt of federal universal service high-cost support on any state action, including adjustments to local rate schedules reflecting federal support. We believe that denying support to states that lack the regulatory authority to ensure that federal funds are used appropriately would penalize those states and would not be consistent with section 254's mandates. We tentatively conclude, however, that even states that lack this authority would be able to certify to the Commission that a carrier within the state had accounted for its receipt of federal support in its rates or otherwise used the support for the "provision, maintenance, and upgrading of facilities and services for which the support is intended" in accordance with section 254(e).²⁹¹ Conversely, if the state were unable or unwilling to take action to achieve the goals of section 254(e), we could allow such states to refuse federal high-cost support. We seek comment on these approaches, including comment on whether implementation of multiple options might best achieve the goals of section 254(e), and comment on whether any carrier-initiated action would be necessary in states with limited authority. Finally, we seek comment on what carrier or state commission action, if any, may be necessary to prevent double-recovery of universal service support at both the federal and state level.

116. Under the approach discussed above, we recognize that we may need to allocate federal support among high-cost wire centers within a carrier's study area. If the federal support amount based on forward-looking cost provides only a portion of the support for a given wire center, or if we choose to fund only a portion of the support otherwise indicated by the model,²⁹²

²⁸⁹ *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 57.

²⁹⁰ *Second Recommended Decision*, 13 FCC Rcd at 24766, para. 58.

²⁹¹ 47 U.S.C. § 254(e).

²⁹² *See* section V(B)(2), *supra*.

we seek comment on means by which to perform this allocation. If a carrier does not receive support equal to the full amount of the difference between the forward-looking cost estimate for the wire center and the threshold level for federal support, we tentatively conclude that it should allocate the support among all lines in these high-cost wire centers in a *pro rata* manner, based upon the difference between the federal benchmark, plus state supported levels, and the wire center's forward-looking cost of providing service. We believe this approach has the potential to foster competition because the amount of the support available to competing eligible telecommunications carriers would be clearly identified, and thus competing carriers would be able to assess more accurately whether competitive entry is viable in a particular high-cost area. In addition, high-cost support would be distributed in such a manner that support levels in each high-cost wire center would be proportionate to costs. We seek comment on these proposals and tentative conclusions.

D. Hold-Harmless and Portability of Support

117. As discussed above in section IV(B)(4), we agree with the Joint Board that the federal high-cost support mechanism should have a hold-harmless provision to prevent immediate and substantial reductions of federal support and potentially significant rate increases. Under such a hold-harmless provision, the amount of support provided would be the greater of the amount generated under the forward-looking mechanism or the explicit amount presently received. We seek comment on how we should implement such a hold-harmless provision to best accomplish this goal. Specifically, we seek comment on whether the hold-harmless provision should be implemented on a state-by-state basis or on a carrier-by-carrier basis.

118. Under a state-by-state approach, the total amount of federal support provided in each state would be the greater of the total amount indicated by the forward-looking mechanism or the total amount presently received by carriers in the particular state. For example, assume a state has two carriers, Carrier A and Carrier B, each presently receiving \$100 in federal high-cost intrastate support. Assume further that under the forward-looking mechanism, Carrier A is entitled to \$100 and Carrier B is entitled to \$95. The total amount of support indicated by the forward-looking mechanism (\$195) is less than the total amount of support under the present mechanism (\$200). Therefore, the hold-harmless provision would supply an additional \$5 of support. Assume, however, that under the forward-looking mechanism, Carrier A is entitled to \$120 and Carrier B is entitled to \$90. The total amount of support indicated by the forward-looking mechanism (\$210) is greater than the total amount of support under the present mechanism (\$200). Although Carrier B would receive less support under the forward-looking mechanism, the state, as a whole, would receive more support under the forward-looking mechanism. Therefore, the hold-harmless provision does not supply any additional support. We believe that such a state-by-state hold-harmless is likely to prevent substantial increases in the size of the high-cost support mechanism because an increase in support for one carrier can be offset by a decrease in support for another carrier when determining the total amount of hold-harmless support provided in a particular state. On the other hand, the state-by-state approach may not prevent a decrease in support for certain carriers within a particular state. Redistribution of

federal support within the state, however, may be accomplished by state commission action.²⁹³

119. In contrast, under a carrier-by-carrier hold-harmless approach, the amount of federal support provided to each carrier in a state would be the greater of the amount indicated by the forward-looking mechanism or the explicit amount presently received by the carrier. For example, assume a state has two carriers, Carrier A and Carrier B, each presently receiving \$100 in support. Assume further that, under the forward-looking mechanism, Carrier A is entitled to \$125 and Carrier B is entitled to \$75. Under a carrier-by-carrier hold-harmless provision, Carrier A would receive \$125 pursuant to the forward-looking model, and Carrier B would receive \$100 pursuant to the hold-harmless provision. Thus, the total amount of federal support provided in that state would increase to \$225. A carrier-by-carrier approach ensures that no carrier receives less support under the forward-looking mechanism than it receives under the present mechanism. We believe, however, that the carrier-by-carrier approach, as opposed to the state-by-state approach, is more likely to inflate the size of the high-cost support mechanism because the amount of support provided to each carrier can only increase under this approach. Using updated model outputs, we ask commenters to comment on whether a state-by-state or a carrier-by-carrier hold-harmless approach is more consistent with universal service principles set forth in the Act and the role of the federal mechanism in providing high-cost support.

120. In addition, in the event that the Commission adopts a state-by-state hold-harmless provision, we seek comment on how such a provision should allocate support among carriers in the event that the total amount of hold-harmless support provided in a particular state is insufficient to fully hold each carrier harmless. Specifically, in the event the Commission adopts a state-by-state hold-harmless approach, we propose allocating the total amount of support *pro rata* among such carriers based on their relative reductions in support. For example, assume that a state has three carriers, Carrier A, Carrier B, and Carrier C. Assume further that, under the present mechanism, Carrier A receives \$150, Carrier B receives \$125, and Carrier C receives \$100. Also assume that, under the forward looking mechanism, Carrier A is entitled to \$175, Carrier B is entitled to \$100, and Carrier C is entitled to \$75. The total amount of support indicated by the forward-looking mechanism (\$350) is less than the total amount of support under the present mechanism (\$375). Therefore, a state-by-state hold-harmless provision would provide an additional \$25 of support. Because Carrier B and Carrier C have experienced a combined reduction in support of \$50 and Carrier A has experienced no reduction in support, the \$25 of hold-harmless support must be allocated between Carrier B and Carrier C. Under our proposal, the hold-harmless support would first be allocated to the carrier experiencing the greater relative reduction in support. Here, Carrier B received 80 percent ($\$100/\125) of its previous support amount, and Carrier C received 75 percent ($\$75/\100) of its previous support amount. In order to place Carrier B and Carrier C on equal footing, therefore, the first \$5 of the total hold-harmless amount would be allocated to Carrier C, resulting in both Carrier B and Carrier C receiving 80 percent of their previous amount of support. The remaining \$20 of support would be allocated *pro rata* between Carrier B and Carrier C so that both carriers receive the same total percentage of the support provided under the present mechanism. Carrier B would receive an additional

²⁹³ See section V(C), *supra*.

\$11.11 ($\$125/\$225 \times \20), for a total of 89 percent ($\$111.11/\125) of its support under the present mechanism, and Carrier C would receive an additional \$8.88 ($\$100/\$225 \times \20), for a total of 89 percent ($\$88.88/\100) of its support under the present mechanism. We believe that this method of allocation allows for an equitable distribution of support in the event that the total state-by-state amount is insufficient to fully hold each carrier harmless. We seek comment on this proposal.

121. In the alternative, we seek specific comment on whether, if we eventually adopt a state-by-state rather than a carrier-by-carrier hold-harmless approach, we should distribute universal service high-cost support directly to the state commissions, rather than to carriers. The Joint Board considered and rejected distributing federal support to the states, rather than directly to carriers because of the long-standing practice of distributing federal support directly to carriers, and the absence of any affirmative evidence in the Act or its legislative history that Congress intended to alter this method of distribution.²⁹⁴ In addition, commenters that addressed this issue oppose a mechanism that would distribute support to the states.²⁹⁵ We seek additional comment, however, on whether support should be distributed to the state commissions for allocation among carriers in each state instead of through a federal allocation mechanism, in the event one or more carriers in the state experienced a reduction in support as a result of a state-by-state hold-harmless mechanism.

122. We also seek comment on the relationship between the hold-harmless approaches suggested above, and the portability of federal high-cost support. As discussed above in section IV(B)(5), we concluded that, consistent with the Joint Board's recommendations and the policy we established in the *First Report and Order*, federal high-cost support should be portable, and available to all eligible telecommunications carriers, regardless of the technology used to provide the supported services. To implement portability, however, we must first determine the amount of support to be ported. Specifically, in the event a competitor wins a customer from an incumbent receiving hold-harmless support, we seek comment on whether the competitor should receive the incumbent's hold-harmless support, or whether the competitor should receive the amount of support determined on a forward-looking basis. Making the hold-harmless amount available to the competitor appears to be more competitively neutral, because both carriers would receive the same amount. However, given that the purpose of the hold-harmless provision is to prevent sudden rate increases by carriers that have grown dependent on current support in designing their rate structures, the hold-harmless amount could represent a windfall to an efficient competitor. While making the forward-looking amount available to the competitor and providing the hold-harmless amount to the incumbent may not be as competitively neutral, it would appear to approximate more closely the amount necessary to support high-cost service in the area. We seek comment on this issue. We encourage commenters to use updated model outputs in framing their comments on the issue of portability.

²⁹⁴ *Second Recommended Decision*, 13 FCC Rcd at 24767, para. 61.

²⁹⁵ RTC comments at 16-17; Sprint comments at 2-3; USTA comments at 9-10.

E. Adjusting Interstate Access Charges to Account for Explicit Support

1. Background

123. As discussed above, we believe that, to implement section 254(e) of the Act, this Commission should make explicit existing implicit support in interstate access charges.²⁹⁶ Thus, we are trying in the universal service and access charge reform proceedings to identify the types and amount of implicit support in interstate access charges. Once we do so, we will require carriers to remove from access charges any amounts we convert to explicit universal service support. In this section we seek comment on how to reduce interstate access charges to account for the high-cost support we determine shall be recovered instead as explicit, high-cost, interstate universal service support.²⁹⁷ We emphasize that in this section we are solely concerned with issues concerning support that is implicit in *interstate* mechanisms. Any support identified in interstate mechanisms is separate and distinct from federal support that may be provided to ensure the reasonable comparability of intrastate rates.

124. In the past, the Commission's price cap and cost-of-service rules resulted in charges to certain end-users that exceeded the cost of the service they received. To the extent that these rates did not reflect the full underlying cost of providing access service, they could be said to embody implicit interstate support. Some of this support resulted from the Commission's rate structure rules, which sometimes prevented incumbent LECs from recovering their access costs in the same way they had incurred them.²⁹⁸ The separations rules, which divide costs between the interstate and intrastate jurisdictions, may have caused additional support.²⁹⁹ These support systems persisted for more than a decade as a means to serve universal service goals.

125. Another source of interstate implicit support stems from our requirement that incumbent LECs recover most of their access charges through averaged rates.³⁰⁰ Rather than

²⁹⁶ As noted in section IV(A)(3), *supra*, this statutory goal is separate and distinct from the statutory goal of ensuring reasonably comparable intrastate rates.

²⁹⁷ We note that the federal support determined by the methodology described in section IV(B), *supra*, is intended to ensure reasonably comparable intrastate rates, and is separate and apart from any support that we may identify in interstate rates. Because the support determined by the methodology described in section IV(B) will be applied to intrastate rates, there is no reason to reduce interstate access charges to reflect that support.

²⁹⁸ *Access Charge Reform Order*, 12 FCC Rcd at 15994-95, 15998.

²⁹⁹ *Access Charge Reform Order*, 12 FCC Rcd at 15995. For example, the separations rules required larger incumbent LECs to allocate the costs of their switching facilities between the interstate and intrastate jurisdictions on the basis of relative use. Smaller incumbent LECs were permitted to allocate a greater share of their switching costs to interstate access services than would result from the relative use allocator.

³⁰⁰ Section 69.3 of the Commission's rules prohibit incumbent LECs from disaggregating or deaveraging their access charges within a study area. 47 C.F.R. § 69.3(e)(7). "Generally, a study area corresponds to a carrier's entire service territory within a state." *In re Price Cap Performance Review for Local Exchange Carriers*, *First*

assess different rates in different parts of their service areas, each incumbent LEC must derive averaged rates. Consequently, the rates will recover more than the cost of providing service in some parts of the incumbent LEC's service area, and less than the cost of providing service in other parts of the service area. Thus, averaged interstate access rates also can be seen as implicit support from areas where the cost of service is less than the averaged rate, to areas where the cost of service is more than the averaged rate.

126. To promote universal service goals while fostering competition, Congress directed in the 1996 Act that federal universal service support be explicit, and recovered on an equitable and nondiscriminatory basis from all telecommunications carriers providing interstate telecommunications services.³⁰¹ In the *First Report and Order*³⁰² and the *Access Charge Reform Order*,³⁰³ the Commission made several changes to its access charge rules in an effort to remove implicit support from interstate access charges and to make federal universal service support mechanisms explicit. The Commission removed Long Term Support (LTS) from interstate access charges and made it part of explicit federal support mechanisms.³⁰⁴

127. In the *Access Charge Reform Order*, the Commission also changed the manner in which price cap LECs recover their permitted common-line revenues.³⁰⁵ As a result, price cap LECs now recover their permitted common line revenues through the SLC, the PICC, and the per-minute CCLC. The SLC is an end-user charge that carriers assess on a per-line basis to recover their average cost of providing a line. Because the SLC for primary residential and single-line business lines is capped at \$3.50, the SLC does not fully recover the permitted common-line revenues of providing service to the majority of these customers. Consequently, the SLC cap may create implicit support to primary residential lines. Revenues from interstate access charges, such as the CCLC and multi-line PICC, provide support that allows us to maintain the primary residential SLC cap. The PICC for primary residential and single-line business lines has a ceiling that will gradually increase until it reaches a level that allows full recovery of the permitted common line revenues from flat charges assessed to end-users and IXCs. As the primary residential and single-line business PICCs increase, the amount of permitted common-line revenues associated with those lines that the non-primary residential and multi-line business line PICCs recover will fall to zero.³⁰⁶

Report and Order, 10 FCC Rcd 8961, 9150 n.615 (1995). *But see, e.g.*, 47 C.F.R. § 69.112 (allowing term and volume discounts in direct-trunked transport charges within each study area).

³⁰¹ 47 U.S.C. § 254(b)(4).

³⁰² *First Report and Order*, 12 FCC Rcd at 9162-70.

³⁰³ *Access Charge Reform Order*, 12 FCC Rcd at 16147-48.

³⁰⁴ *First Report and Order*, 12 FCC Rcd at 9169; *Access Charge Reform Order*, 12 FCC Rcd at 16145-48.

³⁰⁵ *Access Charge Reform Order*, 12 FCC Rcd at 16007-33.

³⁰⁶ *Access Charge Reform Order*, 12 FCC Rcd at 15999-16000.

2. Discussion

128. As discussed above, in section IV(A)(3), we agree with the Joint Board that we have the jurisdiction and statutory obligation to identify any universal service support that is implicit in interstate access charges and, as far as possible, make that support explicit. In this section we seek comment on how we should adjust interstate access charges to offset universal service support that we subsequently identify in interstate access charges and allow carriers to recover through increased support from the new federal mechanism. Because of the role access charges have played in supporting universal service, it is critical to implement changes in the interstate access charge system together with the complementary changes in the federal universal service support mechanism we adopt today. We seek comment on how we should adjust interstate access charges to reflect any increases in federal explicit support provided to non-rural carriers under the new federal mechanism and methodology.

129. The Commission determined in the *First Report and Order* that non-rural carriers would begin to receive high-cost support on July 1, 1999, based on forward-looking costs, and delayed the implementation of support based on forward-looking costs for rural carriers until at least January 1, 2001.³⁰⁷ As discussed above,³⁰⁸ more time is needed to verify the models that will determine the forward-looking costs on which the intrastate high-cost support for non-rural carriers will be based. Thus, we are postponing the July 1, 1999, implementation of intrastate high-cost support for non-rural carriers until January 1, 2000. Because these models may also be used to determine levels of implicit support in interstate access charges and the amount of federal support a carrier should receive, this will also delay determination of the interstate high-cost support for non-rural carriers. This section addresses only the question of how to reduce interstate access charges to reflect increased explicit federal support for non-rural carriers that currently flows within the interstate jurisdiction. We will address any necessary interstate access charge reductions for rural carriers at a later date.

130. We tentatively conclude that we should require price cap LECs to reduce their interstate access rates to reflect any increased explicit federal high-cost support they receive. To do otherwise would give these carriers a windfall by allowing them to maintain rates that include implicit high-cost support even after the support has been made explicit. We tentatively conclude that the carriers should make an exogenous downward adjustment to the common line basket. In the short run, this will reduce the CCLC and multi-line PICCs. In the longer run, this adjustment will keep down scheduled increases for the primary residential and single-line business PICC. The PICC is often passed on to the end user by the IXC that pays it. This approach will serve the dual purpose of eliminating implicit support and holding down per-line rates associated with primary

³⁰⁷ *First Report and Order*, 12 FCC Rcd at 8910, 8917-18. The *First Report and 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. *Referral Order* at para. 6.

³⁰⁸ See section IV(B)(1), *supra*.

residential and single-line business lines. This will, therefore, help keep basic telephone service affordable and comparable.³⁰⁹

131. We seek comment on whether we should require price cap LECs to reflect explicit high-cost support by making the downward exogenous adjustment to their common line basket's price cap indexes (PCIs). Alternatively, we seek comment on whether we should instead permit incumbent LECs to reduce their access rates to offset the explicit support by lowering their common line charges on a geographically deaveraged basis. For example, we could reduce implicit support resulting from geographic averaging by permitting carriers to lower their SLCs on a deaveraged basis, reducing SLCs in low-cost areas, while maintaining the SLC caps in our rules for high-cost areas. We seek comment on whether we should allow carriers to determine where they lower their rates under such an approach. Alternatively, we seek comment on whether we or the state commissions should delineate the permissible areas for deaveraged reductions, and how those areas should be determined. We could, for example, require the deaveraging to occur based on the same rate zones that some states have already identified pursuant to our deaveraging requirement for the pricing of unbundled network elements and interconnection.³¹⁰ We also seek comment on which common line rate elements should be deaveraged.

132. We also seek comment on whether price cap carriers should also reduce their base factor portion (BFP).³¹¹ For carriers that calculate their SLC based on the BFP,³¹² this would result in reductions to the SLC for multi-line business and non-primary residential lines, which would be offset by smaller reductions in CCL and multi-line PICC rates. We also seek comment on whether a downward adjustment to the incumbent LECs' PCIs should be across-the-board instead of targeted to the common line basket.

133. We also seek comment on whether we should reduce the SLC on primary residential and single-line business lines. Although such a reduction is an option, it would not further the goal of reducing implicit interstate support, unless it was targeted to low-cost wire centers within a study area. The current SLC cap of \$3.50 per month on primary residential and single-line business lines already creates interstate implicit support for most of those lines. A general reduction in the SLC would increase the need for such support and would not reduce support

³⁰⁹ 47 U.S.C. § 254(b).

³¹⁰ As discussed in note 272, *supra*, our deaveraging rules, *see* 47 C.F.R. § 51.507(f), are currently subject to a temporary stay that we issued to allow states time to come into compliance with the rules following the U.S. Supreme Court's decision reaffirming the Commission's authority to regulate the pricing of unbundled network elements and interconnection. *Stay Order*, FCC 99-86.

³¹¹ To compute the SLC, price cap and rate-of-return LECs generally forecast their actual common line costs using rate-of-return principles and compute the BFP of this common line revenue requirement. LECs compute the BFP revenue requirement by forecasting their total common line revenue requirement for the upcoming tariff year, and deducting certain costs that are assigned directly to carrier common line rate elements. 47 C.F.R. §§ 69.501, 69.502.

³¹² *See* 47 C.F.R. § 69.152(c)(1), (b)(2).

implicit in the CCLC and the multi-line PICC. Although, at the end of the transition initiated by our *Access Charge Reform Order*, the combination of the SLC and PICC assessed to each line will permit carriers to recover the full interstate-allocated portion of their common line costs from the line that caused those costs to be incurred, any reduction in the SLC would delay this transitional process and result in a higher PICC on primary residential and single-line business lines. We do not expect any reductions to the common line basket to reduce common-line recovery below \$3.50 per month, per line, but we seek comment on whether we should limit any reductions to the common line basket to the amount needed to reduce common line revenues per line to \$3.50. We seek comment on how the remainder of the adjustment should be applied if that were to occur.

134. We tentatively conclude that non-rural rate-of-return LECs should apply additional interstate explicit high-cost support revenues to the CCL element, thus reducing CCL charges. We seek comment on this tentative conclusion. We also seek comment on whether these revenues should instead be deducted from the BFP, which would reduce the SLC for multi-line business lines and diminish the reduction to the CCLC. Furthermore, as noted in section IV(A)(3), above, the Joint Board set forth certain guidelines that the Commission should follow when taking action to remove implicit support from interstate access rates, including: (1) there should be a corresponding dollar-for-dollar reduction in interstate access charges as implicit support in interstate access rates is replaced with explicit support;³¹³ (2) any reductions in interstate access rates should benefit consumers;³¹⁴ (3) universal service should bear no more than a reasonable share of joint and common costs;³¹⁵ and (4) reasonable comparability should not be jeopardized, and neither consumers in general nor particular classes of consumers should be harmed.³¹⁶ We seek comment on whether our proposals in this section conform to the Joint Board's guidelines.

135. Finally, we recognize that some proposals for access reform may have the added benefit of directing more federal support to high-cost areas, relative to low-cost areas. For example, some parties have suggested using the cost proxy model as the basis for converting the excess of access rates above the forward-looking cost of access from implicit support to geographically deaveraged support amounts.³¹⁷ These support amounts would be both explicit and portable to competing LECs that serve the lines to which these support amounts would be assigned. It would appear that these proposals could potentially serve to direct more federal support to high-cost areas, relative to low-cost areas, much like we believe the use of the cost

³¹³ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

³¹⁴ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

³¹⁵ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23. *See also* 47 U.S.C. 254(k).

³¹⁶ *Second Recommended Decision*, 13 FCC Rcd at 24755, para. 23.

³¹⁷ *See, e.g.* "A Proposal for Universal Service and Access Reform" by Bill Rogerson and Evan Kwerel, CC Docket Nos. 96-45, 96-262 (filed May 27, 1999).

model in conjunction with an appropriate benchmark could direct such additional support to high-cost areas. We seek comment on whether and how adoption of an access reform proposal that would direct more federal support to high-cost areas, relative to low-cost areas, should affect our calculation of high-cost universal service support, if at all. To the extent possible, parties commenting on this issue should address specific access reform proposals that could be used in this manner to reform both high-cost universal service and access charges simultaneously.

VI. PROCEDURAL MATTERS

A. Regulatory Flexibility Act Certification

136. The Regulatory Flexibility Act (RFA)³¹⁸ requires a Regulatory Flexibility Act analysis whenever an agency publishes a notice of proposed rulemaking or promulgates a final rule, unless the agency certifies that the proposed or final rule will not have "a significant economic impact on a substantial number of small entities," and includes the factual basis for such certification.³¹⁹ The RFA generally defines "small entity" as having the same meaning as the term "small business concern" under the Small Business Act, 15 U.S.C. § 632.³²⁰ The Small Business Administration (SBA) defines a "small business concern" as an enterprise that (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA.³²¹

137. We conclude that neither an Initial Regulatory Flexibility Analysis nor a Final Regulatory Flexibility Analysis are required here because the foregoing FNPRM seeks comment only on the mechanisms that the Commission should use to provide high-cost support to non-rural LECs, and the foregoing Report and Order adopts a final rule affecting only the amount of high-cost support provided to non-rural LECs. Non-rural LECs generally do not fall within the SBA's definition of a small business concern because they are usually large corporations, affiliates of such corporations, or dominant in their field of operations.³²² Therefore, we certify, pursuant to the RFA, 5 U.S.C. § 605(b), that the proposals contained in the FNPRM, and the final rule adopted in the Report and Order, will not have a significant economic impact on a substantial

³¹⁸ The RFA, *see* 5 U.S.C. § 601 *et. seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

³¹⁹ 5 U.S.C. § 605(b). *See* 5 U.S.C. §§ 603, 604.

³²⁰ 5 U.S.C. § 601(3), (6) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of small business concern applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."

³²¹ 15 U.S.C. § 632. The SBA defines a small telecommunications entity in SIC code 4813 (Telephone Communications, Except Radiotelephone) as an entity with 1,500 or fewer employees. 13 C.F.R. § 121.201.

³²² *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, Fifth Report and Order, 13 FCC Rcd 21323, 21362-63, paras. 93-94 (1998) (No FRFA required where report and order affected only non-rural LECs); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, Further Notice of Proposed Rulemaking, 12 FCC Rcd 18514, 18582-83, paras. 183-185 (1997) (No IRFA required where further notice of proposed rulemaking affected only non-rural LECs).

number of small entities.³²³ The Office of Public Affairs, Reference Operation Division, will send a copy of this certification, along with this FNPRM and Report and Order, to the Chief Counsel for Advocacy of the SBA in accordance with the RFA, *see* 5 U.S.C. § 605(b), and to Congress pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996, *see* 5 U.S.C. § 801(a)(1)(A). In addition, this certification, as well as this FNPRM and Report and Order (or summaries thereof), will be published in the Federal Register.

B. Effective Date of Final Rules

138. We conclude that the amendments to our rules adopted herein shall be effective upon publication in the Federal Register. Pursuant to our rules, our existing high-cost support mechanism is scheduled to be phased out on July 1, 1999.³²⁴ In this Order, however, we conclude that the new forward-looking high-cost support mechanism should be implemented on January 1, 2000, instead of July 1, 1999, as previously planned. The amendments we adopt in this Order extend the present high-cost support mechanism from July 1, 1999, until January 1, 2000, when the new forward-looking high-cost support mechanism will be implemented. Thus, the amendments must become effective before July 1, 1999. Making the amendments effective 30 days after publication in the Federal Register would jeopardize the required July 1, 1999 effective date. Accordingly, pursuant to the Administrative Procedure Act, we find good cause to depart from the general requirement that final rules take effect not less than 30 days after their publication in the Federal Register.³²⁵

C. Filing Comments

139. Pursuant to Sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments on or before July 2, 1999, and reply comments on or before July 16, 1999. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies. *See Electronic Filing of Documents in Rulemaking Proceedings*, 63 Fed. Reg. 24,121 (1998).

140. Comments filed through the ECFS can be sent as an electronic file via the Internet to <<http://www.fcc.gov/e-file/ecfs.html>>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and

³²³ 5 U.S.C. § 605(b).

³²⁴ *See* 47 C.F.R. § 36.601(c).

³²⁵ *See* 5 U.S.C. § 553(d)(3).

should include the following words in the body of the message, "get form <your e-mail address." A sample form and directions will be sent in reply.

141. Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appear in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number. All filings must be sent to the Commission's Secretary, Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 445 Twelfth Street, S.W.; TW-A325; Washington, D.C. 20554.

142. Parties who choose to file by paper should also submit their comments on diskette. These diskettes should be submitted to: Sheryl Todd, Accounting Policy Division, Common Carrier Bureau, Federal Communications Commission, 445 Twelfth Street, S.W., Room 5-A523, Washington, DC 20554. Such a submission should be on a 3.5 inch diskette formatted in an IBM compatible format using WordPerfect 5.1 for Windows or compatible software. The diskette should be accompanied by a cover letter and should be submitted in "read only" mode. The diskette should be clearly labelled with the commenter's name, proceeding, including the lead docket number in this case (CC Docket No. 96-45), type of pleading (comment or reply comment), date of submission, and the name of the electronic file on the diskette. The label should also include the following phrase "Disk Copy - Not an Original." Each diskette should contain only one party's pleadings, preferably in a single electronic file. In addition, commenters must send diskette copies to the Commission's copy contractor, International Transcription Service, Inc., 1231 20th Street, N.W., Washington, D.C. 20037.

VII. ORDERING CLAUSES

143. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 1-4, 201-205, 218-220, 214, 254, 303(r), 403, and 410 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 201-205, 218-220, 214, 254, 303(r), 403, and 410, the REPORT AND ORDER IS ADOPTED. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

144. IT IS FURTHER ORDERED that Part 36 of the Commission's Rules, 47 C.F.R. § 36, IS AMENDED as set forth in Appendix C hereto, effective immediately upon publication in the Federal Register.

145. IT IS FURTHER ORDERED that the Further Notice of Proposed Rulemaking contained herein IS ADOPTED.

146. IT IS FURTHER ORDERED that the Commission's Office of Public Affairs, Reference Operations Division, SHALL SEND a copy of the Further Notice of Proposed Rulemaking, including the Regulatory Flexibility Act Certification, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

APPENDIX A PARTIES FILING INITIAL COMMENTS

<u>Commenter</u>	<u>Abbreviation</u>
Airtouch Communications	AirTouch
Ameritech	
AT&T Corp.	AT&T
Bell Atlantic Telephone Companies	Bell Atlantic
BellSouth Corporation	BellSouth
Boston University	Boston
California Public Utilities Commission	California Commission
Colorado Public Utilities Commission	Colorado Commission
Competitive Telecommunications Association	CompTel
District of Columbia Public Service Commission	D.C. Commission
Dobson Communications Corporation	DCC
General Services Administration	GSA
GTE Service Corporation	GTE
Harris Skrivan & Associates LLC	HSA
Illinois Commerce Commission	Illinois Commission (Supplement)
Iowa Utilities Board	IUB
ITCs, Inc.	ITC
Kentucky Public Service Commission	Kentucky Commission
MCI Worldcom, Inc.	MCI Worldcom
Maine Public Utilities Commission	Maine Commission, <i>et al.</i>
Arkansas Public Service Commission	
Kansas Corporation Commission	
Montana Public Service Commission	
New Hampshire Public Utilities Commission	
New Mexico Public Utilities Commission	
Vermont Public Service Board	
West Virginia Public Service Commission	
Maryland Public Service Commission	Maryland Commission, <i>et al.</i>
Connecticut Department of Public Utility Control	
Delaware Public Service Commission	
Illinois Commerce Commission	
Massachusetts Department of Telecommunications and Energy	
National Exchange Carrier Association	NECA
New York State Department of Public Service	New York Commission
Personal Communications Industry Association	PCIA
Public Utilities Commission of Ohio	Ohio Commission
Puerto Rico Telephone Company	PRTC
Rural Telephone Coalition	RTC
SBC Communications, Inc.	SBC
Sprint Corporation	Sprint

Telecommunications Resellers Association
United States Telephone Association
U S WEST Communications, Inc.
Virgin Islands Telephone Corporation
Western Wireless Corporation
Wyoming Public Service Commission

TRA
USTA
U S WEST
Vitelco
Western Wireless
Wyoming Commission

APPENDIX B PARTIES FILING REPLY COMMENTS

<u>Commenter</u>	<u>Abbreviation</u>
Ad Hoc Telecommunications Users Committee	Ad Hoc
Ad Hoc Telecommunications Users Committee	Ad Hoc (Erratum)
Ameritech	
AT&T Corp.	AT&T
BellSouth Corporation	BellSouth
Communications Workers of America	CWA
General Communication, Inc.	GCI
General Services Administration	GSA
GTE Service Corporation	GTE
MCI Worldcom, Inc.	MCI Worldcom
Maine Public Utilities Commission	Maine Commission <i>et al.</i>
Arkansas Public Service Commission	
Kansas Corporation Commission	
Montana Public Service Commission	
New Hampshire Public Utilities Commission	
New Mexico Public Utilities Commission	
Vermont Public Service Board	
West Virginia Public Service Commission	
Pennsylvania Public Utility Commission	Pennsylvania Commission
Puerto Rico Telephone Company	PRTC
Rural Utilities Service	RUS
Sprint Corporation	Sprint
United Service Administrative Company	USAC
United States Cellular Corporation	USCC
United States Telephone Association	USTA
U S WEST Communications, Inc.	U S WEST
Western Wireless Corporation	Western Wireless

APPENDIX C FINAL RULES

Part 36 of Title 47 of the Code of Federal Regulations is amended as follows:

**PART 36 - JURISDICTIONAL SEPARATIONS PROCEDURES; STANDARD
PROCEDURES FOR SEPARATING TELECOMMUNICATIONS PROPERTY COSTS,
REVENUES, EXPENSES, TAXES AND RESERVES FOR TELECOMMUNICATIONS
COMPANIES.**

1. Section 36.601 is amended as follows: all references in paragraph (c) to "July 1, 1999" are replaced with "January 1, 2000."

**Statement and Dissent in Part of
Chairman William E. Kennard**
on
*Federal-State Joint Board Recommendations
Regarding High-Cost Support for Non-Rural LECs*

One of the most important parts of the Telecommunications Act of 1996 was the affirmation of the universal service principle. This principle has several applications, all of them based on the congressional commitment that quality services should be available to all Americans at just, reasonable and affordable rates. Congress made clear that consumers in rural and other high-cost areas should have access to a wide variety of telecommunications and information services that are reasonably comparable to those available in urban areas, and at reasonably comparable rates.

Our responsibility to ensure that telecommunications services are reasonably comparable in all areas and available at just, reasonable, and affordable rates is one that we share with the states. This partnership works best when the Commission and state commissions work together. Today, we adopt a new framework for high-cost support for non-rural telephone companies based on recommendations from the Federal-State Joint Board on Universal Service. This action reflects the dedicated, unified effort of the Commission and state commissions in pursuit of common goals.

We conclude that a primary purpose of federal high-cost support mandated in section 254 of the Telecommunications Act is to ensure that states have the ability to achieve reasonably comparable rates within and among states. Accordingly, we adopt a mechanism that provides high-cost support based both on the costs of providing supported services and on the state's ability to support those costs using its own resources. We also adopt a "hold harmless" provision, which will ensure that the amount of support provided in each state will not be less than the current amount of explicit support provided in that state. Finally, we ask for comments on some issues related to the manner in which high-cost support should be calculated and distributed.

I not only support this Report and Order and Further Notice, I am proud of most of the decisions in this item. I do have one disagreement with the majority on this item, however. In paragraph 118 of the Further Notice, the Commission is seeking comment on an idea that high cost support might be distributed directly to state commissions rather than to carriers. Although one might imagine situations where such "block grants" might be appropriate or even desirable, I am confident that this is not such a situation. The Joint Board considered and rejected this idea, and for good reason. Federal support has traditionally been distributed directly to the carriers themselves. Under section 254 of the Act, support must ultimately go to carriers. Accordingly, the block grant idea amounts to a proposal to add an additional layer of administration, which is bound to increase costs and reduce efficiency. The states themselves are generally opposed to the idea as evidenced by the rejection of this idea by the Joint Board. Similarly a majority of the commenters in this proceeding, including many of the recipients of high-cost support are also opposed to the idea. In sum, block grants are not a good idea for high-cost support.

SEPARATE STATEMENT OF COMMISSIONER MICHAEL K. POWELL

Re: Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262, CC Docket Nos. 96-45, 96-262

I am writing separately to raise just a couple of points in my current thinking on high cost universal service and access reform that I believe deserve emphasis.

First, as this *Order* indicates, the Commission has concluded, in consultation with the Federal-State Joint Board, that phone rates are generally affordable and that federal high cost support for the intrastate jurisdiction should not grow significantly at this time. I believe these goals are two of the most important we should pursue as we push forward to finalize the high cost support mechanism. I also would favor targeting high cost support in a way that better promotes competitive entry.

Second, I am intrigued by the idea, suggested by our Chief Economist and perhaps others, that there may be ways to direct additional support to high cost areas as a by-product of reforming access charges. In particular, I am open to the idea that the cost model our staff is developing could be effective in geographically de-averaging the support in access that we might convert from implicit to explicit. I think this approach may have some important merits. For example, it could potentially facilitate competition by making access support de-averaged and portable so that CLECs can win the support associated with particular customers when they convince those customers to switch to the CLEC from the ILEC. In addition, this approach might discourage inefficient entry in denser, low cost areas by lessening the degree to which access subsidies are exaggerated in those areas, thereby also making high cost consumers relatively more attractive to CLECs. (Note, however, that in declaring my openness to this sort of approach, I do not wish to prejudge the important issue of whether and the extent to which access charges overall should be cut.)

I must stress that my interest in pursuing this approach is tentative but serious. As such, I encourage parties to comment on whether such an approach is workable and whether it would provide for moderate increases in federal high cost funding and better promote competition without abandoning the Joint Board's goal of not increasing such funding substantially.

In closing, I would like to thank our diligent and exceptional Common Carrier Bureau staff for their efforts on this *Order* and on high cost universal service and access reform generally. These issues are almost frightfully complex, and we could never reach our collective goal of reforming access charges and universal service without the staff's talent and dedication. I hope the Commission can marry the staff's dedication with the courage we will need to resolve these complex and politically-charged issues in a rational way. I look forward to working hard toward that goal with the staff and my colleagues over the next few months.