

I. INTRODUCTION

1. In the Telecommunications Act of 1996 (1996 Act),¹ Congress directed the Commission and states to take the steps necessary to establish support mechanisms to ensure the delivery of affordable telecommunications service to all Americans, including low-income consumers, eligible schools and libraries, and rural health care providers. Specifically, Congress directed the Commission and the states to devise methods to ensure that "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas . . . have access to telecommunications and information services . . . at rates that are reasonably comparable to rates charged for similar services in urban areas."² Congress further directed the Commission to define additional services for support for eligible schools, libraries, and health care providers, and directed the Commission to "establish competitively neutral rules . . . to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms, health care providers, and libraries."³

2. This Order sets forth a plan that satisfies all of the statutory requirements, and puts in place a universal service support system that will be sustainable in an increasingly competitive marketplace. Consistent with the explicit statutory principles, our immediate implementation of section 254 is shaped by our commitment to achieve four critical goals. First, we must implement all of the universal service objectives established by the Act, including those for low-income individuals, consumers in rural, insular, and high cost areas, schools, libraries, and rural health care providers.⁴ Second, we must maintain rates for basic residential service at affordable levels. We believe that the rates for this service are generally at affordable levels today. Third, we must ensure affordable basic service continues to be available to all users through an explicit universal service funding mechanism. For the present, we believe we can achieve this goal by maintaining our existing high cost mechanism at current funding levels, picking a platform mechanism by December 1997, and implementing a forward-looking

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

² 47 U.S.C. § 254(b)(3).

³ 47 U.S.C. § 254(h)(2)(A). Telecommunications carriers are required to provide service to rural health care providers "at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(h)(1)(A). Schools and libraries now are entitled under federal law to service "at rates less than the amounts charged for similar services to other parties." 47 U.S.C. § 254(h)(1)(B). In addition, Congress directed the Commission to "enhance . . . access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms, health care providers, and libraries." 47 U.S.C. § 254(h)(2).

⁴ *See, e.g.*, 47 U.S.C. §§ 254(b), (h), and (i).

economic cost mechanism for universal service for non-rural carriers starting January 1, 1999. Fourth, we must bring the benefits of competition to as many consumers as possible. To implement this goal, we must, in our access charge reform proceeding, address the implicit subsidies in interstate access charges.

3. Today, we adopt rules that reflect virtually all of the Joint Board's recommendations⁵ and fulfill the universal service goals established by Congress. We recognize, however, that future developments in the competitive telecommunications marketplace and the necessary actions of the states may warrant further Commission action to ensure that we create sustainable and harmonious federal and state methods of continuously fulfilling universal service goals. Therefore, we will seek additional fact-finding and deliberation by the Joint Board, and further coordination with individual state commissions, during approximately the next fifteen months. With the benefit of further specific recommendations from the Joint Board, specifically on the implementation of support for rural, insular, and high cost areas, this Commission will act not later than August 1998. By adopting in large measure the recommendations of the Federal-State Joint Board and referring several issues to the Joint Board for further review, we commit ourselves to working in close partnership with the states to create complimentary federal and state universal service support mechanisms.

4. This proceeding is part of a trilogy of actions that are focused on achieving Congress's goal of establishing a "pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening up all telecommunications markets to competition."⁶ The other components of the trilogy are the local competition⁷ and access reform rulemakings.⁸ Pursuant to the mandate of the 1996 Act, these three proceedings

⁵ See Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Recommended Decision*, 12 FCC Rcd 87 (1996).

⁶ Joint Explanatory Statement at 1.

⁷ Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, *First Report and Order*, 11 FCC Rcd 15499 (1996) (*Local Competition Order*) stayed in part pending judicial review sub nom. *Iowa Utils. Bd. v. FCC*, 109 F.3rd 418 (8th Cir. 1996). See also Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, Area Code Relief Plan for Dallas and Houston Ordered by the Public Utilities Commission of Texas, and Administration of the North American Numbering Plan, Second Report and Order, and Memorandum Opinion and Order, 11 FCC Rcd 19392 (*Local Competition Second Report and Order*).

⁸ 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, *Notice of Proposed Rulemaking, Third Report and Other and Notice of Inquiry*, 62 Fed. Reg. 4,670 (rel. Dec. 24, 1996) (*Access Reform NPRM*); *First Report and Order*, FCC 97-158 (adopted May 7, 1997) (*Access Charge*

are collectively intended to encourage the development of competition in all telecommunications markets.

5. In the *Local Competition Order*,⁹ we set forth rules to implement sections 251 and 252 of the Communications Act. As with all of Part II of Title II of the Communications Act, those sections, and the rules implementing them, seek to remove the legal, regulatory, economic, and operational barriers to local telecommunications competition. Sections 251 and 252 provide entrants with the opportunity to compete for consumers in local markets by either constructing new facilities, purchasing access to unbundled network elements, or reselling telecommunication services.

6. Through this Order and our accompanying *Access Charge Reform Order*, we establish the definition of services to be supported by federal universal service support mechanisms and the specific timetable for implementation. We set in place rules that will identify and convert existing federal universal service support in the interstate high cost fund, the dial equipment minutes (DEM) weighting program, Long Term Support (LTS), Lifeline, Link Up, and interstate access charges to explicit competitively neutral federal universal service support mechanisms. We will provide universal service support to carriers serving rural, insular, and high cost areas through a mechanism based on forward-looking economic cost beginning on January 1, 1999, for areas served by non-rural LECs, and establish the process to determine a forward-looking economic cost methodology for areas served by rural LECs. That mechanism will -- based upon cost studies states will conduct during the coming year or, at the state's election, based upon Commission-developed methods -- calculate the forward-looking economic cost of providing service to consumers in a particular rural, insular, or high cost area. In this proceeding, we modify the funding methods for the existing federal universal service support mechanisms so that such support is not generated, as at present, entirely through charges imposed on long distance carriers. Instead, as the statute requires, we will require equitable and non-discriminatory contributions from all providers of interstate telecommunications service. We also take other steps to make federal universal service support mechanisms consistent with the development of local service competition.

7. When it enacted section 254 of the Communications Act, Congress set forth the principles to guide universal service reform. It placed on the Commission the duty to implement these principles in a manner consistent with the pro-competition purposes of the Act. It also emphasized that the preservation and advancement of universal service was to be the result of

Reform Order). See also Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, *Fourth Report and Order*, FCC 97-159 (adopted May 7, 1997).

⁹ The pricing provisions and the "pick and choose" rule in the *Local Competition Order* have been stayed. On November 1, 1996, the court reinstated the Commission's "reciprocal compensation" requirements, which dictate how local exchange carriers (LECs) and wireless carriers are compensated for transporting and terminating each other's traffic. See *supra* note 7.

federal and state action, stating "[t]here should be specific, predictable and sufficient Federal *and State* mechanisms to preserve and advance universal service."¹⁰ Congress also entrusted the states with a role in universal service, including expressly granting states the authority "to adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service," and requiring every telecommunications carrier that provides intrastate telecommunications services to "contribute, on an equitable and nondiscriminatory basis, in a manner determined by the state, to the preservation and advancement of universal service in that state" when such state establishes universal service support mechanisms.¹¹ States traditionally have promoted universal service by, among other things, assuring affordable residential access by explicitly and implicitly subsidizing and pricing basic telephone service at levels associated with very high telephone subscribership rates, currently 94.2%.¹²

8. Universal service support mechanisms that are designed to increase subscribership by keeping rates affordable will benefit everyone in the country, including those who can afford basic telephone service. At the simplest level, increasing the number of people connected to the telecommunications network makes the network more valuable to all of its users by increasing its usefulness to them. Increasing subscribership also benefits society in ways unrelated to the value of the network per se. For example, all of us benefit from the widespread availability of basic public safety services, such as 911.

9. Congress also specified that universal service support "should be explicit," and that, with respect to federal universal service support, "every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."¹³ As explained further in the Joint Explanatory Statement of the Committee of the Conference, Congress intended that, to the extent possible, "any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today."¹⁴

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

¹¹ 47 U.S.C. § 254(f).

¹² States also have done much to enhance access in schools and other specific targeted areas, and for low-income consumers and other specific targeted groups.

¹³ 47 U.S.C. § 254(d)-(e).

¹⁴ Joint Explanatory Statement of the Committee of the Conference (H.R. Rep. No. 458, 104th Cong., 2d Sess.) (Joint Explanatory Statement) at 131.

10. Today, universal service is achieved largely through implicit subsidies.¹⁵ The Commission currently has in place some explicit support mechanisms directed at increasing network subscribership by reducing rates in high cost areas (the high cost fund and Long Term Support) and at making service affordable for low-income consumers (the Lifeline and Link Up programs). The current "system," however, consists principally of a number of implicit mechanisms at the state and, to a substantially lesser extent, federal levels designed to shift costs from rural to urban areas, from residential to business customers, and from local to long distance service.

11. The urban-to-rural subsidy has been accomplished through the explicit high cost fund mentioned above, and through geographic rate averaging. The result of state requirements that local telephone rates be averaged across the state is that high-density (urban) areas, where costs are typically lower, subsidize low-density (rural) areas. State pricing rules have also in many cases created a business-to-residential subsidy. Most states have established local rate levels such that businesses pay more on a per-line basis for basic local service than do residential customers,¹⁶ although the costs of providing business and residential lines are generally the same.¹⁷ In addition, rates charged for vertical services such as touch tone, conference calling and speed dialing, subsidize basic local service rates. Finally, interstate and intrastate access charges are set relatively high in order to cover certain loop costs not recovered through local rates. These usage-based charges are then recovered through higher usage charges for interstate long distance service. Thus, interstate long distance customers -- and particularly those with higher calling volumes -- indirectly subsidize local telephone rates.

12. Of the three implicit subsidy mechanisms -- geographic rate averaging, subsidizing residential lines via business lines, and interstate access charges -- only the interstate access charge system has been regulated by the Commission, and this contributes the smallest subsidy of the three. Thus, a number of factors operate today to keep basic local telephone rates low, and Congress ordered that we devise a coordinated federal-state scheme to achieve universal service goals.

13. By our Orders today, we reject the arguments made by some parties that section

¹⁵ When we refer to "implicit subsidies" in this discussion we generally mean that a single company is expected to obtain revenues from sources at levels above "cost" (i.e., above competitive price levels), and to price other services allegedly below cost. Such intra-company subsidies are typically regulated by states. An example at the federal level, however, is the geographic averaging of interstate long distance rates. In section 254(g) of the Act, Congress expressly directed that this implicit subsidy continue.

¹⁶ Federal Communications Commission, Common Carrier Bureau, Industry Analysis Division, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, tbls. 2-3 (Mar. 1997).

¹⁷ To the extent businesses tend to be concentrated in areas with relatively dense populations, business loops are shorter and, therefore, less costly to serve.

254 compels us immediately to remove all universal service costs from interstate access charges.¹⁸ As stated previously, we have met section 254's clear command that we identify the services to be supported by federal universal service support mechanisms, and that we establish a specific timetable for implementation. Under that timetable, we will over the next year identify implicit interstate universal support and make that support explicit, as further provided by section 254(e). Moreover, as with any implicit support mechanism, universal service costs are presently intermingled with all other costs, including the forward-looking economic cost of interstate access and historic costs associated with the provision of interstate access services. We cannot remove universal service costs from interstate access charges until we can identify those costs, which we will not be able to do even for non-rural incumbent local exchange carriers (ILECs) before January 1, 1999.

14. We do not, by our Order today, attempt to identify existing implicit universal service support presently effected through intrastate rates or other state mechanisms, nor do we attempt to convert such implicit intrastate support into explicit federal universal service support. The Commission, in light of section 2(b) of the Communications Act,¹⁹ does not have control over the local rate-setting process, which generally has aimed at ensuring affordable residential rates. States have maintained low residential basic service rates through, among other things, a combination of: geographic rate averaging, higher rates for business customers, higher intrastate access rates, higher rates for intrastate toll service, and higher rates for vertical features. States, acting pursuant to sections 254(f) and 253 of the Communications Act, must in the first instance be responsible for identifying intrastate implicit universal service support. We further believe that, as competition develops, the marketplace itself will identify intrastate implicit universal service support, and that states will be compelled by those marketplace forces to move that support to explicit, sustainable mechanisms consistent with section 254(f). As states do so, we will be able to assess whether additional federal universal service support is necessary to ensure that quality services remain "available at just, reasonable and affordable rates."²⁰

15. Federal universal service support will be distributed based on the interstate portion of the difference between the forward-looking economic cost of providing service and a nationwide revenue benchmark. The amount of support will be explicitly calculable and identifiable by competing carriers, and will be portable among competing carriers, i.e., distributed to the eligible telecommunications carrier chosen by the customer. It will be funded by equitable and non-discriminatory contributions from all carriers that provide interstate

¹⁸ See, e.g., *Access Charge Reform Order* at section IV.A.

¹⁹ Section 2(b) of the Act provides that in most cases, "nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." 47 U.S.C. § 152(b).

²⁰ 47 U.S.C. § 254(b)(1).

telecommunications services. In the *Access Charge Reform Order* that we also adopt today, we direct that federal universal service support received by ILECs be used to satisfy the interstate revenue requirement otherwise collected through interstate access charges. Accordingly, through this Order and the *Access Charge Reform Order*, interstate implicit support for universal service will be identified and removed from interstate access charges, and will be provided through explicit interstate universal service support mechanisms. To the extent that we fail to identify a source of implicit support, we are confident that the marketplace will, as competition develops, highlight it for further Commission attention.

16. We wish to avoid action that directly or indirectly raises the price of the basic residential telephone service that guarantees access to the local telephone network. We also believe, as did the Joint Board,²¹ that raising the existing flat-rate charge on every consumer's line for access to interstate telephone service -- the subscriber line charge (SLC) on primary residential lines -- is not desirable, because it could adversely affect the affordability of local service. Therefore, we decide in today's Order and its companion *Access Charge Reform Order* that we will not permit any increase in the primary residential line SLC and will not order the creation of any additional end-user charges for local service over these lines. Our primary reason for not mandating the recovery of universal service contributions through basic rates, directly raising charges for basic access through an increase in the primary residence SLC, or adopting any new end-user charge from the local telephone company to the residential consumer for basic access is that we have high subscribership rates today, and therefore believe that current rate levels are "affordable." We see no reason to jeopardize affordability by raising rate levels.

17. At present, the existing system of largely implicit subsidies can continue to serve its purpose, and our current implementation of section 254 relies principally on the continuation of existing mechanisms, with modifications to make them more consistent with the statutory requirements and principles. This system is not sustainable in its current form in a competitive environment. Implicit subsidies were sustainable in the monopoly environment because some consumers (such as urban business customers) could be charged rates for local exchange and exchange access service that significantly exceeded the cost of providing service, and the rates paid by those customers would implicitly subsidize service provided by the same carrier to others. By adoption of the 1996 Act, Congress has provided for the development of competition in all telephone markets.²² In a competitive market, a carrier that attempts to charge rates significantly above cost to a class of customers will lose many of those customers to a competitor. This incentive to entry by competitors in the lowest cost, highest profit market segments means that today's pillars of implicit subsidies -- high access charges, high prices for business services, and the averaging of rates over broad geographic areas -- will be under attack.

²¹ Recommended Decision, 12 FCC Rcd at 472.

²² See, e.g., 47 U.S.C. § 253.

New competitors can target service to more profitable customers without having to build into their rates the types of cross-subsidies that have been required of existing carriers who serve all customers.

18. By this Order, therefore, we will retain, with some limited modifications, the existing explicit high cost and low-income support programs until January 1, 1999, but make collection more equitable and nondiscriminatory and allow carriers other than ILECs to receive support; we will continue to coordinate with the states to determine the appropriate extent of universal service support for high cost areas as competition and related state decisions dictate; and we will fund universal service for eligible schools, libraries, and rural health care providers consistent with the statute. The total amount of federal high cost support (both implicit and explicit) will not decline materially, but will be restructured.

19. Over time, it will be necessary to adjust the universal service support system to respond to competitive pressures and state decisions so that the support mechanisms are sustainable, efficient, explicit, and promote competitive entry. We expect to use both prescriptive (i.e., regulatory) and more permissive (i.e., market-based) approaches to complete this task. We expect that reform of both the universal service and access charge systems in accordance with Congress's direction and the principles set forth in the Act and this Order will achieve the following results:

- universal service support will be available for rural, insular, and high cost areas where local rates would otherwise become unaffordable for some users;
- state and federal universal service contributions will be collected equitably and non-discriminatorily from providers of telecommunication services, consistent with the statute's definitions;
- residential customers will be more likely to remain on the network by maintaining or improving today's subscribership rates, and others -- particularly classrooms, libraries, and rural health care providers -- who often lack network connections today will be connected;
- universal service will be sustainable in a competitive environment; this means both that the system of support must be competitively neutral and permanent, and that all support must be targeted as well as portable among eligible telecommunications carriers;
- universal service support will be specific, predictable, and sufficient to deliver service efficiently;
- originating and terminating per-minute access charges will be at forward-looking economic cost-based levels; and

- the total of the subscriber line charge and the presubscribed interexchange carrier (PIC) charge that we adopt today in our access reform proceeding, in combination with federal and state universal service support, will recover the deaveraged non-traffic sensitive costs of serving each customer;

20. Today's Order establishes the new federal universal service system that Congress and the Joint Board envisioned. Our continuing work with the states through the Joint Board process will ensure that this system is sustainable in a competitive marketplace, thus ensuring that universal service is available at rates that are "just, reasonable, and affordable" for all Americans.²³

²³ 47 U.S.C. § 254(b)(1).