

En Banc Hearing - Universal Service Methodology

June 8, 1998

Morning Session

- 9:30 Welcome by Chairman Kennard
- 9:35 Summary of universal service methodology, Common Carrier Bureau
- 9:45 Opening remarks by Commissioners
- 10:15 Summaries of each proposal.

Ameritech-- Thomas Reiman, Senior VP of Public Policy
Arizona -- Jim Irvin, Chairman, Arizona Commission
CFA -- Mark Cooper, Director of Research
Time-Warner -- Susan Baldwin, VP at Economics and Technology, Inc.
GTE -- Dennis Weller, Senior Economist
Bell South -- Ernest Bush, Asst. VP, Regulatory and Policy
Ad Hoc Committee -- Peter Bluhm, Director of Regulatory Policy, Vermont PSB
Variable support amount / Variable benchmark -- Warren Wendling, Supervising
Professional Engineer, Colorado PUC
U S West --Glenn Brown, Executive Director - Public Policy
AT&T -- Joel Lubin, Regulatory VP, Law and Public Policy
Sprint --Jim Sichter, VP, Regulatory Policy

11:15 Break

11:30 Commissioner questioning of panelists

12:45 Lunch Break

Afternoon Session

2:30 Optional reaction by Commissioners

2:50 Discussion among Commissioners.

Presenters from morning available for questions

4:20 Wrap-up

4:30 Adjourn

Ameritech Proposal

**biography of presenter
executive summary of proposal
written testimony**

**Thomas J. Reiman
Senior Vice President
Public Policy**

Thomas J. Reiman is senior vice president of public policy for Ameritech, responsible for developing and responding to the company's long-term policy issues.

A worldwide leader in making communications easy, Ameritech serves millions of customers in 50 states and 40 countries. Ameritech provides a full range of communications services - including local and long distance telephone, cellular, paging, security monitoring, cable TV, electronic commerce, on-line services and more. One of the world's 100 largest companies, Ameritech has 69,000 employees, 1 million share owners and \$24 billion in assets.

Reiman was appointed to his current position in October 1997 after serving as Ameritech's senior vice president of state and government affairs. Prior to that, he was president of product management, responsible for a product development organization made up of teams in each Ameritech business unit. He also served as president and chief executive officer of Ameritech Indiana for two years. Previous positions at Ameritech include: vice president-sales and service; vice president-marketing and secretary to the company, and vice president-general counsel. Before joining Ameritech Indiana in 1986, he held various legal department assignments - including Ameritech vice president and associate general counsel and Ameritech Michigan attorney. He began his career in AT&T's legal department.

Reiman is a member of the board of directors of Anicom, Inc. and Evanston Northwestern Healthcare. He is on the board of trustees of the University of Indianapolis and a member of the Columbia Institute for Tele-Information's advisory board, the Brookings Council President's Circle, and the Metropolitan Planning Council's board of governors.

AMERITECH PRESENTATION

FEDERAL COMMUNICATIONS COMMISSION

EN BANC HEARING

ON

PROPOSALS TO REVISE METHODOLOGY FOR

DETERMINING UNIVERSAL SERVICE SUPPORT

JUNE 8, 1998

Good morning, my name is Tom Reiman, and I am Senior Vice President of Public Policy at Ameritech. With me is Dick Kolb, director of Universal Service at Ameritech, and our subject matter expert.

I am mindful of the thousands of pages of incredibly complex comments, plans, studies and formulas that have been filed with this Commission on the subject of Universal Service and the High Cost Fund. I will try not to add to the complexity.

Ameritech's message is actually quite simple this morning:

Stay the course with a smaller fund, continuing the pressure on the states to carry their share of the burden. Contrary to much of the rhetoric flowing around Washington on this topic, the Commission's original proposal of a 25/75% jurisdictional split, funded by interstate revenues, is the best plan currently before the Commission. It maintains the current Federal level of responsibility while allowing the states to come forward with their own innovative approaches for their share of the total solution.

Fourteen (14) years ago, as Associate General Counsel for the newly created Ameritech, I spent months here in Washington negotiating, debating and arguing with Bert Halprin, then Chief of the Common Carrier Bureau, on what the first Federal Access Charges should look like. Guess what, the issues weren't much different then than they are today: making implicit subsidies explicit; recovering subsidies in a competitively neutral

manner; minimizing rate increases to end-users; and, keeping telephone service affordable and universally available.

Underlying the debate, then and now, are four basic tenets:

- Subsidies and free market competition are natural enemies;
- Subsidies should be collected in a competitively neutral manner (and there is no truly competitively neutral manner as long as they are collected by one or more of the competitors);
- End-user customer rate increases are politically unpopular, and,
- It's the public policy of this nation to keep telephone service affordable.

Now, how does this history and these factors apply to Universal Service, and the High Cost Fund in particular?

Well, let me answer it this way. If we were starting with a clean sheet of paper, we would not design the system we have today that this Commission and the state commissions are trying so hard to make work.

I submit that this Commission would create a plan designed to deliver a set of desired results:

- Affordable local service (and, by the way, studies show that affordable toll rates are also integral to high subscribership levels).
- Robust competition in all markets.

- Increased infrastructure investment leading to new and innovative services.

Competition and investment are driven by economically rational pricing. Simply stated: local rates must at least cover their costs.

Once local rates are set to cover costs, then affordable service is maintained by targeting subsidies only to customers who can't afford to pay the full rate. (As an aside, Ameritech strongly believes that both the collection and distribution of those subsidies should be done by the government, outside of telecom service pricing. It's a tax – treat it like a tax.)

We would not design a system that subsidizes 60-70% of the cost of telephone service of an Ameritech officer's Beaver Creek, Colorado condominium.

We would not design a system that subsidizes rates that have been kept far below any rational definition of reasonable (like \$5/mo. where the state-wide average is closer to \$12).

However, we don't have a clean sheet of paper. We have a huge and complex system in place. But this Commission and the state commissions should keep these desired results firmly in mind, and all decisions should drive the system closer to, not farther away from the desired results.

Using this model, it's clear, I submit, that this Commission is on the right track staying with its current proposal, based on a 25-75% jurisdictional split, funded on the basis of interstate revenues.

Not only is this consistent with the historical separations formula, but – more importantly, it keeps in place the incentive for the states to fix their part of the problem which is setting economically rational local rates. Expanding the Federal Fund to cover more of the subsidy is a move in the wrong direction. It sends the wrong message. It does not move closer to the desired results.

As Chairman Kennard said, “The vast bulk of universal service support today is generated and spent within the boundaries of each state. This means that the real key to subsidy reform is state rather than federal action...unless states act promptly to reform intrastate implicit subsidies, both incumbent and new entrants will be hobbled competitively.”

Ameritech has worked hard on lowering its costs. Some of our state commissions are national leaders in moving towards economically rationale local rates. As a result, Ameritech is the only RBOC that receives no high cost support today. Don't punish our customers for our leadership position by asking them to substantially increase the amount of subsidy they send out of state.

Let's not move backwards. Don't use the Federal High Cost Fund as a quick and easy fix to local rate imbalances suffered by nationwide local

carriers. Challenge the industry and the policy makers in the states to fix local prices so that residential competition can flourish. Then build on that base to refine the system so that subsidies only go to those who truly can't afford to pay cost-based rates. This is what is happening around the world as other nations – in Europe, Canada, Mexico, New Zealand and the Philippines, among others – tackle this issue. Let's not fall behind. To quote from the ads for the current movie *Godzilla*: "Size does matter." Only with subsidies, I submit, smaller is better.

Arizona Proposal

biography of presenter
executive summary of proposal

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COMMISSIONER-CHAIRMAN JAMES M. IRVIN

James M. Irvin was sworn into the Office of Commissioner of the Arizona Corporation Commission on January 6, 1997. On November 6, 1997, he was voted Commission Chairman. During his first year at the Arizona Commission, Chairman Irvin established a Universal Telephone Service Task Force with one of its primary functions being to investigate ways of bringing service to unserved and underserved areas of Arizona. Prior to beginning his service at the Commission, Chairman Irvin served in the private sector as Chief Executive Officer of C.S.G. Security Services, Inc. from 1983 to 1997 and as Vice-President of a Northern California Trucking Company from 1979 to 1983. Chairman Irvin has been named twice to the Who's Who of Business Executives; 1992-1993, and 1996-1997. He was also a member of the American Management Association, the President's Association Division. Chairman Irvin is also actively involved in the Phoenix community working with local schools, serving as a volunteer Deputy Sheriff, serving on the Board of Directors for Silent Witness, and participating as a member of Rotary International. He is a graduate of the University of Southern California with a bachelor of science degree in education. He also has a masters degree in business administration from Loyola Marymount University. He is married to Carol Fehring Irvin and has three children, Lauren, Ashley and Daniel.

June 2, 1998

**EXECUTIVE SUMMARY OF THE ARIZONA CORPORATION COMMISSION
PROPOSAL FOR DISTRIBUTION OF FEDERAL USF FUNDS TO ESTABLISH
SERVICE TO LOW-INCOME CUSTOMERS IN UNSERVED AREAS**

The Arizona Corporation Commission's ("Arizona Commission") Proposal is unlike the other Proposals before the FCC in that it covers a very discrete issue which undermines universal service in several regions of the country including western states such as Arizona and upon which the federal funding mechanism has thus far been silent. This problem is the inability of low-income customers located in unserved and underserved areas to obtain telephone service because they cannot afford to pay the line extension or construction charges necessary to extend facilities to their homes.

The Arizona Commission's Proposal is to set aside a fixed proportion of federal funds to begin to address the problem of unserved and underserved areas and the inability of low-income customers to obtain telephone service because they cannot afford to pay the required line extension or construction charges. The distribution of these funds would be accordance with fixed federal and state guidelines to be established by the Joint Board and FCC.

High Cost Fund ("HCF") support has traditionally and still is, only directed towards keeping monthly rates low for customers who already have telephone service. There is no vehicle or mechanism for assistance to help the "unserved" and "underserved" low-income customer to obtain telephone service. Other existing measures are also inadequate to effectively address this issue:

1. Section 214(e)(3) of the Telecommunications Act of 1996 ("Federal Act") relating specifically to unserved areas does not apply here. Specifically, the carrier is willing to serve the customer but due to the costs involved, the customer cannot afford to pay the line extension charges required under state tariff.
2. The FCC's Lifeline Program subsidizes the monthly rates of low-income customers. Unfortunately, because some low-income customers in Arizona are unable to pay to have facilities connected to them, they are unable to take advantage of this important program and the lower monthly rates.
3. The FCC's Link Up Program is limited to providing a reduction in the carrier's customary charge for commencing telecommunications service for a single telecommunications connection at a customer's place of residence. No assistance is provided to offset line extension or construction charges, which act to prevent the establishment of service in many cases.

4. Measures contained in existing state line extension or construction charge tariffs which pass through a reduced, pro-rated cost to the customer have not solved the problem since customers cannot afford to pay even the pro-rated cost.
5. While the Rural Utilities Service ("RUS") provides low interest loans to companies for the purpose of bringing facilities into remote areas, these loans are not available in all cases and some companies have chosen not to utilize this option.
6. Cellular or wireless technologies are not a viable option at this time since the networks do not yet exist in remote areas or in some instances wireless cannot be provided due to geographical constraints.

The Arizona Commission is recommending in its Proposal that the Joint Board and FCC take the following steps:

1. Define and recognize the problem at the federal level for purposes of the federal funding mechanism.
2. Determine the extent of the problem on a nationwide basis.
3. Focus upon low-income customers who meet the federal lifeline default eligibility criteria.
4. Allocate a fixed amount of federal USF funds to be used to partially offset line extension charges and/or line construction charges associated with establishing service to low-income customers.
5. Establishment of federal and state guidelines setting criteria and standards for distribution.
6. States to examine cases on an individual basis.

Time Warner Proposal

**biography of presenter
executive summary of proposal
written testimony**

Susan M. Baldwin, a Vice President for Economics and Technology, Inc. (ETI), has worked nineteen years in public policy, thirteen of which have been in telecommunications. She is an expert in diverse telecommunications areas including universal service, cost proxy models, numbering issues, alternative regulation, network modernization, local exchange competition, cost methodology, and rate design. (ETI specializes in telecommunications economics, regulation, and public policy.) Ms. Baldwin has participated in numerous state and federal telecommunications policy proceedings, has testified as an expert witness before state regulatory commissions, and has served as an advisor to several state regulatory commissions and consumer advocates. Ms. Baldwin served four years as the Director of the Telecommunications Division for the Massachusetts Department of Public Utilities, where she advised and drafted decisions for the Commission in numerous proceedings and directed a staff of nine. In addition, Ms. Baldwin has worked with local, state, and federal officials on energy, environmental, budget, and welfare issues. [Master of Public Policy, Harvard University's John F. Kennedy School of Government; Bachelor of Arts, Mathematics and English, Wellesley College, nominee, Rhodes Scholar.]

**EXECUTIVE SUMMARY OF TIME WARNER COMMUNICATIONS
HOLDINGS INC. COMMENTS REGARDING UNIVERSAL SERVICE
METHODOLOGY; CC DOCKET NOS. 96-45, 97-160, DA 98-715**

Wherever possible, the FCC should avoid subsidizing rates in rural, insular and high cost areas where cost-based rates are affordable. This policy approach comports with Section 254(b)(1) and sound policy. Wealth transfers to consumers with relatively high incomes advance absolutely no identifiable social goal.

In a paper submitted in this proceeding, "Defining the Universal Service 'Affordability' Requirement: A Proposal for Considering Community Income As a Factor in Universal Service Support" ("ETI Study"), Economics and Technology, Inc. ("ETI") quantifies the harm in not recognizing that consumers in the top 30 percent income bracket can easily afford cost-based rates. The ETI Study analyzes average income by census block group ("CBG") in conjunction with cost model results to determine universal service funding requirements in high-cost, high-income areas. It demonstrates that approximately 20-30% of the high-cost universal service fund could be eliminated if support were limited to households with incomes below the 70th income percentile. This could result in up to \$4.5 billion in savings nationally.

Thus, the FCC should work toward eliminating federal universal service funding for CBGs with average median incomes above an appropriate threshold, for example the 70th percentile. The elimination of these subsidies will of course result in lower compensation for the carrier serving these high-cost areas. In many states, incumbent LECs do not have the flexibility to raise rates to account for the elimination of the federal subsidy. A state could respond to this problem either by gradually phasing in cost-based rates to avoid rate shock (the preferred outcome) or by increasing the state subsidy to make up for the loss of federal funds. In any event, the decision to subsidize high-income areas should be made by and paid for by the states. In addition, as the ETI Study acknowledges, certain consumers in a particular high income CBG may not have the ability to pay cost-based local telephone rates without serious difficulty. Accordingly, where a state has transitioned to cost-based rates, it may be necessary to establish a "safety net" for those consumers. Finally, the FCC should consider establishing a cost-based local service "cap" beyond which all costs would be subsidized at the federal level, so as to avoid any consumer shouldering an extraordinarily burdensome monthly local telephone bill.

**FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

**EN BANC HEARING ON
PROPOSALS TO REVISE THE METHODOLOGY FOR
DETERMINING UNIVERSAL SERVICE SUPPORT**

CC Docket Nos. 96-45 and 97-160

STATEMENT OF SUSAN M. BALDWIN

**Senior Vice President
Economics and Technology, Inc.
Boston, Massachusetts 02108**

on behalf of

Time Warner Communications Holdings Inc.

June 8, 1998

STATEMENT OF SUSAN M. BALDWIN

I am Susan M. Baldwin, Senior Vice President of Economics and Technology, Inc. ETI is a consulting firm specializing in telecommunications economics, regulation, management and public policy. I was a principal author of the paper, *Defining the Universal Service "Affordability" Requirement*, that forms the basis for Time Warner Communications' proposal to the FCC for consideration of community income as a factor in universal service support.

ETI's analysis of the relationship between income and high-cost support was an outgrowth of our detailed analyses of various cost proxy models that were first presented to the Commission in 1996, in the early stages of CC Docket 96-45. One thing that struck us was the fact that the models that purported to "target" support on the basis of high-cost also directed support to many well-to-do communities where customers clearly could afford to pay for the entire cost of their local telephone service, without any subsidy whatsoever. Further research demonstrated that this was not an isolated condition; it was a nationwide pattern. ETI's analysis demonstrated that a decision not to fund support to high-income CBGs would result in a significant reduction in the overall size of the interstate high-cost fund.

The *Telecommunications Act of 1996* explicitly requires that "affordability" be included as a consideration in the development of a comprehensive universal service support mechanism: "Quality and rates — Quality services should be available at just, reasonable, and *affordable* rates." The extent to which service is "affordable" to an individual consumer is inextricably tied to that consumer's income level and ability to pay, and in fact the Joint Board, in its Recommended Decision, and the Commission, in its Report and Order, have acknowledged that income level directly affects the determination of what is an "affordable" price. The Commission has also agreed that community income, as represented by the percentage of students eligible for school lunches, is a valid basis for establishing the variable discounts necessary to make telecommunications affordable to schools and libraries.

The universal service goal is not advanced by subsidizing consumers who can afford to pay the entire cost of their telephone service — and whose decision to take service is unaffected by the presence of such a subsidy. Indeed, some of the specific attributes of exclusive high-income communities — large lots, low population density, remoteness from primary population centers — are the very same conditions that tend to raise the cost of providing local telephone service. Ironically, many low-income areas, such as densely populated inner-city communities, are because of such attributes also *low-cost* areas, and could well be forced to subsidize the “high rent” high-cost-to-serve suburbs.

Policies that would flow universal service support to such communities serve only to impose significant costs and economic burdens upon other segments of the economy while doing nothing to advance the cause of universal service or produce any other offsetting economic or social benefit. Among other things, a funding obligation that is larger than one that is minimally necessary to achieve the universal service goal will undermine other Commission and Congressional objectives, perhaps even including universal service itself! By forcing new entrants to make larger-than-necessary payments to the universal service funding mechanism, such policies will increase the costs of and barriers to competitive entry, and thereby diminish the prospects for effective competition overall. They will also work to suppress demand for price-elastic services, thereby limiting the potential benefits that all sectors of the economy can derive from increased access to and use of the nation's telecommunications resources.

The ETI study and Time Warner's proposal are not offered as providing definitive or prescriptive guidance as to how to structure an income-based funding mechanism. Rather, it is offered to demonstrate

- that many “high-cost” communities are also high-income communities;
- that public data is available from the Census Bureau to support the administration of a community income-based funding mechanism; and

- that there is an opportunity to achieve a significant decrease in the overall size of the universal service support fund, fully consistent with the statutory requirement that service be "affordable," without any consequential impact upon the overall universal service goal.

The structure of a community income-based funding mechanism should be built upon three specific policy initiatives:

- *First*, the FCC and the states should conclude that the highest income high-cost areas are to be excluded from universal service support. For example, if all CBGs with median income levels in the top 30% of their state were placed in this category, the funding requirement could be reduced by as much as 20% to 30%. The specific policy can be highly flexible, and can involve state-specific or national income standards, or some combination, as well as absolute and/or flexible affordability thresholds.
- *Second*, there should be a safety net for low-income consumers residing within high-income high-cost areas who cannot afford to pay full cost-based rates.
- *Third*, to avoid rate shock, transition plans should be established that would allow carriers to move rates in high-cost high-income areas toward their full forward-looking costs.

If done correctly — and it can be done correctly — the result will be "win-win" for all concerned: Universal service at affordable rates can be assured, while minimizing the potential adverse impact upon nascent competition, innovation, and the economy generally.

Thank you very much for the opportunity to present these comments here today.

GTE Proposal

biography of presenter
executive summary of proposal
written testimony: to be added

Dennis Weller
Biographical Information

Dennis Weller is Chief Economist at GTE. Mr. Weller is responsible for GTE's policy positions on such issues as the transition to competition, universal service, and access reform. Prior to joining GTE, Mr. Weller served as pricing strategist for AT&T. Mr. Weller did his graduate work in economics at Stanford.

SUMMARY

GTE welcomes the Commission's effort to reevaluate the universal service plan it adopted in May of 1997. If the Commission is to carry out its mandate under the Telecommunications Act of 1996 to preserve and protect universal service, then significant changes must be made to that plan.

The Commission has wrestled for the last two years over the development of cost models, and over the choice of benchmarks and other parameters for the calculation of Federal universal service support. GTE submits that it is possible – and indeed necessary – to establish relatively clear measures of the minimum amount of support that the Federal plan must provide. These are as follows:

1. The Federal plan must provide support that is sufficient to replace the flow of implicit universal service support that is generated today by interstate access charges.
2. The Federal plan should provide a reasonable amount of support to states, particularly those with high costs and/or low revenues, to help those states replace the implicit support that is generated today by state rates for services such as access, toll, and vertical features.
3. The Federal plan should maintain the support that is provided to non-rural companies by the current high cost fund.

These policy goals provide an objective measure of whether the Federal plan is sufficient; the benchmarks and percentages used to calculate Federal support should be chosen to ensure that the plan provides at least the support required to meet these goals.

GTE proposes that the Commission should establish a sliding scale of benchmarks and percentages for Federal support. A simple example of such a framework would be the two-benchmark approach which has been proposed by US West. However, an additional benchmark (or benchmarks) may be needed to allow the plan to achieve the Commission's policy goals.

The structure and parameters of this framework cannot be chosen in a vacuum. Instead, the parameters should be chosen to ensure that the policy goals listed above are met. The Commission should choose the cost model and inputs it will employ in the calculation *before* it chooses the benchmarks and percentages, so that it can assure itself that the parameters chosen will produce the desired results.

The Act requires that the sum of the universal service support provided by state and interstate mechanisms be sufficient, but it does not specify the proportion of that total that must be provided by the Federal plan. It is therefore reasonable that the Federal plan should include a benchmark which serves as a dividing line between state and Federal responsibility. However, the Commission's framework must be designed to be consistent with its plenary responsibility – which the Commission itself recognizes – to ensure that the overall effect of universal service mechanisms are sufficient. Thus, the Federal benchmark (or benchmarks) should simply represent cost levels at which the Federal plan will intervene to provide support. They should not represent an assumption by the Commission that implicit universal service support, provided today by the rates charged for other services, can or should continue into the future.

The contributions necessary to fund the Federal support amount should be based on the total of carriers' state and interstate retail revenues. Carriers should recover their contributions through a uniform percentage surcharge.

GTE proposes a methodology consistent with the requirements of the Telecommunications Act of 1996 and which meets Congress' express intention to introduce competition into the telecommunications marketplace only while protecting universal service.

Bell South Proposal

**biography of presenter
executive summary of proposal
written testimony**

Ernest L. Bush
Biographical Sketch

Ernest Bush, Assistant Vice President - Regulatory Policy and Planning, BellSouth Telecommunications. Ernest began his telephone career in Macon, Georgia with Southern Bell in 1970 after graduating from the Georgia Institute of Technology, Atlanta, Georgia with a degree in Industrial Management. Ernest has held a number of positions within the Southern Bell Comptrollers department in Macon and Atlanta including operations and methods staff assignments. From March 1977 to January 1980 Ernest worked for AT&T in New Jersey in the Comptrollers Operations-CRIS (Customer Records Information System) department. Ernest returned to Southern Bell in February 1980 working in the CRIS group in Atlanta, Georgia. In April 1985 he was appointed Director-Federal Regulatory for BellSouth in the company's Washington office. Ernest returned to Atlanta in January, 1990 as Assistant Vice President-Regulatory, BellSouth Services. On October 1, 1991 he became Assistant Vice President-Regulatory Policy and Planning. He is currently responsible for the provision of staff support for regulatory policy and planning activities for BellSouth Telecommunications.

Overview of BellSouth's Federal High Cost Universal Service Funding Proposal

Overview: BellSouth's proposal is focused on replacing the implicit support that exists today in **Interstate** access rates with an explicit and sustainable funding mechanism. The states would **still be** responsible for setting up explicit and sustainable state funds to deal with any implicit support that remains after the federal fund is implemented.

Specifics of BellSouth's Plan:

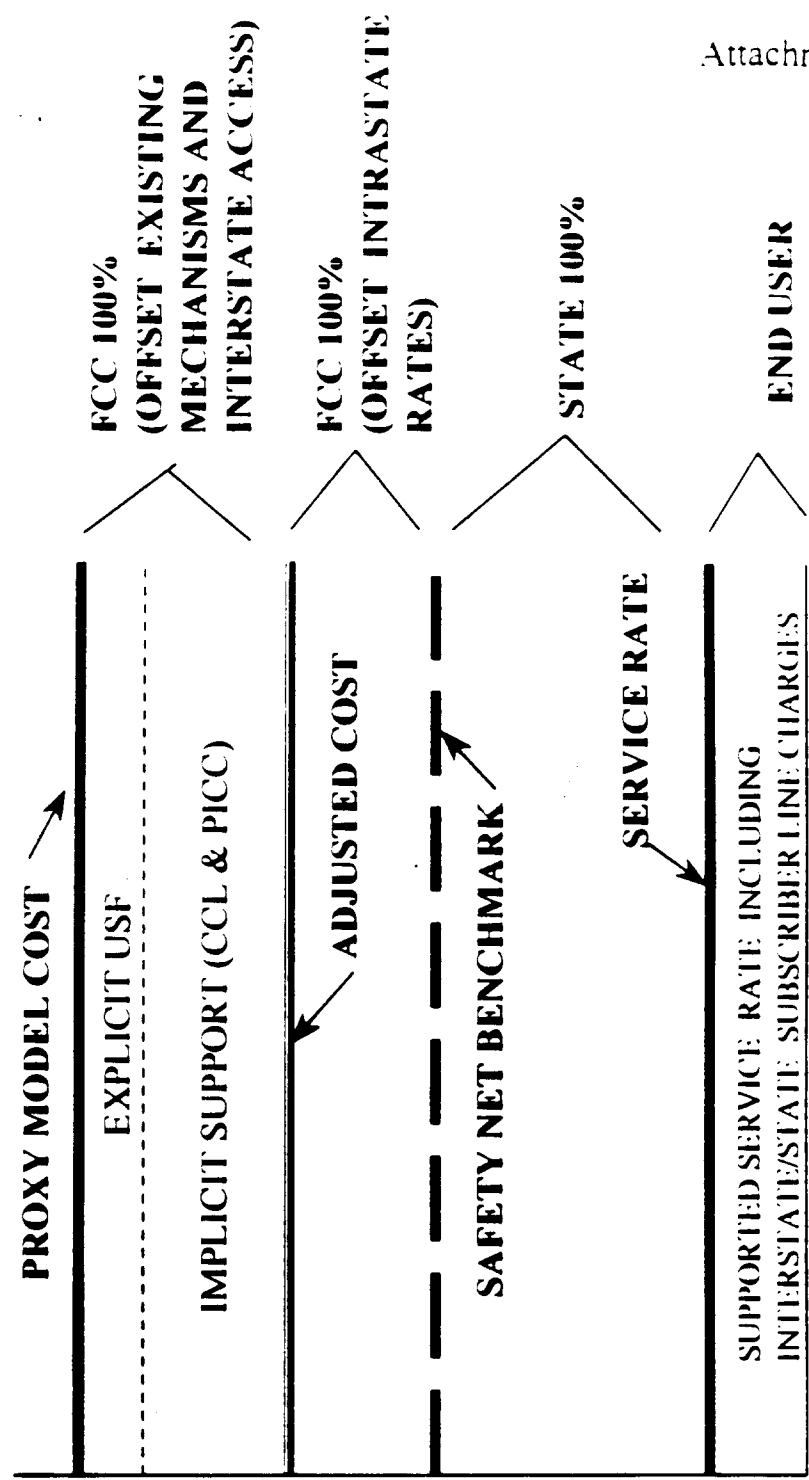
1. Identify the economic cost of providing universal service for areas no larger than wire centers through use of a reasonable cost proxy model. This allows identification of the full amount of implicit subsidy currently built into rates.
2. Identify the amount of implicit and explicit support that is currently being funded within the interstate jurisdiction. These amounts would include any existing support mechanisms (the current High Cost Fund, DEM weighting, and Long-Term Support), and implicit support built into switched access rates (which is calculated by state and by company based on the sum of Carrier Common Line revenues and Presubscribed Interexchange Carrier Charges (PICCs)).
3. Calculate all federal support on a per line basis by wire center. This amount can be calculated based on the results of the cost proxy model. For example, if the total support in a given state for a given company is \$50 million (based on economic cost), and the federal amount of support is \$22 million (calculated pursuant to step 2), then the per line results from the cost proxy model can be multiplied by 44% ($\$22M/\$50M$) to arrive at the federal support per line in a given wire center. The per line level of support is portable to any eligible carrier.
4. Carriers should first use net revenues from the new fund to offset support that will be lost from the existing mechanisms. Then, any additional net support should be applied to CCL, multi-line business PICCs and finally residential and single-line business PICCs. The bottom line is that the total of the revenue reductions should be equal to the net amount of funding received from the federal high cost fund.

Other Points:

1. The states would be responsible for making explicit any implicit support that remains after the federal fund is implemented. The states would thus need to compare the state's view of the economic cost of providing the supported services to the maximum price that can be charged for the supported services, and provide explicit funding or rate rebalancing to deal with any implicit support not taken care of by the federal fund.

2. The Federal fund should be supported by all providers based on an assessment against both intrastate and interstate revenues received from endusers. Both interstate and intrastate retail revenues should be assessed because it will become increasingly difficult to tell these revenues apart.
3. The Federal fund should be implemented on 1/1/99 as planned. Nothing in this proposal would make that date unattainable.
4. For rural LECs, support from the new fund should be equal to the amount of support previously provided by the NECA Universal Service Fund, DEM Weighting and LTS.
5. Since local exchange carriers will also have to pay into the fund, some kind of PICC charge will likely remain even after implementation of the new universal service fund to allow LECs an opportunity to recover their assessment.

POSSIBLE COMPROMISE SOLUTION FOR FEDERAL USE



**SUMMARY OF BELLSOUTH'S UNIVERSAL SERVICE PROPOSAL
FCC EN BANC MEETING
Ernest L. Bush, Assistant Vice President, Federal Regulatory
June 8, 1998**

In response to the Public Notice released April 15, 1998 by the Common Carrier Bureau, BellSouth submitted its proposal for a methodology for sizing the federal universal service fund on April 27, 1998. Since the FCC's adoption of its "25/75 interstate/intrastate" plan in its May 7, 1997 Order, numerous commenting parties, including states, Congress, and industry participants, have expressed concern that the FCC's methodology will result in a federal support mechanism that is insufficient to cover all of the existing support, implicit and explicit, received today. BellSouth believes that its proposal, set forth below, resolves many of the concerns raised by the FCC's plan. BellSouth's methodology would establish the minimum size federal fund necessary to assure that current implicit and explicit levels of federal support for universal service are maintained. At the same time, nothing in BellSouth's methodology would preclude the Commission from identifying circumstances under which the Commission would provide states with additional federal support.

Similar to the FCC's proposed four-step methodology, BellSouth's methodology begins with determining the cost of universal service for areas no larger than wire centers based upon a reasonable economic cost model. In the second step, the current state-specific implicit support that is included in interstate access charges is determined. The loop-related access charges whose cost recovery has been assigned to the interexchange carriers, rather than the end users—the carrier common line charges and the presubscribed interexchange carrier charges—contain the implicit support for universal service. In step three, these amounts would be deducted from the total universal service costs derived from the model with the residual being the universal service support responsibility of the states.

The size of the federal high cost fund would be the implicit support identified in step two and the amounts associated with the existing explicit mechanisms which include the interstate high cost loop fund, dial equipment weighting, Long-Term Support, and Lifeline and Link-Up programs. BellSouth's proposal is visually depicted in the attached Exhibit 1. Support would be calculated on a per line basis in a given wire center and would be portable to any eligible carrier.

BellSouth's methodology provides an efficient means to achieve the Commission's objective that the states receive from the federal fund at least the same level of support that they are receiving from current implicit and explicit mechanisms. An integral part of building a sufficient universal service support program is the states' responsibility for creating explicit and sustainable state funds to replace any implicit support that remains after the federal fund is implemented. Each state would thus need to compare the state's view of the economic cost of providing the supported services to the maximum price that can be charged for the supported services, and provide explicit funding or rate rebalancing to deal with any implicit support not taken care of by the federal fund.

The federal USF should be supported by all providers based on an assessment against both intrastate and interstate revenues received from end users. Local exchange carriers could recover their contributions to the USF through a per line charge on the interexchange carrier similar to the PICC. The federal USF would be implemented, as planned, on January 1, 1999. BellSouth's proposal would apply to non-rural companies; rural carriers would continue to receive the amount of support currently provided.

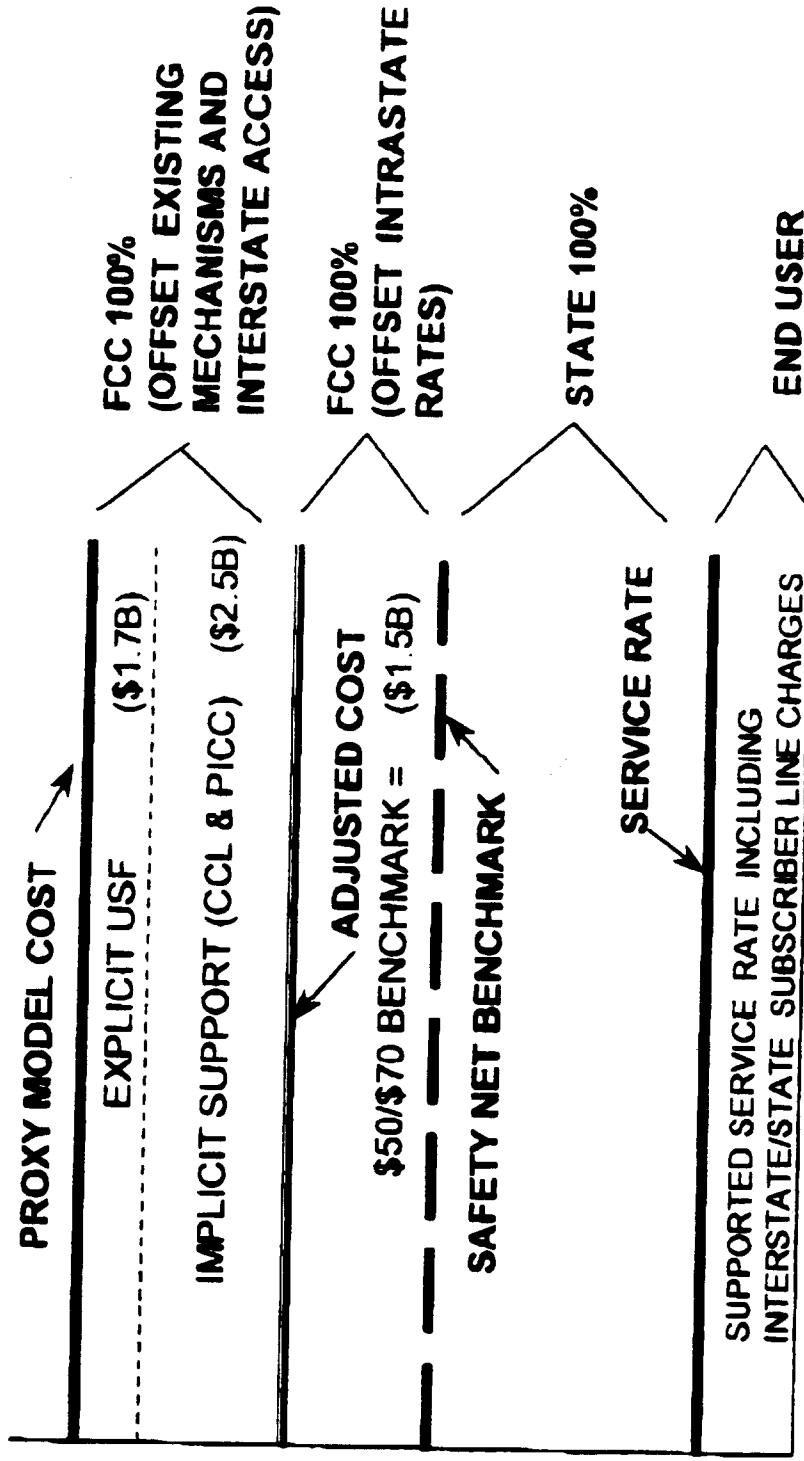
As previously discussed, BellSouth believes that this proposal is the minimum necessary to assure that the federal fund continues to provide an amount equal to the current implicit and explicit support provided today in the interstate arena. In an effort to address additional concerns of a number of parties, BellSouth proposed a compromise solution in its May 15 Comments in this proceeding. In addition to the minimum USF outlined above, BellSouth recognizes the valid concern of some states that they will be unable to support a state USF that places the majority of the funding burden on the intrastate jurisdiction. Therefore, BellSouth incorporated into its proposal a "safety net" benchmark that would shift the burden of support in those states with high costs to the interstate USF above the "safety net" benchmark.

This benchmark would be compared to an adjusted per line cost that accounts for the support already provided by the federal USF. Any amount above the safety net benchmark would be fully supported by the federal USF. This approach is similar to that proposed by US West. In the attached Exhibit 1, BellSouth's calculations are based upon a \$50 benchmark for residential lines and a \$70 benchmark for single line business lines. As shown in the Exhibit 1, the additional funding requirement would be approximately \$1.5 billion.

Thus, BellSouth's methodology provides for adequate federal universal service support. The Commission has already acknowledged that the new, explicit federal USF should assure each state the same level of support that the state receives from existing interstate implicit and explicit mechanisms. At the same time, the state commissions have made a compelling case that the federal fund should provide additional support to the states to assist them in reducing intrastate implicit support. BellSouth's compromise solution would meet all of these objectives.

EXHIBIT 1

BELLSOUTH COMPROMISE SOLUTION FOR FEDERAL USF



FEDERAL FUND WOULD APPROXIMATE \$5.7B

Ad Hoc Working Group Proposal

**biographies of presenters
executive summary of proposal
written testimony**

BIOGRAPHY

Joel B. Shiffman

- **Senior Advisor - Maine Public Utilities Commission**
- **Staff of 80-286 (Separations) Joint Board**
- **Lead Commenter for the "Rural States Group" in the § 254 Universal Service Joint Board Docket**
- **Leader of the Regulatory Methodologies Issue Group of the NARUC Staff Subcommittee on Communications**
- **Formally General Counsel of Maine Public Advocate**
- **Worked for 10 years as a Telecommunications Attorney with West Virginia Public Service Commission .**
- **Bachelors Degree from Carnegie Mellon University - 1970
Pittsburgh, Pennsylvania**
- **Law Degree from West Virginia University - 1975
Morganstown, West Virginia**

Hobbies: Telecomm History

Biographical Information on Peter Bluhm
May 28, 1998

Peter Bluhm holds a law degree from Albany Law School and a Master of Public Administration from S.U.N.Y. at Albany. For twenty years Peter has lived in Vermont and has worked for Vermont state government. For ten years he served as Legislative Draftsman and Committee Counsel to the Vermont Legislature. He also has worked as Vermont Assistant Attorney General for the Department of Mental Health, General Counsel to the Vermont State Board of Education, and as Vermont Deputy Secretary of Administration.

Currently Peter is employed as Director of Regulatory Policy at the Vermont Public Service Board where he directs the Board's legislative program and is the head of the Board's Telecommunications Team. He also serves as a hearing officer on cases from a variety of industries and is responsible for overseeing Vermont's Universal Service Fund for telecommunications.

Peter is also the Immediate Past-President of the Vermont School Boards Association.

AD HOC WORKING GROUP PROPOSAL

EXECUTIVE SUMMARY

Representatives of low and high cost states, local exchange carriers large and small, and other industry participants have worked since the summer of 1997 to develop an approach to funding for high cost areas that satisfies both the Telecommunications Act of 1996 (Telecom Act) and their legitimate and diverse interests. The resulting proposal is a reasoned compromise that, if adopted, will satisfy the goal of the Telecom Act to ensure reasonably comparable rates for high cost areas of the country without creating an unduly large burden on cost in low cost areas. The key elements in the proposal are:

- 1) that funds should flow from state to state only to the extent that a state is unable, by balancing high and low cost areas within its boundaries, to achieve average cost levels consistent with the national average;
- 2) that current support levels for rural companies are maintained to avoid near-term disruption for rural companies; and
- 3) that the impact of anomalies in cost data is moderated by basing support on the lesser of embedded or forward-looking state average costs, with a provision to accommodate states that require rapid replacement of older infrastructure.

These elements, taken together, require a fund of modest size (under \$2 billion nationwide using current cost estimates) and provide sufficient additional support that high cost states can satisfy their obligations under the Telecom Act.

Perhaps the most important benefit of the proposal, however, is that, because it is the product of extensive negotiation and give and take, its adoption will minimize the degree to which litigation will dominate the Universal Service Fund landscape. High cost states supporting the proposal would give up the opportunity to claim that, under the Telecom Act, far greater federal funding is required; low cost states, for their part, would give up the opportunity to claim in court that any obligation is too great.

Numerous principles guided the design of the plan. These principles are endorsed by all the submitting states as a package, although some states may differ with some of the individual principles.

- The principal purpose of federal high cost support is to maintain reasonably comparable intrastate rates, and not to reduce interstate access charges.

- Consumers in rural, insular and high cost areas should have access to a similar spectrum of telecommunications services as consumers in urban areas, at rates that are reasonably comparable to rates charged for similar services in urban areas elsewhere in the country.
- The federal high cost support program should be as small as possible.
- Revenues for the federal high cost support program should be derived from a charge on only the interstate revenues of interstate carriers.
- Collection and distribution of high cost support should be competitively neutral.
- Federal support should create appropriate incentives for investment in the network.
- Federal support for high cost areas should be compatible with the method of separating costs and revenues between interstate and intrastate jurisdictions.
- Federal support for high cost areas should be distributed in a manner determined by state commissions and that is compatible with the state's decisions on related issues of rate deaveraging and establishing the size of service areas.
- Carrier earnings should be based upon success attracting customers in a competitive market, not based upon exploiting irregularities of state and federal regulatory policy.
- Federal support should be based upon cost, and should be based upon the differences among the states in the ability to provide reasonably comparable rates with internally generated explicit subsidies. Federal support should permit each state to have rates equal to the overall national average, which is an acceptable definition of rates "reasonably comparable" to urban rates.
- Both forward looking cost and embedded cost should set upper limits on federal support. This will ensure that any errors generated by forward-looking cost models do not have unduly harsh consequences.
- Federal support should consist of a single system. No distinction should be made between rural and non-rural carriers, nor between loop and switch costs.
- Carriers should be assured that federal support will not decrease until the reliability of forward looking models has been securely established.

To satisfy these principles, the proposal would calculate and distribute high cost fund support using the following sequence:

1. **Using forward-looking cost models**, calculate the difference between each state's average cost **and the national average**. Remove the 25% of these costs already covered by interstate revenues under separations.
2. Using reported embedded costs of incumbent carriers, calculate the difference between each state's average (embedded) cost and the national average. Remove the 25% already covered by interstate revenues under separations.
3. For each state, take the lesser of the amounts from step 1 and step 2. This is the minimum amount of federal support for each state.
4. Calculate hold-harmless support for each state. For most states, this consists of support under existing support systems (i.e., support for loops and switches). For states with above average embedded costs that currently make a net contribution to federal support, the hold-harmless amount is increased to ensure that the state will not have to increase its net contribution.
5. Federal support under the proposal is the greater of this "hold-harmless" amount and the minimum amount from step 3.
6. State commissions would assign federal support first to carriers who would receive support under existing systems, and distribute remaining support (if any) according to plans adopted by the states and approved by the FCC to ensure consistency with the Telecom Act. States could distribute federal support in accordance with one of several options, each of which would ensure that rates in rural areas are reasonably comparable to rates in urban areas.

Statement of the Ad Hoc Working Group

Mr. Chairman, members of the Commission, members of the Joint Board. I am Peter Bluhm, Policy Director for the Vermont Public Service Board. I appreciate being invited here to discuss with you how to satisfy the Telecommunications Act's requirement that rates for customers in rural areas be affordable and reasonably comparable to rates in urban areas. With me today is Joel Shifman of the Maine Public Utilities Commission, the other lead staff author of the Ad Hoc Plan who will be available to answer questions this afternoon.

I will focus on the two key tests of a successful universal service plan: The universal service plan must be sufficient and it must be efficient.

Sufficiency means that the system of support for high cost areas must allow affordable local telephone rates to be available to subscribers everywhere in the country. Rates do not have to be equal between downtown Los Angeles or Houston and rural Vermont, but they must be reasonably comparable. A sufficient universal service plan is essential for the benefits of competition to be realized by all Americans.

Efficiency is also necessary. Financial resources are limited, and regulators cannot federalize all high cost support objectives including all implicit subsidies existing in state rate structures. It is neither economically desirable nor politically possible to raise \$10 or \$15 billion dollars through a surcharge on interstate services. Universal service at the federal level must make do with a smaller budget, and should be limited to supporting the areas that are most closely connected with the comparability objectives of the Telecommunications Act.

The current system fails first because it is insufficient. It does not even pretend to

support all rural and high cost areas equally, in that it discriminates against rural areas served by large companies. Vermont is by one definition the most rural state in the country, yet its major carrier serve 85% of our customers. Customers who live in the area served by this carrier receive substantially less support for high-cost loops and switching than do customers in other, equally rural areas. Furthermore, the current program totally ignores the high interoffice costs in many rural states. Thus the rate comparability requirements of the Act cannot be achieved unless the current system is substantially modified.

The current system also fails to comply with the Act because, by basing support in part on the size of the incumbent, the current system is incompatible with competition. Competition requires that subsidies be explicit and portable. A support system that links the amount of support available in an area to the identity of the incumbent clearly would destroy any effort to achieve meaningful portability.

The Commission's order of May 1997 establishing a 25/75 federal/state split likewise fails the test of sufficiency. The rule itself actually moves away from sufficiency by in effect repealing current high cost support.

Even if current support levels were maintained, however, the 25-75 plan is insufficient. Indeed, even if the Commission were to apply the full 25 percent support entirely to the state jurisdiction, the results still would not be sufficient to ensure that customers everywhere in the country have reasonably comparable rates.

Simply put, some states have low-cost urban areas from which they can draw support. Other states, however, have only small urban areas, and very limited ability to finance high

costs. For these states, average costs are so high that it is impossible for them to obtain comparable rates, no matter what they do. In states with many high cost customers and few low-cost customers, the surcharges needed to achieve comparable rates would be so large that, when added to existing rates, the total cannot be comparable with low-average-cost states. These high average cost states would face the Hobson's choice of either imposing very high end user surcharges, thus destroying comparability, or imposing very high interexchange carrier access charges, thus impeding competition and economic development.

A universal service support system can be both sufficient and efficient. The Commission should set up an overall framework for support, but that framework can anticipate that the states will fill in some of the pieces. While the Act does not require any state to enact a high cost support program, the Commission can appropriately make some assumptions about state effort. The only alternative is raising \$8 to \$10 billion dollars, something that is politically unacceptable to the Congress, and frankly, something that is not necessary.

A sufficient fund of more modest size, however, requires regulators to be selective about how federal support will be distributed. If support is given to areas that can raise that support another way, such as from low-cost areas inside their own states, there will not be enough funds left over to finance affordable and comparable rates in other states.

The Ad Hoc Plan limits federal support to states to the amount by which that state's cost exceeds a national average. The plan assumes that if a state has average costs that are at or below the national average, the state can support its high cost areas from within its own

borders by surcharging its own low-cost areas to support its own high-cost areas. This decision is appropriate since much of the anticipated support is implicit today in rates that are set by state commissions. There is no immediate need to replace these instate transfers with federal support.

The Ad Hoc mechanism also uses both forward-looking and embedded costs in calculating support. This feature has been controversial, but it serves important purposes beyond constraining the size of the interstate fund. First, there is much uncertainty about the accuracy of forward-looking models. I recommend that the Commission find a way to limit their applicability until there is more confidence that they predict costs accurately. The use of embedded costs also creates incentives for network upgrades in areas that have suffered from under-investment, and encourages competition by not overcompensating incumbents in areas where they have old and highly depreciated plant.

The AD Hoc Plan provides a sound framework to meet the requirements of the Telecommunications Act. Working together, the Commission and the states can ensure that all of their resources are used, fairly and evenly, to guarantee to customers everywhere in the country rates that are affordable and reasonably comparable.

I appreciate the opportunity to speak to you today. Mr. Shifman and I will be pleased to answer your questions at the appropriate time.

Variable Support/Variable Benchmark Options

biography of presenter
executive summary of proposal
written testimony

**VITA of
WARREN L. WENDLING**

Mr. Wendling has been a member of the Staff of the Colorado Public Utilities Commission for 16 years and now serves in the capacity of the Supervising Professional Engineer. Mr. Wendling received his Bachelor of Science Degree in Electrical Engineering, Masters of Electrical Engineering, and Master of Business Administration from the University of Colorado, Boulder. He is a registered Professional Engineer in the State of Colorado.

Mr. Wendling has testified on numerous occasions before the Colorado Commission and Colorado State Courts as an expert witness. His testimony has addressed utility operating practices, and engineering issues, including outside plant construction. Since 1983, he has been involved primarily in telecommunications matters brought before the Colorado Commission. His work includes performing and advocating cost-of-service studies for telecommunications services.

Since 1990, Mr. Wendling has served as the lead Staff member in designing, advising and administering the Colorado High Cost Fund.

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

Variable Benchmark Option

Under the variable benchmark option, the federal high cost program would supply 100% funding support to areas served by non-rural LECs whose costs to serve an area exceed a benchmark that varies from state to state. The cost would be determined by using a forward-looking economic cost proxy model. Conceptually, the benchmark would vary based on a measure that reflects a state's ability to internally support and fund universal service requirements. States that have a relatively low ability to internally support universal service would have a relatively low benchmark, while states that have a relatively high ability to internally support universal service would have a relatively high benchmark.

The variable benchmark would be based on two principal components: (1) the state's forward-looking economic cost as determined by the cost proxy model; and (2) the state's ability to internally fund its universal service requirements. This option contemplates that the first component would require the use of a forward-looking cost model for determining costs on a relatively small geographic basis. Creation of a state high cost fund is neither required nor precluded under this option. Non-rural Eligible Telecommunications Carriers would be reimbursed directly by the federal high cost fund administrator for customers served within the high cost area. This approach would ensure that all of the very highest cost areas throughout the nation are supported through the federal program.

Incorporating the second component - a state's ability to fund its universal service requirements internally - into a variable benchmark would be a two-step process. First, a factor must be selected that serves to differentiate among states that will get more versus less support. Second, that factor must be

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

used to vary the benchmark over the range of benchmarks to be considered. As an example, "State A" might have a large revenue base that would require less support, and its benchmark for the federal fund might be \$75, while "State B" might require more support, and would have a federal funding benchmark of \$40. The factor used to differentiate among the states must be based on independent, publicly available data. Such a factor might recognize the ratio of intrastate revenues to total revenues; the ratio of intrastate traffic volumes to total traffic volumes; the degree of variability of cost throughout the state; the ratio of lines located in urban and rural areas of the state; the state's ability to keep local rates within a reasonable range, a measure of local competition in the state, or some combination of these or other measures. Other parties may provide different logical and relevant choices for the factor to be used in this option, and the FCC should consider all reasonable alternatives.

Because the FCC has not yet chosen the most appropriate forward-looking cost model or its inputs, this option is presented on a conceptual basis at this time. It is meaningless to calculate a total fund size or a state-by-state distribution of support resulting from use of this option without resolving the cost model platform issues, choice of inputs, geographical support area and the factor(s) for varying the benchmark. Because of the wide range of options, however, it is clear that this option could be designed to provide a wide range of support amounts while reasonably controlling the size of the federal fund.

Variable Support Option

Under this option, the support amount for each non-rural Eligible Telecommunications Carrier would be computed as the

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

difference between the cost of serving an area and a nation-wide benchmark; however, the federal percentage of high cost funding would vary from state to state. In contrast to the plan adopted in the FCC's May 8, 1997 order in which the payment of federal support remains a constant 25% in all states, under this option the percentage of federal support provided will vary depending on the state's ability to internally support universal service. States that have a relatively low ability to internally support and fund universal service will have a relatively high percentage of support provided through the federal program, while states that have a greater ability to internally support universal service will receive a lower percentage of federal support.

Like the variable benchmark option, this option would reflect the state's ability to fund its universal service requirements internally. This option contemplates the use of a forward-looking cost model for determining the amount of support on a relatively small geographic basis. However, contrasted with the variable benchmark option, the variable support option would utilize a single benchmark for all states. Variability would occur in the percentage of the federal contribution to the support of the high cost areas for each state. This variability would be based on a factor that would yield a range of funding percentages. As with the variable benchmark option, any factor used for this purpose should be based on independent, publicly available data. The factor for varying the federal support percentage might include the ratio of intrastate revenues to total revenues; the ratio of intrastate traffic volumes to total traffic volumes; the degree of variability of cost throughout the state; the ratio of lines located in urban and rural areas of the state; the state's ability to keep local rates within a reasonable range, a measure of local competition in the state, or some combination of these or other

Talking Points: USF
Warren Wendling, Staff
Public Utilities Commission of the State of Colorado

measures. Other parties may provide different logical and relevant choices for the factor to be used in this option, and the FCC should consider all reasonable alternatives.

Because the FCC has not yet chosen the most appropriate forward-looking cost model or its inputs, this option is presented on a conceptual basis at this time. It is meaningless to calculate a total fund size or a state-by-state distribution of support resulting from use of this option without resolving many issues, including the choice of the cost model platform, choice of inputs, geographical support area and the factor(s) to be used for varying the federal support amount. Because of the wide range of options, however, it is clear that this option could be designed to provide a wide range of support amounts while reasonably controlling the size of the federal fund.

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US WEST Proposal

**biography of presenter
executive summary of proposal
written testimony**

Glenn Brown

Executive Director - Public Policy

Washington, D.C. Office

U S WEST, Inc.

Glenn Brown is presently Executive Director - Public Policy for U S WEST, Inc. in Washington, D.C. He began his career with Mountain Bell in 1971 in the Engineering Department, and in 1973 moved to the Rates and Tariffs organizations where he held a variety of assignments related to the pricing, costing and regulation of telecommunications services. Mr. Brown has presented testimony in over fifty state and federal commission proceedings on the pricing of a wide variety of telecommunication services. In 1985 Mr. Brown founded the first marketing organization within Mountain Bell focused on Interexchange Carrier customers. In 1990 he returned to the Public Policy organization where he was responsible for managing the Federal Regulatory staff. In 1993 he relocated to Washington, D.C. where he is responsible for managing a variety of public policy issues related to the introduction of local exchange competition and the preservation of universal service. Mr. Brown is active within the United States Telephone Association where he has served as Vice- Chairman of the Regulatory Policy Committee.

Mr. Brown has a Bachelor of Science degree in Industrial Engineering from Lehigh University and a Master of Business Administration degree for the University of Colorado.

"INTERSTATE HIGH COST AFFORDABILITY PLAN"

A Proposal by U S WEST

April 27, 1998

The Interstate High Cost Affordability Plan (IHCAP) is being proposed by U S WEST to assure the availability of affordable basic telephone service and network access to all Americans, particularly those living in rural and other high cost areas. We believe that this plan can form a workable alternative to the plan previously proposed by the Commission which assigned 25% of the explicit high-cost funding responsibility to the federal jurisdiction, and the remaining 75% to the states. We appreciate the FCC's intention, expressed in their April 10, 1998 Report to Congress, to reconsider this issue.

In their May 8, 1997 order, the FCC laid out a plan for accomplishing the directives of the Act. They defined a "benchmark" level (roughly \$30 for residential customers) above which explicit universal service support would be required to assure affordable service. They also directed that a "proxy cost model" be developed to determine the cost of serving customers by "small areas of geography", such as Census Block Groups, Wire Centers or Grids. Costs for customers above the benchmark level would be aggregated and recovered from an explicit universal service mechanism. Recovery of these costs would be split into two pieces, with 25% of these costs recovered from an Interstate fund, and the remaining 75% of the costs recovered from separate State funds developed and administered by each state. The problem is that, for some states, removing all of the present implicit support and making it explicit would result in surcharges which could, themselves, threaten the basic concept of affordability. Generally, the states which will have the most difficulty have significant numbers of high-cost customers, but do not have large low-cost urban areas over which to spread these costs

The IHCAP plan solves this problem by defining a second "super-benchmark" to identify the "very-high" cost customers. Costs between the basic-benchmark (\$30/month) and the super-benchmark (say, \$50/month) would be handled the same as in the FCC's proposed plan, with 25% of the funding responsibility assigned to the interstate jurisdiction, and the remaining 75% assigned to the states. Costs above the super-benchmark would be assigned 100% to the interstate jurisdiction. Based upon our analysis to date, removing these "super-high" costs from the intrastate equation would appear to level the playing field, and leave each state with a more solvable problem.

One advantage of the IHCAP plan is that it leaves the primary role for rebalancing rates, defining the need for explicit support, and assuring the continued availability of affordable service with the people who know the local customers and the local markets best - the State regulators. The size of the interstate fund is kept smaller by assuming full support responsibility only for those costs in excess of \$50/month (states would still be responsible for 75% of the costs between \$30 and \$50). Said another way, the interstate fund would cover 25% of costs between \$30 and \$50, and 100% of customer costs in excess of \$50. Most of the customers who would be eligible for funding under the single-benchmark proposal, and a significant portion of the funding need, is due to customers slightly above the \$30 benchmark but shy of the \$50 super-benchmark. By leaving

responsibility for most of these costs with state regulators, they will be able to devise rate rebalancing and/or explicit funding plans which are right for their markets. This plan also reduces the burden on customers in lower cost states, since it only requires them to contribute support to those customers who unquestionably will require some sort of assistance to retain affordable service.

The need for a plan like IHCAP is not limited to the western states served by U S WEST. Southern states, such as Mississippi, Kentucky and Alabama, New England states such as Vermont, New Hampshire and Maine, and Appalachian states like West Virginia have similar problems with many high cost customers and relatively few low cost customers. The IHCAP plan has been designed to benefit all Americans.

Lower cost states also benefit from IHCAP for two reasons. First, all states have some customers who are costly to serve. The IHCAP fund will support very high cost customers in all states, reducing the size of the problem that each state must deal with. Second, customers in all areas of the country benefit from ubiquitous access to all people and businesses nationwide. High cost and rural areas possess agricultural, energy and recreational resources on which urban areas depend. Rural areas contain many customers for goods and services produced in urban areas. IHCAP assures affordable service for all Americans, consistent with the directives of the 1996 Act.

1998-06-08 10:00 AM 100-433-400 1

En Banc Hearing
June 8, 1998
Statement of Glenn Brown

Good morning Mr. Chairman and Joint Board Members. My name is Glenn Brown, and I am Executive Director - Public Policy for U S WEST. Among my areas of responsibility are the related subjects of Universal Service and Access Reform.

On behalf of U S WEST and the many high-cost rural customers we serve, I would like to thank the FCC for deciding to reconsider the earlier 25/75 split of funding between the interstate and state jurisdictions. I am here today to describe the Interstate High Cost Affordability Plan (IHCAP) which has been presented in this proceeding by U S WEST. This plan was developed in an effort to find a workable middle-ground solution to an urgent and critical problem - preserving the availability of affordable basic service and access to advanced services in rural high-cost areas of the "non-rural" LECs.

As many commenters have stated, a stronger federal role in supporting universal service will be necessary in the more rural regions of the nation including many of the Western, Southern, New England and Appalachian states. For example, in U S WEST's 14 state service territory, we serve over half a million customers who cost in excess of \$50/month, and of that total, 200,000 cost over \$100/month. In many of these states there are no large urban centers to offset these costs.

It is also vitally important that the Commission meet its January, 1999 target for implementing new explicit funding for non-rural LECs. Currently, U S WEST faces competition for local customers, particularly in business markets. In August of 1996 the Commission took action to open local markets. In July of 1997, and again this July, the Commission will direct significant reductions in access charges. As these sources of implicit support are removed, it is absolutely essential that new explicit support be provided, particularly when it is required to serve as a "safety net" for the highest-cost of our rural customers.

In developing the IHCAP plan, we had four objectives:

1. It must be simple and understandable.
2. It must leave the states with the primary role for rate rebalancing and the assuring affordable service to all of their customers.
3. It must appropriately address the needs of states that face a disproportionate problem because of large numbers of high-cost rural customers and relatively few low-cost urban customers - and it must do so with minimum additions to the federal fund.
4. It must be capable of implementation by January 1, 1999.

The workings of the IHCAP plan are shown on Chart 1. A proxy model is run to determine the forward-looking cost of serving customers by small areas of geography. It is important that these areas be as small as possible and practical so that support may be efficiently targeted to the customers who need it the most. Areas where the cost is less than \$30/month would receive no explicit federal support. Where costs are between \$30/month and \$50/per month, explicit funding responsibilities would be split between the federal and state jurisdictions consistent with the 25/75 relationship established in the prior FCC Order. Costs over \$50/month would be funded 100% from the federal fund.

Chart 2 illustrates the impact of the IHCAP plan on five "randomly" selected states (SD, MO, GA, TX, FL). The solid bar shows the required surcharge on intrastate revenues to meet the high-cost funding obligations under the 25/75 plan. The striped bar shows the impact of the IHCAP plan.

We believe that IHCAP offers a simple, effective and fair method for the FCC to assure that the mandates of the 1996 Act for affordable service in rural high-cost areas are fulfilled. I must point out in closing, however, that, as demonstrated by BellSouth and GTE, there will still be considerable implicit support remaining in interstate access following the implementation of IHCAP. The Commission must continue to address and carefully manage this implicit support as local competition evolves.

Thank you, and I look forward to your questions.

Chart 1

Operation of IHCAP Plan

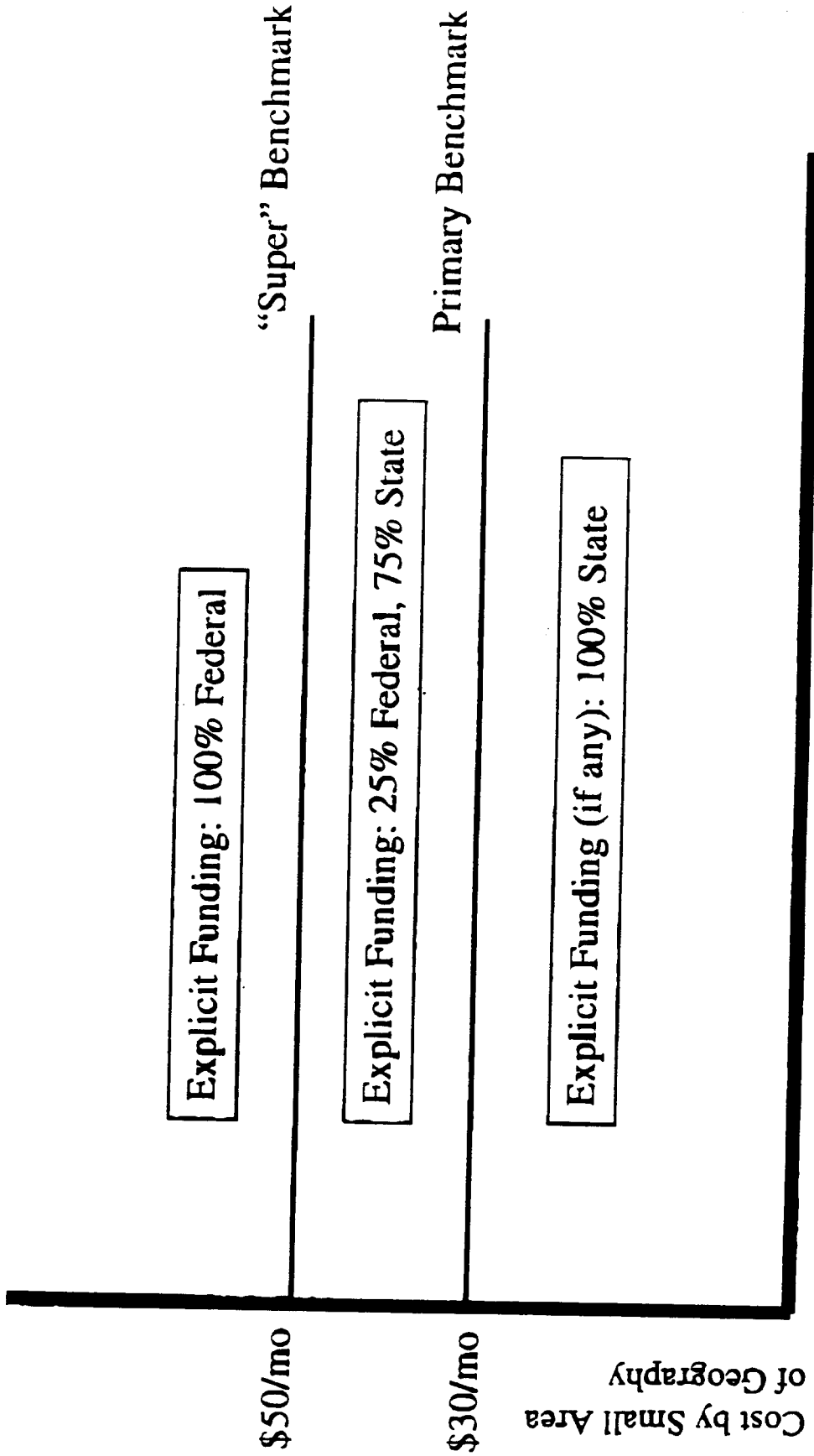
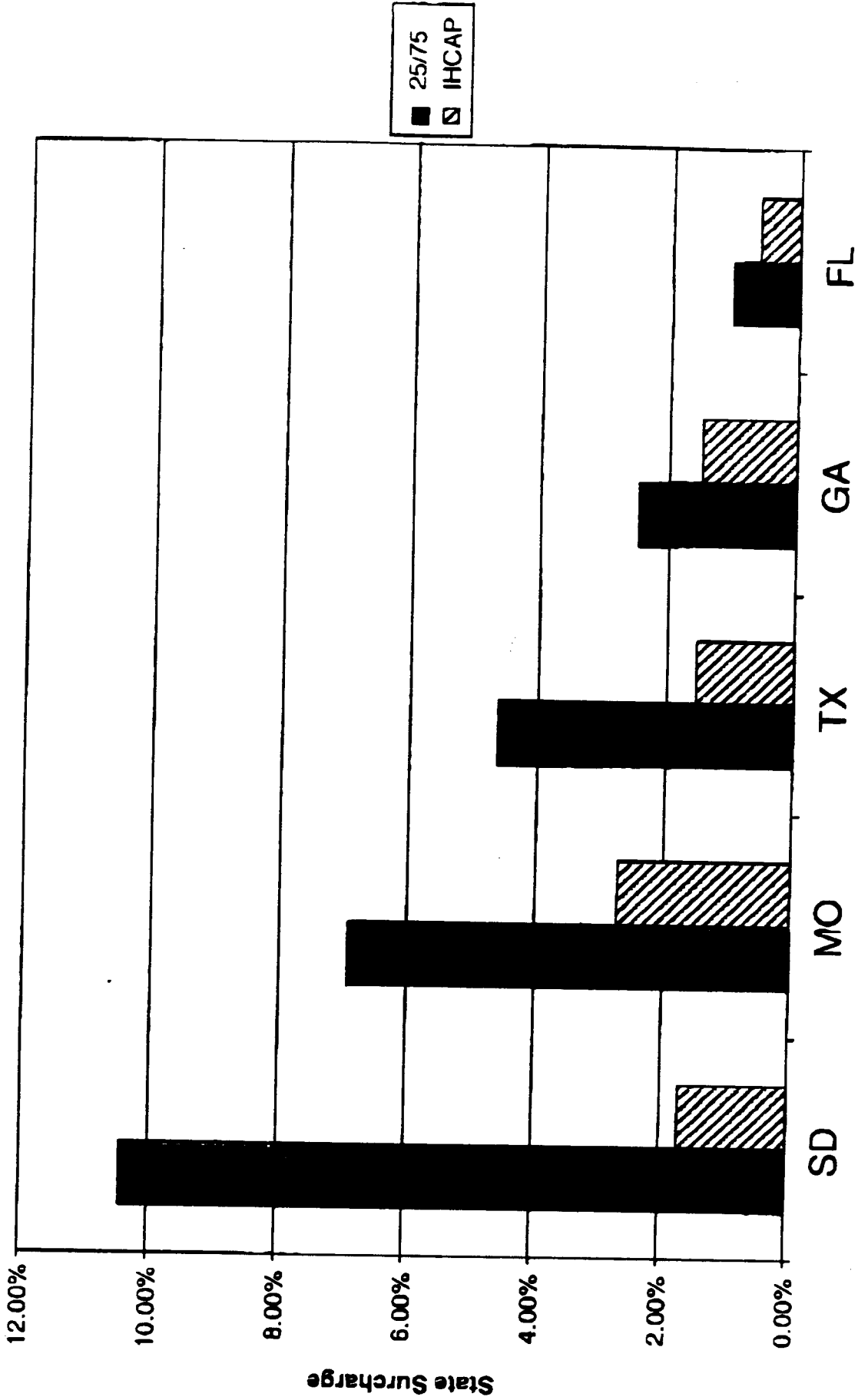


Chart 2 Impact of IHCAP



Note: This chart assumes a fund size of \$4.5B derived from using FCC "common inputs" in the BC'PMJ model. The actual fund size will be determined after completion of further proceedings to finalize model inputs.

AT&T Proposal

biography of presenter
executive summary of proposal
written testimony: to be added

BIOGRAPHY

JOEL E. LUBIN

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Joel E. Lubin is Regulatory Vice President in the Law and Public Policy Organization at AT&T. He is responsible for developing public policy at the Federal and State levels. In particular, he formulates regulatory policies associated with access issues, universal service, local exchange competition and LEC regulation.

Prior to his present assignment, Joel held various positions in Federal Regulatory, Marketing, Service Cost and Rates, Long Lines and Bell Telephone Laboratories.

Joel received a BA degree in Mathematics from Wilkes College in 1969, an MS in Operations Research from Columbia University in 1972, and an MBA from Fordham University in 1976.

EXECUTIVE SUMMARY OF AT&T's USF PROPOSAL

1. Local **service** revenues *alone* cover all universal service costs in the vast majority of the major non-rural LECs' (the RBOCs, GTE, and SNET) study areas. And this holds true without even counting the numerous other sources of support they have available such as intrastate toll services, yellow pages, and wireless services. These large LECs do not require *any* federal universal service support under present conditions. Therefore, regardless of what fund distribution methodology the Commission ultimately adopts, it should immediately cancel all federal payments to the major non-rural LECs until these LECs can show that the contribution they receive from the revenue sources that they enjoy due to their position as incumbent local monopolists has fallen below the forward-looking economic cost of universal service.
2. Under such circumstances it would be especially ironic if federal USF support to nonrural carriers would increase on January 1, 1999. Yet this appears likely to occur if support is calculated on a wire center or below basis. Not only will such a mechanism needlessly increase the size of the USF by allowing these large carriers to receive substantial payments for their **minimal numbers** of high-cost wire centers, but it also will allow these LECs to bank as **pure profit** all of the above-cost revenues that they receive from their lower-cost wire centers.
3. Because **significant increases** in the federal fund are not needed for universal service purposes. And because such increases would retard the development of local competition, and would damage both political support for the fund and its ability to be competitively

neutral, the Commission should calculate universal service support on no finer than a study area basis.

4. In addition, the Commission should consider deferring implementation of the new system.

The assumed predicate for the new system was the widespread development of local competition, but such local competition has not yet arrived. Under these conditions, implementation of a new plan is not immediately necessary and, indeed, would be counterproductive if federal funding increases as a result.

Sprint Proposal

biography of presenter: to be added
executive summary of proposal
written testimony

James (Jim) W. Sichter

Vice President, Regulatory Policy, Sprint Local Telecom Division. B.A., University of Kentucky, M.S. (economics), Wright State University; Masters, Public Administration, University of Missouri-Kansas City. Responsibilities include both state and federal regulatory policy for Sprint Local Telecom Division. Previous experience in policy analysis, access planning, cost analysis, revenue planning and corporate strategic planning. Member of the faculty, National Association of Regulatory Utility Commissioners (NARUC) Advanced and Annual Regulatory Studies Programs.

SPRINT'S FEDERAL UNIVERSAL SERVICE FUND PROPOSAL

- I. **Existing, implicit subsidies must be eliminated. To the extent that subsidies are required, they should be funded through an explicit, competitively neutral USF.**
 - The elimination of explicit subsidies is required by the Telecommunications Act of 1996
 - Existing, implicit access subsidies:
 - are not competitively neutral (only IXCs/toll users fund subsidies);
 - thwart facilities-based local competition; and
 - uneconomically and inequitably burden long distance users.

- II. Principles upon which the federal USF plan should be based:
 - ***Support should be based on forward looking costs***
 - Using a forward-looking cost methodology as the starting point in calculating the support amount is appropriate since it enables the Commission to arrive at a rate that emulates competitive market conditions. Facilities-based competition will not develop unless the sum of revenues and subsidies is predictable and accurate. Using forward-looking costs is the only way the marketplace will send the correct signals to potential entrants.
 - If costs are under-estimated, that will artificially attract inefficient entry that should not occur.
 - If costs are over-estimated, that will discourage efficient entry that should occur.

 - ***Federal USF should be a national fund, based on both state and interstate retail revenues***
 - The Commission has stated, both in its May 8th Order and in its recent Report to Congress, that Section 254 grants it the authority to create a national fund made up of contributions from intrastate as well as interstate revenues.
 - In order to ensure competitive neutrality, as well as sufficient support flow between states, a national fund is not only reasonable, but essential.
 - To assess USF contributions on only interstate revenues would effectively exempt ILECs from contributing to universal service support.

- ***Where a cost-based rate might be considered prohibitive, the federal benchmark should be based on the maximum affordable local service rate***
 - Since the benchmark is intended to be a measure of "affordability" the appropriate standard is the basic local service rate, not average revenues.
 - Income considerations should be excluded, since low income households are addressed directly through the Lifeline/Link-up programs.
 - The federal benchmark rate should be set at a level representing the maximum affordable local service rate – a rate which is considerably higher than the below-cost local service rates that exist today

- ***Implementation of the plan should be revenue neutral at its inception***
 - Any new USF funding (i.e., funding in excess of current levels of high cost support) to a company should be offset, dollar-for-dollar, with reductions in access charges

- ***USF fund obligations should be recovered through a surcharge on end users' retail charges.***
 - The end user surcharge is the key to any workable USF plan. Without it, competitive neutrality, both in terms of contribution levels and recovery, is a virtual impossibility.
 - Because implicit subsidies exist today, end users are already supporting the universal service fund. Consequently, the removal of these implicit subsidies, replaced with the explicit surcharge, will not result in an overall increase in consumer charges.
 - In its recent order regarding Local Number Portability cost recovery, the Commission found that it was appropriate to allow LECs to recover their LNP costs through a monthly end user surcharge. The Commission should apply the same reasoning to USF cost recovery.

- ***States are free to adopt intrastate USF plans if they desire***
 - Employing a lower benchmark affordable rate, the state plan would act as a safety net for those areas where the federal benchmark rate may, in the state's opinion, prove burdensome.
 - Funding for state plans must come solely from intrastate retail revenues.