

FEDERAL COMMUNICATIONS
COMMISSION

In the Matter of:)
)
EN BANC HEARING -)
UNIVERSAL SERVICE METHODOLOGY)

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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EN BANC HEARING -)
UNIVERSAL SERVICE METHODOLOGY)

Federal Communications
Commission

1919 M Street, N.W.
Room 865,
Commission Meeting Room

Washington, D.C.

Monday,
June 8, 1998

The parties met at 9:30 a.m.

APPEARANCES:

CHAIRMAN WILLIAM KENNARD
COMMISSIONER MICHAEL K. POWELL
COMMISSIONER HAROLD FURCHTGOTT-ROTH
COMMISSIONER SUSAN NESS
COMMISSIONER GLORIA TRISTANI
GLENN BROWN
PAT WOOD III
DAVID BAKER
LASKA SCHOENFELDER
JULIA JOHNSON
MARTHA HOGERTY
TOM REIMAN
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JOEL LUBIN
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APPEARANCES: (Continued)

JIM SCHLICHTING
JOEL SHIFTMAN
MAUREEN SCOTT

1 P R O C E E D I N G S

2 CHAIRMAN KENNARD: Good morning. Good morning and
3 welcome to today's En Banc hearing of the Federal
4 Communications Commission with the Joint Board concerning
5 universal service.

6 We are joined today by the state commissioners who
7 are members of the Federal State Joint Board on universal
8 service and of course, by the consumer advocate member of
9 the Joint Board, Martha Hogerty. We're delighted that
10 you've traveled to join us here today.

11 We have a lot to accomplish today. This will be
12 an open meeting of the Commission. So, we'll have a
13 transcript prepared. And that transcript will be placed in
14 the docket of the universal service reconsideration
15 proceeding.

16 Before we get started, let me give you sort of a
17 brief overview of how we intend to proceed today. First of
18 all, all of the Commissioners on the En Banc panel will be
19 giving brief opening statements. That will be followed by
20 an overview by Jim Schlichting who is Deputy Chief of the
21 Common Carrier Bureau, who will sort of set the stage for
22 the issues that we're going to be discussing today.

23 Next, we will listen to presentations from

1 representatives of 11 different interests -- stakeholders,
2 if you will, who have an interest in the outcome of this
3 proceeding. The presentations will conclude at about 11:15.
4 We have our very expert and experienced timekeeper, LaVera
5 Marshall who will be making sure that you all hold to your
6 appointed three minute presentations.

7 At 11:15, we'll break for about 15 minutes. Then,
8 we will resume again at 11:30 whereupon the Commissioners
9 will engage in questioning of the presenters. And that
10 should take us to about 12:45 when we'll break for lunch.

11 We will then reconvene at 2:30 for about two hours
12 of discussion of the panelists and presenters. And we
13 intend to conclude promptly at 4:30 p.m. today.

14 Well, obviously, we are here to address some very
15 difficult, vexing issues, but issues of great importance to
16 the country at this time. And I think it's important that
17 we not try to sugarcoat these problems. They are very hard.
18 They involve lots of different and competing interests. And
19 frankly, it tends to invoke a lot of emotion. In my six
20 months as Chairman, I don't think any issue has evoked more
21 emotion than universal service from many, many different
22 quarters.

23 So, it's important that we recommit ourselves

1 today to working together to solve these issues, because at
2 the most fundamental level, universal service is about
3 keeping our nation connected and not dividing us. It's
4 about guaranteeing that all Americans have access to
5 advanced telecommunications at affordable rates,
6 particularly those who live in rural and high cost areas.
7 And it's also about implementing the law in a meaningful way
8 to make sure that schools, libraries and rural healthcare
9 centers can also enjoy the benefits of our finest -- the
10 finest telecommunication system in the world.

11 Now, I know we're here to talk specifically about
12 high cost, but I don't think that we can do so without
13 recognizing the intense debate that is swirling around us
14 today about the implementation of the schools and libraries
15 provisions of the '96 Act. A very intense debate fueled by
16 the announcement of -- by AT&T and others that they will
17 start assessing their customers for universal service
18 contributions based on a percentage of each customer's bill,
19 around five percent.

20 Now, I mention this because this is just the tip
21 of the iceberg in this debate in my view, because while some
22 of these assessments will go to schools and libraries, a
23 major portion will also go to fund the high cost mechanism

1 of universal service. So, you can't talk about one
2 mechanism without talking about the other. They are
3 interrelated.

4 Now, interrelated -- and we're undergoing a
5 transition in universal service in this country. A
6 transition from monopoly regulation where we had implicit
7 subsidiaries to a competitive environment with explicit
8 subsidies.

9 And it's going to be a difficult transition. But
10 in the long run, I think we have to count on -- we have to
11 have faith in the fact that competition will ultimately
12 bring rates down. Competition will also make these
13 subsidies explicit. I think we've got to recognize that
14 we're moving toward a two-tier pricing system where carriers
15 will pass their -- recover their fixed costs with a flat
16 line and compete on per minute rates. That's an
17 inevitability, and we're going to have to adjust to that.

18 And in this adjustment, we certainly can't do it
19 alone. We're going to have to work together, the state
20 jurisdiction and the Federal jurisdiction. The state
21 commissioners are our partners today at this hearing, and
22 will be our partners in the future.

23 I want to offer my gratitude to all of them. I

1 want to welcome, in particular, Pat Wood, who is joining us
2 today for the first time, and Dave Baker, also joining us
3 for the first time on the Joint Board, and welcome you and
4 thank you for your sacrifices in taking this effort on.

5 In talking to many of our colleagues, both on the
6 Joint Board, and generally among state commissioners, it's
7 very clear that folks are very focused on this issue. And
8 the state commissioners want to very much participate in
9 this and obviously, have to have a vital role.

10 I conferred with Julia Johnson and other members
11 of the Joint Board and they have formally requested that we
12 refer some of these matters, formally, to the Joint Board.
13 And I'm amenable to doing that. I think that that would be
14 a useful exercise if we can agree on the scope of the
15 referral and if we can agree on a specific time period
16 within which to act. It's vitally important that we
17 continue the momentum of trying to solve this problem going,
18 because we've got to get a solution in a matter of months
19 and not years.

20 Well, today, I hope we can get a lot of good and
21 useful proposals on the table to insure that universal
22 service support continues to keep basic telephone service
23 affordable for Americans in rural and high cost areas, and

1 doing so in a competitively neutral manner.

2 But I think we also have to recognize, as we
3 consider these issues, that all of you here today are
4 motivated by self-interest. You represent companies and
5 organizations that have a particular stake. And I think
6 that in order for us in Government to solve this problem,
7 we're going to challenge you to sort of peel back the veil
8 of self-interest and level with us, and tell us who has
9 truly benefitted and who is truly disadvantaged by these
10 proposals. I'm going to do that in the questioning. And I
11 invite my colleagues up here to do the same.

12 It sort of reminds me of the movie about Watergate
13 when Woodward and Bernstein are consulting with their
14 source, Deep Throat. And they're pressing Deep Throat to
15 try to tell them how to really get to the bottom of the
16 Watergate problem -- the scandal. And Deep Throat, in the
17 now famous utterance said, "Well, just follow the money."
18 Well, I think that's what universal service is all about.
19 It's following the money, finding out who is getting the
20 money and who is paying the money.

21 And I think that we can have an appreciation of
22 where your various proposals -- what they really do unless
23 you level with us on that score.

1 So, I look forward to your cooperation and getting
2 your help today. And I would like now to turn this over to
3 my colleague at the Commissioner, Susan Ness, who has
4 devoted a lot of time and attention to these issues and has
5 been an invaluable member of the Joint Board. And I am
6 pleased that she has agreed to serve as chair of the Joint
7 Board for this, probably its most challenging period.

8 Sorry to put you on the spot yet again, Susan.
9 Commissioner Susan Ness.

10 COMMISSIONER NESS: Thank you, Mr. Chairman. And
11 I, too, wish to extend my welcome and appreciation to my
12 colleagues on the Joint Board for joining us here today.

13 This is universal hearing -- service hearing high
14 cost redux. We have been looking at these issues for an
15 extended period of time. The underlying precepts have been
16 discussed, debated. The Joint Board originally issued its
17 recommendations a year and a half ago. And a year ago last
18 May, the FCC adopted, for the most part, most of the
19 recommendation that have been put forward by the Joint
20 Board. It was a very collaborative process. And the Joint
21 Board members continue to work with us through up until the
22 very end when the Commission itself rendered its decision.

23 Certainly, we will be doing the same thing now,

1 working to refer some items hopefully, to the Joint Board
2 and then proceeding to work through these issues,
3 collaboratively, with the members of the Joint Board up
4 until the final decision is rendered by the Commission. And
5 the reason for that basically is, we're in it together. As
6 Chairman Kennard was saying, basically, it is a
7 collaborative process. It's a bit like a three-legged race
8 in that we cannot move ahead in one piece without the other
9 piece coming together and moving in unison.

10 It is a very complicated situation, made even more
11 cumbersome perhaps by the fact that a lot of the basic
12 assumptions of the speed with which the other pieces of the
13 puzzle, namely the interconnection order and access reform,
14 would take place where -- how rapidly we would see
15 competition unfold, has not met expectations. That's, in
16 large measure as the Chairman was pointing out, because
17 everyone is operating under their own economic self-
18 interests. And perhaps some of those self-interests found
19 their heart in court rather than in the marketplace.

20 But in the meantime, we are, in fact, moving
21 ahead. The concerns that were raised in why we moved so
22 rapidly in the very beginning to try to resolve these
23 extremely difficult issues, was because we recognized that

1 as competition unfolds, the implicit subsidies that have
2 been relied on for so many years to underwrite the cost of
3 local service in high cost areas, were being competed away.

4 And that be the case, some of those implicit
5 subsidies, either by state commission action to reduce them
6 and make them explicit or by FCC action to reduce them and
7 make them explicit, or by the effect of the marketplace,
8 that the underpinning for universal service implicit
9 subsidies might very well begin to deteriorate. We have not
10 seen that happen today, largely because the pace of
11 competition has not been as rapid as we envisioned.

12 The point that I want to make here is that the
13 most important thing, perhaps, for everybody to understand
14 as we enter into this discussion of high cost is that these
15 subsidies are still -- continue to be in effect. Consumers
16 in high cost areas today are enjoying the very same benefits
17 of subsidized service that they have in the past. The Joint
18 Board and the FCC have done nothing that would require local
19 rates to increase.

20 The existing systems of subsidies, of course,
21 needs to be changed and to make it more competitively
22 neutral, competitively sustainable. But again, I want to
23 underscore consumers in high cost areas are already

1 protected. So, the first rule that we ought to be thinking
2 about is, do no harm.

3 The focus with our discussions on high cost fund
4 primarily are engaged around the large local exchange
5 carriers. Once again, at least with respect to the
6 decisions that have been made to date, the rural carriers
7 are not implicated by these decisions in the sense that any
8 efforts to extend the systems to the rural carriers would
9 not take place for several years to come, and then, only if
10 we are absolutely convinced that the effect of these changes
11 will not unduly harm the rural carriers by virtue of
12 assumptions that are being made that are inapplicable to
13 small carriers.

14 So, these are some of the concerns that I want to
15 put to rest and some of the fears that seem to be out there
16 that somehow by the FCC's decisions in the past, that there
17 is a likelihood that rates are going to go up dramatically
18 in the rural areas. That is not so. I don't think there's
19 anyone here that believes that that is our goal, nor is that
20 the mission that has been undertaken today.

21 Another myth I want to put to rest is, folks have
22 come to believe the FCC was trying to shed three quarters of
23 its burden that we previously carried in our 2575 rulemaking

1 that was in place at the time last May. And the reason for
2 the 2575 was a placeholder, because we hadn't completed all
3 of our thought processes with respect to how to structure
4 the high cost fund.

5 We needed to have something in place, and what we
6 thought by preserving what we have in place today, which is
7 essentially 2575, that we were not going to be changing
8 anything dramatically, but basically giving everyone an
9 opportunity to then think about how we go from here to the
10 next step. And again, it was not our intention for anyone
11 to think that we were trying to shed three quarters of our
12 burden that we have undertaken in the past. And again, this
13 does not effect the rural carriers.

14 We do need to be sensitive to shifting more of the
15 burden to the intrastate jurisdiction. Some say we need
16 four billion dollars. Some say it's a 20 billion dollar
17 fund. But even four billion, would require a tax of well
18 over five percent if it's collected solely on intrastate
19 revenues. And this is a very sensitive issue. It's one
20 that we need to think about.

21 So, as I sit and listen to the discussions today,
22 I am going to be focusing on issues such as, what will
23 provided downward pressure on prices? What will keep a fund

1 low? What will encourage competition? What will be fair to
2 folks in the high cost states as well as those in the lower
3 cost states and trying to work with colleagues so that we
4 have a solution that works for both the high cost states and
5 the low cost states because anything else is going to be
6 mired in litigation, as is likely as it is that I finish
7 this cup of coffee by the end of this hearing.

8 I am pleased that Chairman has mentioned that. We
9 are planning to refer some of these issues to the Joint
10 Board. I look forward to working very diligently with my
11 colleagues on the Joint Board to come up with solutions that
12 meet all of those criteria that I just established, and
13 particularly, serve both the needs of the high cost as well
14 as the low cost states. And the sacrifices, gang, have only
15 just begun. So, with that, I want to thank the Chairman for
16 convening this hearing.

17 CHAIRMAN KENNARD: Thank you, Commissioner Ness.
18 And now for the Chairman Julia Johnson who was chairman of
19 the -- really co-chair of the Joint Board. Works with the
20 state members in conjunction with Commissioner Ness as
21 chairman. Wonderful leader, Julia Johnson.

22 MS. JOHNSON: Thank you, Mr. Chairman. I wanted
23 to thank you for convening the meeting and inviting the

1 state members of the Joint Board to participate in this
2 forum. I think this is an excellent first step.

3 Your comments were right on point. The issues are
4 very, very complex. Certainly as Commissioner Ness
5 mentioned, no one's goal is to see local rates go up or to
6 see high cost areas that are not adequately served. And I
7 think by working closely with the state regulators and
8 consumer advocates, we will have a better opportunity to
9 insure that we come up with policies that will, indeed, be
10 fair and reasonable to all.

11 Our expertise, generally, is working with and
12 understanding the local rate-making process and
13 understanding how those mechanisms work. That, coupled with
14 the expertise from the Federal members of the universal
15 service Joint Board, I think, will serve us all quite well
16 in reaching resolution.

17 On March 11, when the state members requested
18 referral of issues to the Joint Board -- universal service
19 Joint Board, we weren't doing that to be contrary. We were
20 doing it to be contributors. And I am pleased to hear that
21 the referral request will indeed be considered,
22 understanding that referral at this point in time, may mean
23 that we may need to add more time to the process.

1 I do understand that the Joint Board process is a
2 formal process, but that allows for dialogue, contribution,
3 reflection, some of the things that we may need to do, and
4 that will, in fact, take additional time. I think it's well
5 worth the time.

6 Let me delineate the issues that we had requested
7 be referred to the Joint Board as, perhaps, a starting point
8 for our discussions when we begin to determine what, in
9 fact, will be referred.

10 First issue, whether the FCC should take
11 responsibility for funding only 25 percent of the high cost
12 subsidy or high cost fund. Now, Commissioner Ness did
13 mention that that particular provision -- the 7525, was just
14 a placeholder. That is encouraging for us. And I think one
15 of our concerns was that, to the extent that it is a
16 placeholder, as we begin developing policies, we'd like to
17 be actively involved in the formulation of those particular
18 policies.

19 Second, whether the FCC should apply Federal
20 universal service funds to reduce interstate access charges.
21 That goes to the paragraph 381 and the access reform docket.
22 We'd like to have more dialogue with respect to that issue.

23 Third, a determination of the appropriate method

1 of formulating and distributing high cost fund money to the
2 states. That, I know and I've read or heard several
3 speeches from members of the FCC and from the states to say
4 that that is an issue that certainly states are interested
5 in. Oftentimes, it's been a debate between states. I think
6 that we can provide some expertise, some knowledge, some
7 sensitivity to that issue as it's being developed.

8 And finally, whether and to what extent the FCC
9 should have a role in making intrastate support explicit.
10 And as part and parcel of any such examination, a referral
11 of Section 254(k) issues concerning the recovery of joint
12 and common costs.

13 Those are the issues that we, originally in our
14 March 11 petition requested to have referred to the
15 universal service Joint Board. We are committed to
16 examining those issues, working closely with our fellow
17 joint board members to reach some resolution on those issues
18 and/or any other issues that we believe and that the FCC
19 believes should be referred to the Joint Board.

20 Again, we welcome and thank you for the
21 opportunity to participate and all of the other
22 commissioners who have had very open door policy, welcomed
23 our comments and our suggestions. I'd like to thank you all

1 because even though we haven't been on this formal track,
2 we've been able to have the kind of dialogue that has been
3 useful to moving the states and the Federal forward. Thank
4 you.

5 CHAIRMAN KENNARD: Thank you, Julia. Next, we'll
6 go to FCC Commissioner Harold Furchtgott-Roth.

7 COMMISSIONER FURCHTGOTT-ROTH: Thank you, Mr.
8 Chairman, and thank you for convening this panel today. I
9 think this is what Congress intended. I think this is the
10 central issue in universal service, coming up with a
11 solution to the high cost fund. And I don't think it can be
12 done by the Federal Commission along. And I think it's
13 absolutely necessary that we have the participation, and at
14 times, even the leadership of the states on this.

15 I am encouraged by the petition from the state
16 members of the Joint Board to have these issues referred to
17 them, not because they're easy issues, not because they're
18 issues that have easy answers, but because the states, and
19 perhaps, the states alone, have the experience and the
20 knowledge to come up with solutions that will work.

21 And I am very pleased to hear that, in fact, some
22 of these issues may be referred to the Joint Board. And I
23 think that, again, is what Congress intended. The language

1 of the statute in 254 that refers to the Joint Board, speaks
2 to its creation, but does not speak to its dissolution.

3 I think only at that time that the issues related
4 to high cost are resolved, can all of the other portions of
5 universal service be adequately addressed. I think it can
6 be done. I think it must be done. And I think that this
7 Commission working together with the states will see to it
8 that Section 254 is fully and properly implemented.

9 We have before us today a great deal of wisdom,
10 many, many panelists, each with different ideas. I think it
11 represents the difficulty of the problems that we all face.
12 Each of you today will give us suggestions that have merit.
13 And it will be up to us, working together with the states,
14 to sort through these options to find one that will work.
15 This is a very difficult challenge.

16 I will keep my remarks brief because mostly what I
17 want to do is to hear from these panelists so I can learn
18 and so all of us can learn about the different options that
19 are before us.

20 Mr. Chairman, I do want to emphasize how grateful
21 I am and how grateful I think the American people that you
22 are holding this session today. And we all look forward to
23 learning from it. Thank you.

1 CHAIRMAN KENNARD: Thank you, Commissioner.
2 Commissioner Schoenfelder.

3 COMMISSIONER SCHOENFELDER: Thank you, Mr.
4 Chairman, and good morning everyone. I am not going to be
5 very long because I don't need to just be redundant, but I
6 do need to thank the Chairman and the rest of the FCC
7 Commissioners for having us here today and for giving us an
8 opportunity to participate in what I consider one of the
9 most important things that I've done since I've been a
10 public utilities commissioner.

11 I think what we're going to do, in collaboration
12 with the FCC, is extremely important. And if it takes a
13 little time, I think it might be time well worth waiting for
14 the end results.

15 I just want to make a commitment now, refer to the
16 Joint Board that the states will step up. We will offer
17 something of substance, and we will do our part. And we
18 will work together with the Commissioners.

19 I would like to go a little bit further with
20 something that Chairman Kennard said, in the fact that, you
21 can't -- today we're going to talk about universal service
22 for non-rural companies. But no company or no service in
23 telephony can be used in isolation or in a box by itself.

1 And I noticed by some of your comments already that were
2 profiled that what some of the proposals do have an impact
3 on rural companies. And so, everything we do has an impact
4 on another part of the network. And I think we're all very
5 much aware of that. And we're also aware of the public
6 policy that we're going to develop here.

7 I think what we're going to do is important. I
8 agree with Commissioner Furchtgott-Roth in the fact that
9 this is what Congress intended for us to do. And I would
10 just like to thank the FCC and everyone else for the
11 opportunity to be here and for the opportunity to address
12 some of these issues one more time. Thank you.

13 CHAIRMAN KENNARD: Thank you. Thank you for being
14 here. Commissioner Powell.

15 COMMISSIONER POWELL: Thank you, Mr. Chairman.
16 This is my first opportunity, formally, to sit down with the
17 Joint Board, and I should say it's a pleasure, but it really
18 is a supreme challenge.

19 Congress has invested this community of people
20 with one of the tallest orders I've ever seen. We are
21 somehow supposed to simultaneously insure affordable, just
22 and reasonable rates for all the nation, including low
23 income consumers, rural insular high cost areas.

1 We're also supposed to provide new services for
2 schools, libraries and rural healthcare providers. We're
3 supposed to do so in a manner that's specific and
4 predictable and sufficient, using both Federal and state
5 mechanisms. And we're not only supposed to preserve
6 universal service, we're supposed to advance it in some way.
7 And all the while, we're supposed to be doing this in the
8 context of stimulating and promoting competition
9 deregulation and innovation.

10 So, I don't need to know if I need to be
11 congratulated or get condolences for now joining this
12 effort. But I'm excited by the challenge.

13 Bill mentioned that it's important for people to
14 speak truthfully about who will really be advantaged and
15 disadvantaged. But when you look at the list of tall orders
16 that we're presented with, the truth to it is, everyone will
17 have an advantage and a disadvantage by the outcome.
18 Anything this complex will mean that. And to recognize
19 that. And to recognize that no one will get everything they
20 want. And everybody will be required to make important
21 compromises that's going to be important.

22 I'd also like to say a word about sort of this
23 controversy about 25 and 75. I think it's really important

1 to remember the key hallmarks of the statute. And the first
2 and foremost of those is sufficiency. It doesn't matter
3 what the mechanisms are, as long as they are sufficient to
4 achieve the national objectives.

5 And so, I challenge us to be creative. Creative
6 in thinking about what universal service is and remember
7 what it's really intended to do. It's hallmark's being,
8 ubiquity and affordability. We should be careful to sort of
9 continue to be vested in legacy forms of doing business that
10 are loaded in the concept of universal service, and instead,
11 sort of sit back and remember what the ultimate objectives
12 of a universal service program are.

13 In conclusion, let me just say that it's very
14 critical we get this right more than anything else. In my
15 own opinion, universal service will be the linchpin for
16 everything that was intended in the Act. And no matter what
17 amount of time it takes, it's first and foremost imperative
18 that we, whatever we do, we'd get it right as much as
19 possible for the first time. I'm pleased to be here and
20 look forward to the discussion. Thank you.

21 CHAIRMAN KENNARD: Thank you, Commissioner.
22 Martha Hogerty.

23 MS. HOGERTY: Thank you, Mr. Chairman. I don't

1 want to be redundant either, but I think it's important to
2 reiterate that the '96 Act envisioned competition in the
3 local network. And once the Bell companies opened their
4 local network to competition, full competition in the long
5 distance network. Those participating in those debates
6 promised more choices, lower rates.

7 Recognizing that pure competition may be
8 inconsistent with our traditional notions of universal
9 service, the Act codified the universal section, and the
10 purpose was to maintain affordable basic services in high
11 cost rural areas and to insure affordable service for low
12 income consumers. Rate increase for basic services were not
13 envisioned, as a couple of the previous Commissioner have
14 pointed out.

15 I think it's very important to remember that the
16 public interest must be interpreted as serving the consumer
17 interest, the consumers of this country, not first and
18 foremost, the industry. The interests of the industry is
19 merely incidental to that of the consumers. The object is
20 not to guarantee financial rewards for industry players, but
21 rather to devise a system to maintain and protect affordable
22 basic rates as competition develops. The pace of the
23 development of competition is key, and it should be focused

1 upon.

2 The challenge for this Board is to insure that a
3 reasonable universal service program is put in place that
4 serves the nations consumers. Thank you.

5 CHAIRMAN KENNARD: Thank you. Commissioner
6 Tristani.

7 COMMISSIONER TRISTANI: Thank you, Mr. Chairman,
8 and good morning. I, too, would like to welcome my friends
9 and former colleagues from the state commissions, both those
10 on the Joint Board and those participating in other ways. I
11 think that some of our colleagues may be listening to this
12 via the phone or via the Internet, so I'll welcome all state
13 commissioners. I also want to thank the panelists for
14 taking time to participate in today's hearing.

15 I first want to note that this hearing is an
16 important step in working closely with state commissions.
17 In previous en banc proceedings, I often found myself seeing
18 an issue differently after hearing it discussed and debated.
19 I think the dynamic of a live discussion, as opposed to a
20 paper presentation, definitely can influence the policy
21 process.

22 I would note my particular interest in a couple of
23 issues that we will discuss today. First, I am interested

1 in hearing about the role of state commissions under each
2 plan. Some plans envision immediate increases in the
3 Federal share of support without requiring additional action
4 by states. Other plans condition additional Federal funds
5 on some sort of state commission action. This is an
6 important issue, and it goes to the question of Federal
7 versus state responsibility.

8 I, personally, believe Section 254 is at the end
9 of the day, a directive to the FCC to insure local telephone
10 service remains affordable. But there are people whose
11 views I greatly respect who favor some sort of state action
12 prior to any change in the Federal share of support.

13 I don't think anyone would say additional Federal
14 support is appropriate only if states balance rates and some
15 customers cancel local service. I also think it is a small
16 number of parties who say the FCC should fund 100 percent of
17 the cost of insuring affordable local service. In between
18 those positions, I expect there are grounds for general
19 agreement. I am optimistic the FCC and the states can
20 devise an approach that can be supported in principle by a
21 large percentage of state and industry segments.

22 The other point I would like to hear more about
23 today is meeting the January 1999 deadline. There are at

1 least two factors that may help us determine whether January
2 1, 1999 is a drop dead date.

3 First, I am interested in knowing how competition
4 is effecting universal service. Some have argued that
5 competition has taken longer than anticipated so there is
6 less pressure on local rates and thus, more time to develop
7 a new universal mechanism.

8 Second, as a matter of process, I would be
9 reluctant to move forward with a final decision if it
10 appears that some additional work would produce a broader
11 base of parties supporting the final result. And Mr.
12 Chairman, with that in mind, I would sure welcome referring
13 maybe the issue or some of these issues to the Joint Board.

14 Finally, Mr. Chairman, I would like to commend the
15 state and federal Joint Board staff for their tireless work.
16 They are the glue that allows the Joint Board Commissioners
17 to work through incredibly complex problems in a productive
18 fashion.

19 CHAIRMAN KENNARD: Thank you, Commissioner.
20 Commissioner Baker.

21 COMMISSIONER BAKER: Mr. Chairman and members of
22 the Federal Commission, thank you for having us here today.
23 We appreciate the opportunity.

1 In his February 9 speak to NASUCA, Chairman
2 Kennard listed what are, by now, the well known eight
3 principles of universal service reform. And I find them
4 noteworthy, not for their complexity, but rather for their
5 simplicity. They exhibit what I would refer to as
6 articulated intuition. That is, stating clearly and
7 succinctly truths that one reaches after a thorough review
8 of the issues. While the list may not be exhaustive, I
9 think it does hit an awful lot of the bases.

10 And while they do need to be viewed together, I do
11 have, if you will, two favorites. Item 5 referred to
12 Federal universal support should be the minimum necessary to
13 achieve statutory goals. All things being equal, when it
14 comes to a universal service fund, smaller is better. This
15 implies efficiency in funding contribution, methodology and
16 distribution. And hopefully, minimizes the distorting
17 effect that such funds can have on otherwise efficient
18 markets.

19 My other "favorite" is Item 6 which states the
20 Federal and state universal support mechanisms should
21 collect contributions in a competitively neutral manner.
22 Universal service funding need not be incompatible with the
23 development of competition in local markets. And such

1 things as portability of support should see CLECs begin to
2 serve customers, will be increasingly important issues.

3 Ideally, competition would drive down prices
4 enough to offset increases that would otherwise occur as
5 prices in many area move toward costs. In those cases where
6 costs are higher than current prices.

7 However, local competition, particularly
8 residential, is far less developed than was envisioned when
9 the Telecom Act became law two and a half years ago. Today,
10 we barely see penetration in residential markets in urban
11 areas. And we see virtually no penetration for local
12 competition in residential market in rural and other non-
13 urban areas.

14 It is therefore all the more important to insure
15 that in designing universal service support, be that high
16 cost funds, schools and library fund, addressing rural
17 carriers or as is the case today, non-rural carriers, that
18 we "do no harm" to emerging competition in markets which
19 will hopefully address many of the same issues that are
20 currently the topic of discussion in today's universal
21 service fund, high cost fund reform discussion. Thank you.

22 CHAIRMAN KENNARD: Thank you. And last but not
23 least, Chairman Pat Wood III.

1 MR. WOOD: Thanks for the invitation to be here.
2 We're always glad to get out of the smoke-covered region of
3 northern Mexico that we call Texas and come up to nice fresh
4 weather up here. The air is just as hot, though, I think,
5 up here. And I've enjoyed watching you alls deliberations
6 from afar and around the time.

7 We're going through the same deal in Texas, trying
8 to do our intrastate fund. We need to do one. We need to
9 do one badly. We had the live hearing. And Gloria, you're
10 right. I think there's no substitute for hearing it live
11 from these folks, a number of whom came down or their
12 circuits came down to Texas to make a lot of the same
13 issues.

14 I think just to cut to the chase as to the non-
15 rural fund issue, you all got most, if not all of it right
16 the first time. I think we need to bring this train on in
17 to the station, and I certainly join forces with my
18 colleagues on the Joint Board to help you all get that done.
19 It should be done.

20 I think this will be an interim fund. The first
21 fund should be set up. The structure is the most important
22 thing to do the first time. The numbers are not. It
23 needn't be perfect. I think anything above a B minus is a

1 passing grade that everybody ought to be proud of.

2 Generation one of this fund will be a defensive
3 fund which will address the parts of the non-rural carriers
4 rate structures that truly are support for their high cost
5 rural operations within the company. And these parts that
6 are most subject to being competed away, particularly in
7 urban areas as competition comes into the market.

8 The offensive fund is generation two. And that's
9 where we really address the proper quantification of the
10 voucher, the shopping credit or whatever we want to call it
11 that goes to the CLECs that go out there to the rural areas
12 to compete. So, I think the sequence is more important to
13 address. These eroding implicit structures are going to be
14 assaulted before the need for the explicit voucher or waiver
15 or subsidy is taken up in the rural areas.

16 So, I think we've got time to work on the model
17 and get the numbers perfect. But the structure's important,
18 I think, for the competitors to get into the business to
19 know how it's going to play out. So, the biggest favor, I
20 think we can collectively do for the industry in furthering
21 competition is to say, "This is how it's going to look. The
22 numbers will get crisper and better later on."

23 The cost models are the only way to go. It's like

1 democracy. It's the worse form except for everything else.
2 And everything else is called historic book embedded. If
3 any of these folks out in the audience or their companies
4 have gone through a probing, thorough rate review at the
5 state level in the last 12 to 24 months, I would encourage
6 you to use their embedded costs, otherwise the costs model
7 is probably going to look better than a thoroughly rate
8 reviewed embedded cost rate review would look. So, I would
9 encourage those parties to pick their poison.

10 The important issue and it's the one today, is the
11 distribution of the dollars -- the Federal dollars portion
12 among the high cost areas of the country. And I think that
13 is -- that's an issue that we don't have to deal with at
14 this state. I mean, we're really trying to deal with the
15 same issues that we don't have other states to deal with.
16 We've just got company.

17 So, it is a unique issue, and I'm glad to be able
18 to sit here with you all and try to puzzle through. I'm
19 pretty open-minded as to the proposals that a number of the
20 parties have put out here. I think there are a lot of
21 creative approaches that can get there. I will indicate a
22 predisposition towards those that do allow states, unlike my
23 own, the ability to get more money if they can't make it

1 work because of their relatively small intrastate taxable
2 base.

3 So, things that are -- mechanisms that allow for
4 that kind of flexibility at the Federal Commission fund
5 level, I think are ones that are -- ones I certainly will be
6 interested in looking and learning more about from these
7 folks here. Let's get on with it.

8 CHAIRMAN KENNARD: Thank you. Okay. We will get
9 down to it then.

10 I will remind the panelists of two things. One is
11 please introduce yourself so that -- we won't introduce you
12 here from the panel. And also, please keep your
13 presentations to three to five minutes. But first, we will
14 start with the -- an impartial overview of this issue from
15 our own Jim Schlichting, who is Deputy Chief of the Common
16 Carrier Bureau.

17 MR. SCHLICHTING: Thank you. Good morning.
18 During the remainder of the day, you will hear and discuss
19 possible changes in the Commission's plan adopted last year
20 to provide free universal service support in rural, insular
21 and high cost areas under Section 254 of the Communications
22 Act.

23 I will give you a brief overview of the high cost

1 universal service. Section 254 of the Communications Act
2 directed the Commission to reform the existing system of the
3 universal service support for high cost areas to make such
4 support compatible with the emergence of competitive local
5 telecommunication markets.

6 Pursuant to that directive, the Commission, in an
7 order issued last May, acted on the universal service Joint
8 Board's recommendation for implementing Federal universal
9 service support for rural, insular and high cost areas.
10 Full implementation of that plan for high cost areas certify
11 larger telephone companies is currently scheduled to occur
12 on January 1, 1999.

13 As background, high cost universal service support
14 is currently achieved through a system of both implicit and
15 explicit subsidies. In addition to the explicit subsidies
16 such as the Federal high cost loop fund, Federal DEM
17 weighting and universal service funds in certain states,
18 there exists implicit subsidies in the form of
19 geographically averaged rates, access charges higher than
20 economic costs and a variety of other increased prices in
21 both the interstate and intrastate jurisdictions.

22 In its universal service order last May, based on
23 the Joint Board's recommended decision, the Commission

1 decided to determine the total need for high cost support
2 for a local service provider in a particular area, replacing
3 both the explicit and implicit subsidies existing today in a
4 two-step process.

5 The order defined high cost support requirements
6 as the difference between one, before looking at costs
7 reasonably incurred to provide quality service in a
8 particular high cost area, and two, an amount computed on a
9 nationwide basis representing the revenues the service
10 provider should expect to receive directly from serving an
11 end-user. Those revenues include, not only local service
12 revenues, but also revenues from access, full service and
13 various discretionary services.

14 Based on the Joint Board's recommendation, the
15 Commissioner determined that costs should be forward looking
16 costs, the costs of constructing the network to provide the
17 supported services using current technology at today's
18 prices. The Commission reasoned that use of forward looking
19 costs would result in high cost support amounts that neither
20 unfairly benefit nor unreasonably harm incompetent local
21 telephone companies or their new competitors in providing
22 supported services. It should also insure that the local
23 service provider will have the incentives to invest in

1 current technologies in high cost areas.

2 With regard to the relative roles of the Federal
3 and state jurisdictions in implementing high cost universal
4 service support, the Commission largely preserved the
5 existing division of responsibility between the FCC and the
6 states for providing support. Noting that state commissions
7 regulate the intrastate rates that reflect implicit
8 intrastate universal service support, the Commission decided
9 not to attempt to identify the amount of implicit support
10 existing in intrastate rates or to convert such implicit
11 intrastate support into explicit Federal universal service
12 support.

13 Instead, the Commission determined that,
14 consistent with the provisions of the Act, states should in
15 the first instance, be responsible for identifying implicit
16 intrastate subsidies and making that support explicit. In
17 essence, the Commission found that the initial
18 responsibility for implementing new high-cost support under
19 the Act would be split among the jurisdictions. The FCC
20 would make explicit, the implicit support existing in
21 interstate rates, while the states would undertake the same
22 tasks on the intrastate side.

23 Looking to the traditional separation of cost of

1 supported network facilities between Federal and state
2 jurisdictions, the Commission that 25 percent of the new
3 high cost need was the FCC's responsibility, while 75
4 percent of that need was initially was within the state
5 purview representing existing intrastate implicit and
6 explicit subsidies. This is what Commissioner Ness referred
7 to earlier today as the placeholder pending further
8 discussions.

9 Because under the new system, high cost need was
10 no longer based on the embedded cost of loop plan, but on
11 the difference between forward looking costs and expected
12 revenues, the universal service order eliminated the special
13 separations rule underlying the old universal service
14 approach. This left the allocation of embedded cost between
15 the jurisdictions to the general purpose separations rules.
16 For effected incumbent local telephone companies that change
17 would transfer a little more than \$200 million in embedded
18 costs to the intrastate jurisdiction with full
19 implementation of the plan.

20 In line with its determination that Federal
21 universal service support in the first instance would make
22 explicit the implicit support existing in interstate rates
23 and to prevent double recovery by local telephone companies,

1 the Commission also decided in paragraph 381 in the
2 companion access reform order, that the amount received by
3 incumbent local telephone companies in interstate high cost
4 universal service support would be used to reduce interstate
5 access charges.

6 Recently, the Commission issued a report to
7 Congress on universal service. In that, the Commission
8 decided to revisit the 25 percent Federal allocation
9 responding to concerns expressed by various parties that the
10 25 percent Federal allocation would not be enough to permit
11 sufficient support for universal service, and might provide
12 less than current interstate high cost support in some
13 areas.

14 In its report, the Commission concluded that a
15 strict across-the-board rule that provides 25 percent of
16 unseparated high cost support to areas served by large local
17 telephone companies, might provide some states with less
18 total interstate high cost support than currently provided.
19 It said that no state should receive less interstate high
20 support than it currently receives.

21 The Commission also found that a state may require
22 greater assistance than it currently receives from
23 intrastate support to maintain affordable rates. As one

1 example, the Commission said that where a state proposed to
2 reform its own universal service mechanisms and collect much
3 of what is currently implicit intrastate universal service
4 report as is possible and consistent with maintaining
5 affordable rates. Additional Federal universal service
6 support should be provided where the state mechanisms in
7 combination with baseline Federal support is not sufficient
8 to maintain rates at affordable levels.

9 It also said it would consider in its
10 reconsideration proceeding any other circumstances under
11 which additional Federal support would be appropriate.

12 That, Mr. Chairman, is sort of the background of
13 what the Commission has said with regard to high cost
14 universal service support. You, in this hearing, along with
15 the other Commissioners will begin the next chapter. Thank
16 you.

17 CHAIRMAN KENNARD: Thank you, Jim. We'll begin
18 now with our first panelist. Mr. Tom Reiman from Ameritech.

19 MR. REIMAN: Good morning. My name is Tom Reiman.
20 I'm senior vice president of public policy at Ameritech.
21 With me this morning is Dick Kolb, director of universal
22 service in Ameritech and our subject matter expert.

23 Though I'm mindful of the thousands of pages of

1 incredibly complex comments, plans, studies and formulas
2 that have been filed with this Commission on the subject of
3 universal service and the high cost fund, and I'll try not
4 to add to the complexity.

5 Ameritech's message is quite simple this morning.
6 Stay the course with a smaller fund, continuing the pressure
7 on the states to carry their share of the burden. Contrary
8 to much of the rhetoric flowing around Washington on this
9 topic, the Commission's original proposal of 25 percent/75
10 percent jurisdictional split funded by interstate revenues
11 is the best plan currently before the Commission. It
12 maintains the current Federal level of responsibility while
13 allowing the states to come forward with their own
14 innovative approaches for their share of the total solution.

15 You know, 14 years ago as associate general
16 counsel of the newly created Ameritech, I spent months here
17 in Washington negotiating, debating and arguing with Burt
18 Halprin, then Chief of the Common Carrier Bureau, on what
19 the first Federal access charges should be like. And guess
20 what? The issues weren't much different than they are
21 today, making implicit subsidies explicit, recovering
22 subsidies in a competitively neutral manner, minimizing rate
23 increases to end users, and keeping telephone service

1 affordable and universally available.

2 Underlying the debate then as now, were four basic
3 tenants. Subsidies and free market competition are natural
4 enemies. Subsidies should be collected in a competitively
5 neutral manner. End user customer rate increases are
6 politically unpopular. And it's the public policy of this
7 nation to keep telephone service affordable.

8 Now, how does this history and these figures apply
9 to universal service and the high cost fund, in particular?
10 Well, let me answer it this way. If we were starting with a
11 clean sheet of paper, we would not design the system we have
12 today, that this Commission and the state commissions are
13 trying so hard to make work.

14 I submit that this Commission would create a plan
15 designed to deliver a set of desired results. Affordable
16 local service. And by the way, our studies show that
17 affordable toll rates are interval to high subscribership
18 levels. Robust competition in all markets, increased
19 infrastructure investment leading to new and innovative
20 services. Competitive and investment are driven by
21 economically rational pricing. Simply stated, local rates
22 must at least cover their costs.

23 Now, once local rates are set to cover costs, than

1 affordable service is maintained by targeting subsidies only
2 to customers who can't afford to pay the full rate.

3 We would not design a system that subsidizes 60 to
4 70 percent of the cost of telephone service of an American
5 officer's Beaver Creek, Colorado condominium. We would not
6 design a system that subsidizes rates that have been kept
7 far below any rational definition of reasonableness like
8 five dollars a month where the statewide average is closer
9 to \$12 a month.

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

16 Using this model, it's clear I submit, that this
17 Commission is on the right track, staying with its current
18 proposal, based on a 25/75 percent jurisdictional split,
19 funded on the basis of interstate revenues. Not only is
20 this consistent with historical separations formula, but
21 more importantly, it keeps in place the incentive for states
22 to fix their part of the problem, which is setting
23 economically rationale local rates.

1 Expanding the Federal fund to cover more of the
2 subsidies is a move in the wrong direction. It sends the
3 wrong direction. It does not move closer to the desired
4 results.

5 As Chairman Kennard said, and I quote, "The vast
6 bulk of universal service support today is generated and
7 spent within the boundaries of each state. This means the
8 real key to subsidy reform is state rather than Federal
9 action."

10 Now, Ameritech has worked in lowering its costs.
11 And some of our state commissions are national leaders in
12 moving toward economically rational local rates. As a
13 result, Ameritech is the only RBOC that receives no high
14 cost support today. Don't punish our customer for our
15 leadership position by asking them to substantially increase
16 the amount of subsidy they send out of state.

17 Let's not move backward. Challenge the industry
18 and policy makers in the states to fix local prices so that
19 residential competition can flourish. Then, build on that
20 base to refine the system so that subsidies only go to those
21 who truly can't afford pay cost-based rates.

22 This is what's happening around the world, in
23 other nations in Europe, Canada, Mexico, New Zealand and the

1 Philippines among others, tackle this issue. Let's not fall
2 behind.

3 To quote from the ad from the current movie
4 Godzilla, size does matter. Only with subsidies, I submit,
5 smaller is better. Thank you.

6 CHAIRMAN KENNARD: Thank you. Mr. Irvin?

7 MR. IRVIN: Thank you, Mr. Chairman and members of
8 the Committee. My name is Jim Irvin. I'm chairman of the
9 Arizona Corporation Commission. I've got a ton -- as a good
10 politician, I've got a ton of paperwork here, which you've
11 all got in front of you, so I'll try to paraphrase so we can
12 get through and stay within the time limits.

13 First of all, I will not be here for this
14 afternoon's panel due to my schedule. I have a early flight
15 out. I do have with me an attorney from our legal division,
16 Ms. Maureen Scott, who can certainly answer any of the
17 panel's questions they may have with regard to our thoughts
18 and ideas this afternoon.

19 I also want to thank the panel and all the people
20 from the FCC, as well as the members of the panel, who have
21 taken their time to look at this issue on how the difficult
22 task before them.

23 What I do want to point out something about our

1 proposal is, it is a lot different than what you're saying
2 today from the other people up here. Our proposal is
3 something that is an alternative, and it's not a
4 comprehensive universal service fund plan.

5 We want to look at our issue as it does deal with
6 the distribution allocation of the Federal universal service
7 funds. However, it is something that an alternative and a
8 partial alternative deal with a very sensitive problem that
9 we have in Arizona.

10 And I have taken every opportunity that I can to
11 make people aware of this opportunity. And that is, the
12 idea to provide telecommunication services to all Americans,
13 not just those who happened to have the infrastructure
14 brought to them. So, please when you look at this, look at
15 this as an alternative and some other ideas in order to help
16 develop our infrastructure and system that we have.

17 The overlooking theme that I would like this
18 Committee to remember is that we have 50 different states
19 and/or regions here in the United States. And this is not a
20 one glove fits all approach. Each state must be noted. And
21 you'll note that in my various exhibits that I have attached
22 with my testimony -- I'll go through those.

23 Our Exhibit A shows the geographical regions and

1 the demographics that face the State of Arizona and why this
2 is a rising problem or problem of great concern, not only
3 amongst myself as a Chairman, but amongst my fellow
4 Commissioners there on the Commission, Commissioners
5 Jennings and Kanasek.

6 Our proposal that we're looking at is an idea
7 that's going to address an area that has not yet been looked
8 at. And that is to address the area of the unserved and
9 underserved people throughout the State of Arizona. And we
10 know there are people throughout this country that have
11 that. And those our customers -- those are Americans who
12 cannot get telephone service because they cannot afford to
13 pay the charges associated with having the facilities or the
14 plants extended to their homes. We cannot ignore this
15 problem any longer as state and Federal regulators. We must
16 be able to address this problem head on.

17 My remarks today will be broken down to basically
18 three parts. First of all, identifying the problem of the
19 unserved and underserved, why the problem exists, and some
20 thoughts and ideas we can do to address it.

21 What I mean in defining the unserved areas and
22 underserved areas, first, the underserved customers are
23 those customers I'm referring to without telephone service

1 who are located outside the exchange boundaries of an
2 incumbent local carrier exchange. And when I refer to
3 underserved areas, I'm talking about citizens and consumers
4 who are not able to get telephone service within the
5 exchange boundaries of an incumbent exchange carrier.

6 But the one underlying program that both of these
7 customers have is, they cannot afford to pay for line
8 extensions or construction charges associated with extending
9 facilities to their homes.

10 A lot of the data that we have received have been
11 presented to through Citizens Utility. They operate three
12 companies in the northern part of our state. They operate
13 the White Mountain telephone service area. They service the
14 Navajo Communications and Citizens Rural Telephone Company.

15 Exhibit B of our program or my comments, contain a
16 random sampling of line extension estimates that were given
17 by Navajo Communications to consumers in its area. And it
18 ranged from a cost of \$83,160 to a low of \$18,480, with an
19 average charge to citizens in that area of \$44,700 for these
20 people to obtain services just to put a phone in their
21 areas.

22 Exhibit C of my testimony shows the actual letters
23 to the consumers provided by citizens, which provide a

1 relevant back-up and data and the estimates provides. In
2 Exhibit D of the information provided, you'll note that the
3 White Mountain Telephone list various underserved areas
4 within its area -- within its exchanged areas. And it gives
5 a number of dwellings, the square miles involved and the
6 request for services reached.

7 And if you will note in Exhibit D -- if you care
8 to go on the bottom of page 2 in Exhibit D, it indicates
9 that in this area of the White Mountains, there are 691
10 known customers in this area of which 288 of these people
11 have requested service. And of that 288, only 74 have been
12 able to obtain line extensions required. And that's because
13 of the cost we have here, which really boils down to of
14 those people, only 11 percent are able to get telephone
15 services.

16 You'll also note that Exhibit D will show that the
17 average cost in this area of the White Mountains ranges for
18 line extensions from \$14,412 to a low of \$314. Exhibit E of
19 our testimony or my testimony here that we filed with you,
20 will show the numerous complaints received by the
21 telecommunications industry.

22 Am I running out of time, Mr. Chairman?

23 CHAIRMAN KENNARD: If you could just sum up, I'd

1 appreciate it.

2 MR. IRVIN: Okay. I will try to sum up in that,
3 this program in moving to it, and we've got a lot of
4 exhibits there, but what we're really asking for is to
5 consider this program as an alternative and look at it and
6 possibly block grants as a way of meeting line extension and
7 meeting this, because it's an area that is not met by
8 existing programs such as your lifeline programs, your hook-
9 up programs and such like that. They talk about monthly
10 recurring revenues. Our problem is talking in trying to
11 meet the needs of the people that do not get the telephone
12 services.

13 And Mr. Chairman, I think if you'll note as
14 principle number 8 that you outlined in your February 9
15 statements, that the was one of the principles, sir, that
16 you underlined, that our program is trying to meet those
17 needs that we have for the people. And we would ask the
18 Board to seriously consider this because this is a problem.

19 While it may not be a problem in Ameritech
20 regions, it is certainly a problem in the midwest, the west,
21 and I would suspect many parts of the Appalachian mountain
22 regions. And we need to get these folks with telephones and
23 get the service so they at least have the opportunity to

1 make the calls necessary.

2 Thank you, Mr. Chairman.

3 CHAIRMAN KENNARD: That's very helpful. Thank
4 you. Mr. Cooper?

5 MR. COOPER: Thank you, Mr. Chairman. My name is
6 Mark Cooper. I'm director of research at the Consumer
7 Federation of America.

8 I always like to start by pointing out that I had
9 the pleasure of filing comments in the original Michigan
10 petition, which was a universal service docket opened up
11 immediately after the break-up of the national telephone
12 monopoly. And since then, I've testified about 50 times at
13 the federal and state level.

14 In fact, on universal service, I've testified a
15 dozen times just since the passage of the Act in states from
16 Washington to Hawaii to Texas to New Jersey. And my message
17 to you today is going to be simply the same message I will
18 deliver tomorrow in North Carolina in a universal service
19 docket.

20 First, you do not need to hurry the creation of
21 the large universal service fund for the large LEC's,
22 because competition has not made it necessary. We don't
23 have much competition. It would be the cruelest of ironies

1 to increase rate payers bills to support universal service
2 in the name of competition when competition is not strong
3 enough to put the downward pressure on prices that was the
4 primary purpose of the Act. You have the time you need to
5 work these issues out.

6 Second of all, when you find you need a fund,
7 analyze the net worth in a sensible manner. And here I
8 agree with the comments of the spokesman from Ameritech,
9 although I don't think the road leads to the same place.
10 But I think you started down the right road. Adopt
11 forwarding looking efficient costs for pricing. Stop
12 building in all these historical inefficiencies that have
13 crept into these models as time has gone forward.

14 Second, the FCC has declared time and again that
15 the loop is a shared cost, and revenues from all the
16 services that use the loop must be included in the
17 calculation in universal service support. There should be
18 no free rides by any service on the loop, which all services
19 use.

20 Third, the FCC has recognized that the universal
21 service area should be the same as the unbundled network
22 element area because that is where we will create
23 competition, and that is where we will create the need for

1 universal service.

2 Follow those three policies and you will have a
3 manageable, sensible fund that will be easy to raise, and it
4 will provide support to the areas that are truly high cost
5 where they don't generate sufficient revenues to cover their
6 costs.

7 Third, when you find you need to raise those
8 funds, raise them the way the Act said, in contributions
9 from telecommunication service providers. Absolutely clear
10 in the Act, it is the providers who use the network to sell
11 services to create profits and value who are supposed to
12 make the contributions to universal service.

13 The FCC started down that path in its original
14 decisions on this. It should stick to those paths. And you
15 have been fighting a very tough fight with them about how
16 those monies should be raised. You are to be commended for
17 sticking to that fundamental principle.

18 Finally, if you want to put a line item on
19 consumers bills, and they have become terribly popular these
20 days. A dollar for schools and libraries. A dollar for
21 local number portability. A dollar for the pixie. A \$1.50
22 for the second line for residential. By the time we're
23 done, those dollars at the bottom of the bill start to mount

1 up. And we have begun, as you know, to raise that concern
2 very strongly.

3 If you think you need a line item on my bill for
4 universal service, than you ought to back it out of the
5 Federal subscriber line charge. The Federal subscriber line
6 charge is a core service defined to be supported by the
7 universal service fund. That would be consistent with the
8 Act, and that position has been put forward by a number of
9 consumer advocates.

10 You can make room for universal service funds
11 without raising my bill by treating it as an offset to that
12 subscriber line charge. When the Telecommunications Act was
13 passed, consumers were promised prices that would go down,
14 choices from competitors and the universal service fund that
15 could be created without raising our bills.

16 Stay the course on the fundamental decisions you
17 have made, and we may, in fact, get to that outcome. Thank
18 you, Mr. Chairman.

19 CHAIRMAN KENNARD: Thank you, Mr. Cooper. Ms.
20 Baldwin?

21 MS. BALDWIN: Thank you, Mr. Chairman. I am Susan
22 Baldwin, senior vice president of Economics and Technology,
23 Inc. ETI's a consulting firm specializing in

1 telecommunications economics, regulation, management and
2 public policy.

3 I was a principle author of the paper, Defining
4 the Universal Service Affordability Requirement that forms
5 the basis for Time-Warner Communications proposal to the FCC
6 for consideration of community income as a factor in
7 universal service support.

8 ETI's analysis of the relationship between income
9 and high cost support was an outgrowth of our detailed
10 analyses of the various cost proxy models that were first
11 presented to the Commission in 1996.

12 One thing that struck us was the fact that the
13 models that purported to target support on the basis of high
14 cost, also directed support to many well to do communities
15 where customers clearly could afford to pay for the entire
16 cost of their local telephone service without any subsidy
17 whatsoever. Further research demonstrated that this was not
18 an isolated condition. It was a nationwide pattern.

19 ETI's analysis demonstrated that a decision not to
20 fund support to high income CBG's would result in a
21 significant reduction in the overall size of the interstate
22 high cost fund.

23 The Telecommunications Act of 1996 explicitly

1 requires that affordability be included as a consideration
2 in the development of a comprehensive universal support
3 mechanism. Quality services should be available at just,
4 reasonable and affordable rates.

5 The extent to which services affordable to an
6 individual customer inextricably linked to that consumer's
7 income level and ability to pay. And in fact, the Joint
8 Board, in its recommended decision, and the Commission, in
9 its report and order, have acknowledged that income level
10 directly effects the determination of what is an affordable
11 price.

12 The Commission has also agreed that community
13 income, as represented by the percentage of students
14 eligible for school lunches is a valid basis for
15 establishing the variable discounts necessary to make
16 telecommunications affordable to schools and libraries.

17 The universal service goal is not advanced by
18 subsidizing consumers who can afford to pay the entire cost
19 of their telephone service and whose decision to take
20 services unaffected by the presence of such a subsidy.
21 Indeed, some of the specific attributes of exclusive high
22 income communities, large lots, low population density,
23 remoteness from primary population centers are the very same

1 conditions that tend to raise the cost of providing local
2 telephone service.

3 Ironically, many low income areas, such as densely
4 populated, inner-city communities are, because of such
5 attributes, also low cost areas, and could well be forced to
6 subsidize the high rent, high cost to serve suburbs.

7 Policies that would flow universal service support
8 to high income communities serve only to impose significant
9 costs and economic burdens upon other segments of the
10 company, while doing nothing to advance the cause of
11 universal service or produce any other offsetting economic
12 or social benefit.

13 Among other things, a funding obligation that is
14 larger than one that is minimally necessary to achieve the
15 universal service goal will undermine other Commission and
16 Congressional objectives, perhaps, even including universal
17 service itself by forcing new entrants to make larger than
18 necessary payments to the universal service funding
19 mechanism, such policies will increase the costs of and
20 barriers to, competitive entry, and thereby diminish the
21 prospects for effective competition overall.

22 They will also work to suppress demand for price
23 elastic services, thereby limiting the potential benefits

1 that all sectors of the economy can derive from increased
2 access to and use of the nation's telecommunications
3 resources.

4 The ETI study and Time-Warner's proposals are not
5 offered as providing definitive or prescriptive guidance as
6 to how structure an income-based funding mechanism. Rather,
7 it is offered to demonstrate that many high cost communities
8 are also high communities. That public data is available
9 from the Census Bureau to support the administration of a
10 community income-based funding mechanism. And that there is
11 an opportunity to achieve a significant decrease in the
12 overall size of the universal service support fund fully
13 consistent with the statutory requirement that service be
14 affordable without any consequential impact upon the overall
15 universal service goal.

16 The structure of community income-based funding
17 mechanism should be built upon three specific policy
18 initiatives. First, the FCC and the states should conclude
19 that the highest income, high cost areas are to be excluded
20 from universal service support. For example, if all CBG's
21 with median -- time is up. Shall I wrap this up?

22 CHAIRMAN KENNARD: Please.

23 MS. BALDWIN: If all CBG's with median income

1 levels in the top 30 percent of their state were placed in
2 this category, the funding requirement could be reduced
3 significantly by as much as 20 to 30 percent. Second, there
4 should be a safety net for low income consumers residing
5 within high income, high cost areas who cannot afford to pay
6 full cost based rates. And third, to avoid rate check,
7 transition plans should be established that would allow
8 carriers to move rates in high cost, high income carriers to
9 their full forwarding looking costs.

10 If it's done correctly, and it can be done
11 correctly, the result will be a win-win for all. Thank you
12 very much for the opportunity to present these comments
13 today.

14 CHAIRMAN KENNARD: Thank you, Ms. Baldwin. Mr.
15 Weller?

16 MR. WELLER: Good morning, Mr. Chairman. My name
17 is Dennis Weller. I'm chief economist at GTE.

18 I've take the liberty of preparing a chart, which
19 is in your materials, to help you follow the money. It
20 shows, basically, an overview of where the money is coming
21 from and where it's going to within GTE-serving areas in 28
22 states today.

23 The chart shows contribution by major service

1 category. And basically, what this is showing you is that
2 you have very large contributions from interstate access and
3 from other state rates, which makes it possible to fund a
4 very large negative contribution from residents local
5 service.

6 For comparison, I've provided another set of rates
7 on the chart which shows what rate these category
8 contributions would like if rates were re-balanced on the
9 basis of a constant percentage mark-up over the direct cost
10 of each service. The difference between the two bars gives
11 you a measure of the intervention, basically, that's been
12 performed by regulation, and also, where the money is
13 flowing in and out of each one of these service categories
14 today.

15 Now, there are several observations I think we can
16 make based on this chart. First, debates about large or
17 small fund sizes, I think, are moot. We already have a
18 large fund. It's on the chart. It's in our rates.

19 Second, only a very small portion of this funding
20 today is implicit. The very small black foot that you see
21 on the left most set of bars, is the explicit support that
22 GTE gets from the high cost fund today.

23 And third, if we use the consistent methodology

1 with respect to both rates and costs, we should be able to
2 look at either end of this chart and get a consistent
3 answer. In other words, we should be able to add up what
4 local is receiving in support or add up what the other
5 services are providing in excess contribution and get a
6 consistent answer.

7 In other words, this is a price system that has to
8 add up. The only way to avoid that is to ignore part of the
9 chart -- some of the bars, or to assume a completely
10 different cost level.

11 Now, why can't we keep on doing this? What's
12 wrong with this picture? Well, the first thing is we can
13 forget about local competition if we keep doing this. I
14 mean, look at this contribution for residents local here.
15 Who wants to enter this market? Nobody does. And the
16 support that comes from the other services implicitly can't
17 be made portable for someone who tries to serve one of these
18 customers. Particularly, if they are low usage customers,
19 which the majority of them are because the distribution of
20 usage is highly skewed. So, that's point number one.

21 You're right, Commissioner Ness, though. The
22 customers are protected. But they're also protected against
23 competition if we don't do something about this.

1 And the second thing, as the Chairman noted, is
2 the competition will, ultimately, erode the sources of
3 implicit support. So, what should we do about this? Well,
4 first, I recommend that the Commission should establish a
5 program that's based on three objectives.

6 The first is, that the fund should be sufficient
7 to replace the implicit support that's coming from
8 interstate access today. That's the left-most bar. It's
9 unreasonable to expect that any state action will address
10 that part of the problem. My calculations show that that's
11 about \$6.3 billion at current levels.

12 Second, the fund should provide a reasonable
13 amount of support for states with high cost and/or very low
14 funding basis. This, obviously, has to be balanced with the
15 interest of other states.

16 And third, as several people have mentioned, the
17 fund should do no harm. That is, it should provide at least
18 as much support. It should, essentially, replace the
19 support that comes from current explicit fund.

20 How would I recommend that we go about that? I
21 propose that the Commission follow the same basic benchmark
22 methodology that it's already adopted, but use an array of
23 benchmarks, which I refer to as a sliding scale. Several

1 benchmarks -- you need several benchmarks to hit the several
2 policy targets that you have. I don't think that you can do
3 it with just one. With increasing percentages of support
4 above each benchmark, I've provided examples and
5 illustrations of this in our comments and in the package in
6 front of you. I won't go into details here.

7 The point is that there's no benchmark that's
8 perfect a priori. A good benchmark is a benchmark that
9 gives a good answer. That's why I've held up in front of
10 you objectives to hit. And the exercise I have in mind is
11 that you adjust the benchmarks until you hit the target. If
12 the benchmarks don't hit the target, you go back and adjust
13 the benchmarks. Obviously, to do this properly, you have to
14 decide on the cost model of the inputs first, otherwise you
15 have no idea of what effect the cost models and the inputs
16 will have.

17 Finally, the cost models are necessary, as
18 Commissioner Wood noted, but they're also unreliable. And
19 that's why it's important to have externally measurable
20 goals that you can judge the reasonableness of the outcome
21 against. If the outcome isn't reasonable, than the model
22 isn't reasonable.

23 Now, how would all this be funded? I propose --

1 well, first let me stop and say, this is a good way of
2 getting the initial level of support in January. But after
3 that, I think that a process of competitive bidding would
4 provide a way of correcting these amounts if they are wrong
5 and also adjusting them over time.

6 Finally, I recommend that this program be funded
7 by a uniform percentage surcharge on both state and
8 interstate rates. I estimate that it would take about a
9 three percent surcharge to do that. Rather than have wildly
10 inconsistent tax rates on different people -- some people
11 paying several hundred percent today through the rates on
12 this chart, I think it's more fair, more competitively
13 neutral and more efficient to have everyone pay three
14 percent.

15 And finally, if we do that, for the first time,
16 carriers will be able to come into local markets and serve
17 these customers and find them a reasonable proposition,
18 which they cannot do today. Thank you, Mr. Chairman.

19 CHAIRMAN KENNARD: Thank you, Mr. Weller. Before
20 we move on, I wanted to introduce and acknowledge one person
21 who's here today. I'm not sure how long she's going to be
22 here, so I wanted to recognize her briefly. And that is
23 Kathy Brown is going to be joining us next week as Chief of

1 the Common Carrier Bureau. She will be leaving her job as
2 associate administrator at the National Telecommunications
3 and Information Administration.

4 And Kathy has already rejected some advice that I
5 gave her. I advised her to take some time off between jobs,
6 but Kathy decided that she would rather be here with us.
7 So, I think that's some measure of her commitment to the
8 challenge that she's taking on. Kathy will be playing,
9 obviously, a major role in grappling the issues that we're
10 discussing today. So, we're delighted that you're here.
11 Thank you.

12 Mr. Bush?

13 MR. BUSH: Thank you, Mr. Chairman. Good morning.
14 My name is Ernest Bush. I'm Assistant Vice president of
15 Federal Regulatory for Bell-South Telecommunications. On
16 behalf of Bell-South, I would like to thank you for the
17 opportunity to appear before you today to share my company's
18 views on the critical issues of high cost support in
19 universal service.

20 As we all know, it's a critical issue and a
21 complicated one, but one that is literally vital to the
22 constituents we all serve, the American public.

23 In the Telecommunications Act of 1996, Congress

1 incorporated language laying out the requirements of the
2 universal service program. Clearly, Congress was concerned
3 about preserving the availability of high quality
4 telecommunications services in all regions of the country.
5 Obviously, any universal service plan adopted by the Federal
6 Commission or the state commissions must address this
7 concern.

8 However, a more subtle point grows out of the
9 impact universal service support has -- universal service
10 support and funding obligations has on the development of
11 competition within the local exchange marketplace.

12 It should be no surprise that my company is
13 concerned about the existence and level of implicit
14 subsidies built into our access and business rates. And we
15 are also concerned and believe others are as well, about the
16 impact that subsidized rates have on the development of a
17 competitive residential marketplace, especially for
18 consumers located in rural and high cost areas.

19 It must be obvious, and indeed, Dennis just talked
20 about it, that new entrants will find it difficult to
21 compete with incumbents who, as a matter of social policy,
22 are required to price their residential exchange service
23 product offering below the cost of providing it. Any high

1 cost universal service plan, then, must not stand in the way
2 of the development of balanced competition. A fund too
3 large is inefficient. However, a fund too small will
4 frustrate balanced competition development.

5 We believe that the Act, as well as sound public
6 policy requires that this implicit subsidy be made explicit.
7 That is, be clearly identified, be shared among service
8 providers in a competitively neutral fashion, and be made
9 available to competing eligible carriers. Failure to do so
10 will, among other things, lead to the erosion of widespread
11 availability of comparable telecommunication services, as
12 well as frustrate the development of a competitive
13 marketplace.

14 Dealing with this implicit subsidy will, in the
15 final analysis, fall to the state public service
16 commissions. However, as we all recognize, there is a
17 substantial role for the FCC to play in providing support
18 targeted at reducing the overall subsidy problem.

19 Clearly, Federal access charges implicitly support
20 the cost of local exchange service. Indeed, the
21 Commission's separations process allocates local loop cost
22 of the interstate jurisdiction for recovery by the -- via
23 the subscriber line charge, pixies and the carrier common

1 line charge. This relationship between common line recovery
2 and the support of universal service has been recognized by
3 the Commission since its inception of its access charge
4 structure.

5 Bell-South's proposal leverages off a statement
6 the Chairman made in the FCC's report to Congress on
7 universal service. The Chairman argued that the state and
8 the Commission should act to preserve existing sources of
9 both implicit and explicit support. We agree.

10 Our proposed plan, laid out more fully in the
11 record, suggests the creation of a Federal high cost support
12 fund for non-rural companies made up of two pieces. The
13 first piece converts existing explicit support plus the
14 implicit support embodied in pixies and CCL, into explicit
15 support targeted at the higher cost wire centers.

16 The second piece, which we refer to as the safety
17 net, provides new support for the very high cost wire
18 centers. Both funds operate to relieve state cost burdens.
19 Taken together, these two new mechanisms can be implemented
20 on a revenue neutral basis. Pixies and CCL charges replaced
21 by the explicit fund can be reduced or eliminated, allowing
22 reductions in toll rates.

23 Safety net support will reduce the need for

1 insupportably large state universal service funds and thus
2 allow more reasonable sharing of universal service
3 obligations in all jurisdictions.

4 Finally, we suggest that the burden of the new
5 Federal fund be shared among all telecommunication providers
6 operating in the interstate marketplace, via an allocation
7 on one of them, based on each carrier's pro rata share of
8 total retail revenues.

9 I thank you for your time, and I look forward to
10 your questions.

11 CHAIRMAN KENNARD: Thank you, Mr. Bush. Mr.
12 Bluhm?

13 MR. BLUHM: Thank you, Mr. Chairman, members of
14 the Commission and members of the Joint Board. I'm Peter
15 Bluhm, Policy Director for the Vermont Public Service Board.
16 With me today is Joel Shiffman from the main Public
17 Utilities Commission who was the other lead staffperson who
18 was the author of the ad hoc plan. Mr. Shiffman will be
19 available after the break to answer your questions.

20 I will focus in my remarks this morning on two key
21 tests of the successful universal service plan. The
22 universal service plan must be sufficient, and it must be
23 efficient. Sufficiency means that the system must be --

1 must allow affordable local telephone rates to be available
2 to subscribers everywhere in the country. Rates do not have
3 to be equal between downtown Los Angeles and rural Vermont,
4 but they must be reasonably comparable.

5 Efficiency is also necessary. Financial resources
6 are limited and regulators cannot federalize all high cost
7 support objectives, including all implicit subsidies that
8 today exist in state rate structures. It is neither
9 economically desirable, nor politically possible to raise 10
10 or 15 billion dollars through a surcharge on interstate
11 services.

12 Universal service at the Federal level must make
13 do with a smaller budget. And it should limit its
14 objectives to supporting the areas that are most closely
15 connected with the objectives of the Act.

16 The current system fails to meet these standards.
17 First, because it is insufficient. It does even pretend to
18 support all rural and high cost areas equally. It
19 discriminates against rural areas that are served by large
20 companies.

21 Vermont is, by one definition, the most rural
22 state in the country, and yet, we have a major carrier who
23 serves 85 percent of our customers. Customers who live in

1 this area receive substantially less support today for high
2 cost loops in switching than do customers in other equally
3 rural areas. Furthermore, the current program totally
4 ignores the high interoffice trunking costs in many rural
5 states.

6 The current system also fails to comply with the
7 Act because, by basing support in part on the size of the
8 incumbent, the current system is incompatible with
9 competition. Competition requires that subsidies be made
10 explicit and portable. A support system that links the
11 amount of support available in an area to the identity or
12 size of the incumbent clearly would destroy any effort to
13 achieve meaningful affordability.

14 The Commission's order of May 1997 establishing
15 the 25/75 split, likewise fails to test its sufficiency.
16 The text of the rule itself actually moves away from
17 sufficient by, in effect, repealing high cost support for
18 the state jurisdiction. Even if current support levels were
19 maintained to the state jurisdiction, however, the 25/75
20 plan remains insufficient. Indeed, even if the Commission
21 were to apply the full 25 percent support entirely to the
22 state jurisdiction, the result still would not be sufficient
23 to insure that customers everywhere in the country have

1 reasonably comparable rates.

2 Simply put, some states have low cost urban areas
3 from which they can draw support. Other states have only
4 small or in one case, no real urban areas, and very limited
5 ability to finance high costs. For these states, average
6 costs are so high that it is impossible for them to obtain
7 comparable rates no matter what they do.

8 In states with many high cost customers and few
9 low cost customers, the surcharges needed to achieve
10 comparable rates would be so large that when they're added
11 to existing rates, the result would no longer be comparable.
12 These high average cost states face a Hobson's choice. They
13 can either impose very high end user surcharges, thus
14 destroying comparability, or they can impose very high
15 interexchange carrier access charges, thus impeding
16 competition and economic development.

17 A universal service support system can be both
18 sufficient and efficient. The Commission should set up an
19 overall framework for support. But that framework can
20 anticipate that the states will fill some of the pieces.

21 While the Act does not require any state to enact
22 a high cost support program, the Commission can
23 appropriately make some assumptions about state effort. The

1 only alternative is raising 8 to 10 billion dollars,
2 something that is politically unacceptable to the Congress,
3 and frankly, something that is not necessary.

4 A sufficient fund of more modest size, however,
5 requires regulators to be selective about how Federal
6 support will be distributed. If support is given to areas
7 that can raise that support another way, such as in low cost
8 areas that are today inside state borders, there will not be
9 enough funds left over to finance affordable and comparable
10 rates in other states.

11 The ad hoc plan, which I worked on, limits Federal
12 support to the amount by which a state's costs exceeds the
13 national average. The plan assumes that if a state has
14 average costs that are at or below the national average, the
15 state can support its own high cost areas from within its
16 own borders by surcharging its own low cost areas.

17 This decision is appropriate since much of the
18 anticipated support is implicit today in rates that are set
19 by state commissions. There is no immediate need to replace
20 these in-state transfers with Federal support.

21 The ad hoc proposal also uses both forward looking
22 and embedded costs in calculating support. This feature has
23 been controversial, but it serves important purposes --

1 CHAIRMAN KENNARD: Mr. Bluhm, I am going to have
2 to ask you to sum up.

3 MR. BLUHM: Thank you, Mr. Chairman. In summary,
4 Mr. Chairman, I appreciate the chance to be here today, and
5 I think you'll find the ad hoc plan provides a sound
6 framework to meet the requirements of the Act. Thank you.

7 CHAIRMAN KENNARD: Thank you very much. Mr.
8 Wendling?

9 MR. WENDLING: Yes, thank you, Mr. Chairman,
10 members of the Commission and state members of the Joint
11 Board. My name is Warren Wendling. I'm on the staff of the
12 Colorado Public Utilities Commission.

13 I'm going to jump right into a couple of specifics
14 of the type of plans that my colleague from Vermont, Mr.
15 Bluhm, was talking about. What happens when a state has
16 relatively high cost and a fairly small revenue pot upon
17 which to develop an intrastate fund?

18 The two proposals I want to outline in some just
19 overview, are called the variable benchmark and the variable
20 support method.

21 The variable benchmark is exactly that. It's a
22 building upon the four step process that the Commission had
23 previously adopted using a forward looking economic cost,

1 but then to adjust the benchmark based upon a state's
2 ability to internally generate funds to meet its share of
3 the requirement for high cost fund. For example, a state
4 that has relatively low cost and lots of intrastate revenue
5 might have a Federal benchmark set at \$75, while another
6 state with more high costs and less revenue -- intrastate
7 revenues, might have a lower benchmark, say, of \$40.

8 What kind of things would differentiate between
9 these two states? Well, the factor might recognize any
10 number of different things. It could be the ratio of
11 revenues -- intrastate revenues -- the total revenues. The
12 ratio of intrastate traffic volumes if you're concerned
13 about the prices that might be set. It could look at the
14 ratio of the variability of costs among the states. Is
15 there a high very cost area and a very low cost area, or it
16 is uniform?

17 The factor might recognize the degree of number of
18 lines located in urban or rural areas. It could be the
19 ability of the state to keep local rates low or within a
20 reasonable range, or it could even incorporate a measure of
21 local competition.

22 The factor could be a combination of those
23 factors. It doesn't have to be any one of those, but any

1 one of those or in combination with several could produce
2 the result of a reasonable size fund that still could be
3 supported within states that have very high costs and low
4 revenues.

5 I have not provided any specifics about dollars of
6 what this would be or how exactly it would work. I think
7 several of the commentators have mentioned one of the first
8 steps we need to have is a Commission-adopted model with a
9 set of inputs that then could be tested. I think it was the
10 Laska comments that said, "Be sure and test what you propose
11 carefully before we adopt it." And I think that's advice
12 well given.

13 Another option that builds upon that, instead of
14 varying the benchmark, if somehow the benchmark has with it,
15 the baggage that that is an affordable benchmark. One could
16 adopt a single benchmark and than just look specifically, to
17 varying the support by state. Adopt a uniform nationwide 31
18 residential/51 business benchmark, but vary the percent from
19 25 percent interstate upward to address those issues of the
20 state's ability to generate a support internally.

21 And again, the same kind of factors are the ones
22 that we would have to look at, like the traffic revenue, the
23 ratio of high cost lines to low cost lines, et cetera.

1 So, I'll be brief, and I think that has come in
2 under my time.

3 CHAIRMAN KENNARD: Thank you. And we appreciate
4 that. Mr. Brown?

5 MR. BROWN: Good morning, Mr. Chairman,
6 Commissioners and Joint Board members. My name is Glenn
7 Brown. I'm Executive Director of Public Policy for U.S.
8 West. And I'm here today to describe the interstate high
9 cost affordability plan or IHCAP as we call it.

10 This plan was developed in an effort to find a
11 workable, middle ground solution to an urgent problem. And
12 that is how to fund continuation of affordable service in
13 high cost rural areas of the "non-rural" LEC's.

14 And this is a problem not just in the western
15 United States that we serve. It's a problem in many
16 southern states. It's a problem in the New England area.
17 It's a problem in the Appalachian areas.

18 Let me give you an example using U.S. West
19 figures. In the 14 states that we serve, we serve over half
20 a million customers who cost, in excess of \$50 per month.
21 And that's not using our cost studies. That's using the
22 common inputs that the FCC staff developed. And of that
23 total, over 200,000 cost in excess of \$100 per month to

1 serve.

2 Now, several times today, there's been discussion
3 about, how important is January of 1999? We think it's very
4 important for this reason. I've heard people say that the
5 competition that people expected with the Act has not
6 materialized. But I think there, we're applying maybe the
7 right data to the wrong problem, because the competition has
8 not materialized for residential and small business
9 customers, which for the most part, are priced near or below
10 cost.

11 But when you look at the large business customers,
12 where a majority of the implicit support is derived, there's
13 vibrant competition going on right now. And our very
14 serious concern is that that competition is draining out of
15 the bucket as we speak. And the customers that are going to
16 feel the impact of that first, are these very highest of
17 cost customers. That's why we developed the IHCAP plan.

18 We had four objectives in mind when we developed
19 it. Number one, it must be simple and understandable. Two,
20 it must leave states with the primary role for rate
21 rebalancing and assuring affordable service to all their
22 citizens. Three, it must address the needs of states that
23 face a problem because of a lot of high cost customers and

1 no large urban areas with low cost customers to spread them
2 over. And it must do so with minimum additions to the
3 Federal fund. And finally, it must be capable of
4 implementation by January 1 of 1999.

5 The working of the IHCAP plan are shown on Chart 1
6 in the material that I provided. As you'll see, for costs
7 as derived by a proxy model under \$30 per month, there would
8 be no Federal support or no Federal explicit support.
9 Between \$30 and \$50, we keep the same 25/75 in the original
10 plan. And then, over \$50 per month, the costs would be
11 funded from the Federal fund.

12 Now, if you look at Chart 2 that I've provided,
13 I've shown, using as a representative cross-section the
14 states represented by the Joint Board Commissioners, the
15 impact of the two plans, the 25/75, the solid line that you
16 see on that chart is the impact stated as a surcharge on
17 intrastate rates of covering 75 percent of that state's high
18 cost need. Again, using the staff's common inputs.

19 The cross-hatched or red line shows what happens
20 when you take the over \$50 customer out of the mix. And I
21 find with this sample, but I also find when I look
22 nationally, that somehow when we take the over \$50 customer
23 out of the mix, we bring each state in with a roughly

1 similar problem to solve. And again, I do believe that the
2 fundamental solutions have to occur at the state level.

3 I agree with Commissioner Wood that we're probably
4 not going to solve the whole universal service in one fell
5 swoop. However, the problems of the very high cost rural
6 customers served by non-rural LEC's are real. They require
7 attention soon. The January 1, 1999 date must be met. I
8 agree with others that have showed that there will be
9 additional implicit support interstate access, and that'll
10 have to be carefully managed as move forward.

11 Thank you. We think the IHCAP plan is a
12 reasonable first start. And I look forward to your
13 questions later.

14 CHAIRMAN KENNARD: Thank you, Mr. Brown. Mr.
15 Lubin?

16 MR. LUBIN: Thank you. My name is Joel Lubin,
17 Regulatory Vice President Public Policy of AT&T. Thank you
18 for giving an opportunity speak before you do on the
19 proposals to revise the methodology for determining high
20 cost support.

21 AT&T supports the Commission's proposed four step
22 methodology for determining high cost funds. However, the
23 Commission should revise the timing and implementation of

1 that methodology.

2 First and foremost, the Commission should withhold
3 payment of any high cost support targeted for major, non-
4 rural LEC's regardless of the methodology employed to
5 determine the support. Today, the major LEC's under 10
6 companies are representing approximately 90 percent of the
7 lines.

8 If I look at the small rural telephone companies
9 which represent over 1,300 companies in this country, they
10 represent approximately 5 percent of the lines. Of those
11 five percent of the lines that their truly rural companies
12 represent, 55 percent of those lines are in areas that have
13 a 100 lines per square mile or less. That is a phenomenal
14 statistic such that clearly there needs to be a solution to
15 the small rural companies that represent 1,300 companies in
16 this country.

17 However, the notion of giving distributions to the
18 major LEC's from an explicit fund, one that ultimately is
19 supported by revenues from their competitors is untenable.
20 These local companies are giant corporations earning record
21 profits. They certainly have the wherewithal to deal with
22 the high cost needs.

23 As AT&T has demonstrated in its May 15 comments,

1 in the vast majority of cases, the major LEC's current local
2 revenues compensate them fully for all of their universal
3 service costs. For 62 of the major non-rural LEC's, 71
4 study areas end user local service revenues, including the
5 interstate subscriber line charge fee, exceed the forward
6 looking costs of service. And indeed, exceed it by well
7 over \$20 billion in aggregate.

8 In the nine study areas where such revenues fall
9 short of forward looking costs, and even here the shortfall
10 is approximately \$200 million in aggregate, these LEC's have
11 additional sources of support including intrastate toll,
12 wireless revenues, Yellow Pages. And this is before they
13 turn to access charges for even one penny of support. Any
14 support explicit further support payments to these LEC's
15 should be canceled until they can show that such payments
16 are necessary.

17 I'd like to emphasize that our proposal of
18 withholding payments of major non-rural LEC's should apply
19 under the current support methodology, as well. Today,
20 there's approximately \$110 million of the current \$1.7
21 billion explicit Federal funds is paid to the major local
22 company.

23 This amount was determined by a joint Federal

1 state agreement that was developed in a monopoly
2 environment. It is counter to the competitive landscape
3 explicitly anticipated by the Telecommunications Act.
4 Equally as distressing is the fact that major LEC's do not
5 need this money to support universal service, is the use by
6 which it has been used to undermine the competitor purposes
7 of the Act and frustrate the development of local
8 competition. Therefore, these payments should be
9 discontinued.

10 AT&T does not oppose payment of high cost support
11 for non-major local companies. However, the Commission
12 should not adopt a methodology that would increase
13 needlessly the size of the fund. Yet, the Commission's
14 proposed methodology, if it determines the high cost funding
15 requirements at the wire center level or below, would do
16 just that.

17 To insure that ratepayers are not burdened with
18 funding support payments beyond what is needed to insure
19 universal service, the Commission should, instead, calculate
20 the support at the study area level. As the Commission,
21 itself, recognized in the universal service order, universal
22 support should not be calculated at a greater level of
23 geographic disaggregation than unbundled network elements.

1 Most states have not disaggregated unbundled network rate
2 elements for the loop below the study area level. And those
3 that have, have disaggregated them into only three or four
4 rate zones. There's probably over 20 or 25 states that have
5 only one unbundled loop rate.

6 In addition, even this slight disaggregation
7 remains more of a theoretical curiosity rather than
8 providing real competitive opportunity because of excessive
9 glue charges and non-functional operating support system,
10 and neither anti-competitive conditions even in the few
11 states that have disaggregated union rates, there has been
12 no ability for new entrants to compete. Therefore, the
13 Commission should continue to calculate support at the study
14 area level in all states as it does under the current
15 system.

16 Finally, because of the underlying predicate for
17 establishment of universal service system, local competition
18 has thus far been stymied. It is not necessary to implement
19 the new high cost support system January 1991.

20 Section 254(a)(2) of the Act expressly authorizes
21 the Commission to establish a timetable for implementation
22 of the new universal service system. That is consistent
23 with the standards and purposes of the Act. But there has

1 been no entry into the local exchange access market
2 sufficient to put competitive pressure on those existing
3 sources of universal service.

4 Therefore, the Commission can and should lawfully
5 postpone implementation of the redesigned system until such
6 competition arrives.

7 Thank you very much.

8 CHAIRMAN KENNARD: Thank you, Mr. Lubin. Mr.
9 Sichter?

10 MR. SICHTER: Yes, thank you. I'm Jim Sichter,
11 Vice President of Regulatory Policy for the Sprint local
12 telecom division.

13 I want to start out with a few general
14 observations to put Sprint's proposal into some context. To
15 begin with, I think we need to start with the reality of
16 today. And the reality of today is that the universal
17 service funding that exists, both implicitly, and more
18 implicitly, as well as explicitly, is indeed huge. The
19 Telecom Act requires that these implicit subsidies be made
20 explicit and recovered in a competitively neutral manner.
21 Indeed, Sprint believes that the development of an explicit,
22 competitively neutral universal service fund is a
23 prerequisite to vibrant facility-based local competition.

1 We also need to recognize that the only way to
2 reduce the size of the universal service funding that exists
3 today is to rate rebalancing. And we are certainly in
4 agreement with others on this panel that have pointed out
5 that the level of local rates today is way below the
6 affordable levels. And that we need to have rate
7 rebalancing considered as a part of the solution to the
8 universal service problem.

9 Finally, we do not need to create new revenues to
10 address universal service funding. The revenues exist
11 today, and simply need to be more efficiently targeted to
12 accomplish the goals of the universal service.

13 Given that background, Sprint's proposal is,
14 first, that the universal service funding be based on
15 forward looking economic costs, that we have a national that
16 universal service funding be assessed on state and
17 interstate revenues, that all services, all providers, all
18 customers pay on an equitable basis. Thirdly, that the
19 benchmark for determining universal service should be set at
20 the maximum affordable rate levels. Again, we need to
21 target subsidies to those who truly need it to keep them on
22 the network and not to maintain low subsidized local rates
23 that are not necessarily to accomplish universal service

1 goals.

2 Support must be made portable and equitably
3 available to CLEC's as well as ILEC's. The plan must be
4 restructured neutral at its inception. Again, any universal
5 service funding that an ILE gets above and beyond today's
6 levels, must be offset dollar for dollar with reductions in
7 implicit subsidies.

8 And finally, universal service funding must be
9 recovered through a uniform surcharge on end user bills.

10 Thank you.

11 CHAIRMAN KENNARD: Thank you very much. We'll now
12 take a short break. Let's reconvene here at 20 minutes to
13 12. And we'll then go to some questioning of the panelists.
14 Thank you.

15 (Whereupon, a short recess was taken.)

16 CHAIRMAN KENNARD: Okay. I'd like to bring us
17 back to order, please, so that we can stay within striking
18 distance of being on schedule today.

19 We're now going to go into the Q and A phase of
20 our panel this morning. And I'd like to do this somewhat
21 freeform, sort of like an oral argument where Commissioners
22 here -- and you will get some rebuttal time, I assure you.
23 So, that Commissioners can jump with questions as the spirit

1 moves them.

2 And I think in these discussions, it's always
3 useful if we can get a little bit of debate going among the
4 panelists. Obviously, you all have differing points of
5 view. You've all done a lot of thinking about your issues.
6 And I think it would be most helpful to us if we could get a
7 little point/counterpoint going. And I'd like to start that
8 off by asking a couple of questions of Mr. Lubin and Mr.
9 Brown.

10 Mr. Lubin, you have advocated for some time now
11 that the FCC should reduce the rate of interstate access
12 charges. And often times, your proposals are met with
13 opposition from the local exchange carriers represented here
14 by Mr. Brown, who have argued that if we are to reduce
15 interstate access charges, than we would somehow threaten
16 universal service.

17 So, I would like to ask each of you to comment on
18 that. And I'd like, particularly to know, how much of the
19 universal service subsidy is today embedded in access
20 charges? And what is the break off point? And if we were
21 to start a process of reducing access charges, how would we
22 reconcile that with the obligation to provide universal
23 service?

1 Mr. Lubin, would you like to start off?

2 MR. LUBIN: Sure. Thank you for the question.
3 Very complicated question, and it finally comes down to what
4 you believe is the cost standard, in my view, for universal
5 service. That's one critical question.

6 The other critical question is, who are we
7 addressing? Are we addressing the major local companies who
8 represent about 90 percent of the lines, or the truly rural
9 companies who represent five to seven percent of the lines?

10 And so, my remarks are going to address the 90
11 percent issue in terms of the major local exchange companies
12 because I truly believe the small rural areas, as I said in
13 my comments, that roughly 55 percent of their lines are in
14 densities that have a hundred lines per square mile. That
15 is a very, very high cost area and creates a unique problem.

16 But for the 90 percent of the lines, the question
17 is, what cross-standard do you use? The Commission came out
18 and said forward looking. And now, there's a critical
19 question is selection of a cost proxy tool and the inputs in
20 the level of disaggregation. And if you select a study area
21 level of disaggregation for the large carriers, what you'll
22 find, at least with the inputs that we've looked at, would
23 say that the local revenues including the interstate

1 subscriber line charges at a study area level for the large
2 major local companies, the revenues are well in excess of
3 forward looking costs.

4 Therefore, from my point of view the interstate
5 access fees -- again, if you pick the model, you pick the
6 inputs and you pick a study area level of aggregation
7 consistent with how roughly 20 to 25 percent of the states
8 don't have disaggregation of the unbundled loop, meaning it
9 is already at a study area level, what I, therefore,
10 conclude, with this interstate aside, because I've included
11 in that analysis. But the carrier to carrier access for the
12 major LEC's is not implicit subsidy.

13 So, from our point of view, given the logic I just
14 laid out, I would say to you, you can -- if you define
15 universal service at the level of disaggregation that I just
16 described, I would say to you that carrier to carrier access
17 fees at the major LEC level, does not include implicit
18 subsidies for local service.

19 And therefore, from my point of view, if you did
20 the kind of things I just said, you can set up a rulemaking
21 tomorrow to aggressively take access costs down with the
22 logic that I just laid out.

23 CHAIRMAN KENNARD: Thank you, Mr. Lubin. Mr.

1 Brown?

2 MR. BROWN: Well, it might not surprise you that
3 I'm going to disagree with Joel.

4 CHAIRMAN KENNARD: That's why I asked both of you.

5 MR. BROWN: I think it's a fairly simple problem.
6 For generations, decades at least, we have been subsidizing
7 local service with long distance services. At divestiture,
8 that subsidy got rolled into access charges. At the access
9 reform decision a year ago, the Commission set a target to
10 reduce access to forward looking costs and estimated that
11 was a reduction of \$18.5 billion dollars.

12 Now, if you run the map, that \$18.5 billion
13 dollars is roughly \$10 per residential line per month of
14 support. Let me come at it from a different angle. If you
15 take the same study I used to build the chart you have in
16 the package using the staff common inputs, the average cost
17 per residential line is \$26 per month. And I don't know
18 what the average residential rate is, but you know, 15 to 18
19 seems ballpark to me. So, there's -- you know, we've got
20 that \$10 per month that, you know, over time, through the
21 separations process, very deliberately at Ozark and
22 Chattanooga and all the other places where the separations
23 evolved, it was put in there.

1 Now, what we've got to do is move it out. And as
2 I mentioned, you know, Commissioner Wood has suggested a
3 phased approach. I think at some point, you know, we have
4 to do one of two things. Either remove it and replace it
5 with explicit support, or you know, maybe it's okay for
6 access charges to have a higher margin.

7 For example, in talking to the people that are
8 running the Media One competitive venture in Atlanta, they
9 tell me that one of the single most important drivers in
10 building a facility-based network, is to be able to bypass
11 Bell-South's access charges. So, don't take them down
12 because that's going to take away our incentives.

13 So, we don't have to pull it out. But as I
14 mentioned in my comments, I think we have to take a reasoned
15 approach to managing it as we go forward.

16 CHAIRMAN KENNARD: Well, certainly, you mentioned
17 that access charges are subsidizing local rates. Certainly,
18 some of that subsidy is coming from intrastate subsidies,
19 business to residential and vertical services, intrastate
20 toll. How do we get a handle on the percentage of subsidy
21 from interstate access versus the intrastate portion of the
22 subsidy?

23 MR. BROWN: Okay. On the loop plan, that's

1 allocate 75 percent to the state, 25 to the Federal
2 jurisdiction. So, I think, you know there was some
3 intuitive logic in the 25/75 split. The problem comes for
4 some states -- and I should mention that some states can
5 solve that 75 percent problem very well themselves. But in
6 other states, I think panelists said where you've got large
7 numbers of high cost customers and no major urban area that
8 gives you lots of low cost customers to spread it over.

9 Take, for example, North Dakota. We've got 21
10 cents a minute intrastate toll rate. We've got 7.6 cents
11 per minute access rate on each end. We've got business
12 rates at three times residents rates. That's where the
13 support is coming from. That's where the vulnerability is
14 because a lot of those are bought by business customers.

15 So, if you were to pile that on the North Dakota
16 customer, that's where you get the spike like I was showing.
17 South Dakota is in a similar situation. They've got similar
18 demographics. And the states that don't have this large
19 mass of low cost customers to spread the cost over, that we
20 need some more help from the Federal jurisdiction.

21 CHAIRMAN KENNARD: Okay. Mr. Weller, did you want
22 to get in here?

23 MR. WELLER: Mr. Chairman, if I could just add

1 something. I think I mentioned earlier that like most
2 economic problems, this one has constraints. The numbers in
3 this chart have to add up and make sense relative to one
4 another.

5 The only way out of that fix is to assume a
6 different cost level. And that's basically what Mr. Lubin's
7 done. For example, we've done a study of our serving area
8 in Texas. If we were to take UNE rates at the levels
9 predicted by the HAI model that Mr. Lubin was using to make
10 his statements about profitability of local service, and if
11 GTE were to sell its entire current output at those UNE
12 rates, our revenue would fall by about 57 percent compared
13 to where it is now.

14 So, that means -- Mr. Lubin's statement may be
15 correct if you're willing to assume that the overall level
16 of costs in the industry will somehow magically fall by half
17 or two-thirds as a result of the FCC adopting an order. I'm
18 not sure that that's a reasonable assumption.

19 Let me also note that if we do a study on
20 individual customer segments by the amount that they
21 purchased from us, and if we now assume, say, a CLEC coming
22 into that same serving area in Texas, and buying UNE's at
23 the interim rates that have been approved by the Texas

1 Commission, 78 percent of the residents customers that we
2 serve today would not cover their costs, even if we include
3 all the revenues from all the services that those customers
4 buy, and if we use those UNE cost rates which are
5 substantially below our current costs as the CLEC's cost
6 level.

7 CHAIRMAN KENNARD: I'd like to give Mr. Lubin an
8 opportunity to respond, and than we'll move to one of my
9 other colleagues here. Mr. Lubin?

10 MR. LUBIN: Thank you, Chairman. Dennis is
11 absolutely right in terms of a key component of what I said.
12 And that is, in Glenn's statement, he used a number of \$26
13 for the cost of local service. Dennis refers to you need
14 some kind of something to check to. And I presume that's
15 kind of embedded costs.

16 And what I have said is not predicated on embedded
17 costs. Absolutely, unequivocally correct. It is based on
18 an estimate of forward looking costs of local service. And
19 when you do that, lo and behold, you don't get this huge,
20 huge dilemma for the major LEC's.

21 And that's why, in my humble opinion, what the
22 condition did May of 1997 when it had an access reform order
23 that talked about a market-based strategy, it basically had

1 a potential solution to the dilemma that said, "Make local
2 exchange competition work. Create the unbundled network
3 elements. Go through and do everything and make the
4 operating systems support a reality."

5 You create universal service using forward
6 looking. And you don't have to have a zero sum, as Dennis
7 would talk about, which would create a huge, huge fund. But
8 you create the soft-landing approach that says, "Hey. Allow
9 competition to enter, and then if there is a drain, it will
10 occur, theoretically, slowly."

11 And by the way, they'll be in other businesses
12 because they would have presumably met the checklist. The
13 problem and the dilemma is, it isn't working. That doesn't
14 mean you should walk away and use embedded costs. I would
15 urge you still to continue to use forward looking.

16 But now, you come into the square dilemma that I
17 posed. And that is if you do use forward looking, which is
18 what I urge you to do to create a USF, what do you do in
19 terms of access, because my assertion is you can take access
20 down immediately. And then the issue is, okay, are you
21 going to take \$6 billion? That's Dennis's number earlier,
22 or \$10 billion out of the system immediately.

23 And I think we need to debate that, because when

1 people say to me, "Hey. Competition and the business is
2 there," and we're draining their profits and their revenues,
3 I don't see it. I see interstate rates of return that each
4 year have been going up in a significant amount. Even last
5 year when there was a July 1997 \$1.5 billion taken out
6 because of the higher productivity factor reinitialized to
7 '96, \$1.5 billion taken out of the system.

8 What I see in April of 1998 showing that 1997 rate
9 of return is a rate of return that was approximately, six,
10 seven, eight percent higher than it was last year. And for
11 some companies, it was probably 10 to 15 percent higher
12 hitting 20 and 22 percent.

13 And so, from my point of view, which is the point
14 earlier that says, "You know, can take some steps." And I
15 think the step is decide the tool, decide the inputs, decide
16 the level of aggregation, make that decision, but you don't
17 have to implement it immediately because this competition
18 isn't working the way in which it was envisioned. Thank
19 you.

20 CHAIRMAN KENNARD: Thank you, Mr. Lubin. I want
21 to go back to one of my opening themes which was follow the
22 money, because, obviously, somebody has to pay for these
23 subsidies. And that somebody is the American consumer. So,

1 we have an obligation to make sure that that subsidy is used
2 in the most efficient way possible.

3 I've proffered some principles on universal
4 service, which really, fundamentally, are about that.
5 Making sure that the subsidy is used in the most efficient
6 manner. That we're not overfunding universal service.

7 Now, Mr. Lubin has proffered a way of doing that,
8 a forward looking cost methodology. I'd like to know if any
9 of the other of view have an alternative way of funding
10 universal service that is not using a forward looking cost
11 methodology, that still satisfies the principle of insuring
12 that these subsidies are used in the most efficient manner
13 possible.

14 Mr. Bush?

15 MR. BUSH: Let me -- Mr. Chairman, let me try.
16 First off, our particular proposal from the state
17 perspective, involves the use of a forward looking model.
18 We propose the utilization of a forward looking model
19 compared to the actual price that the consumer pays for the
20 universal service service set, as sizing the total universal
21 service fund. And it's a large fund. And indeed, as Dennis
22 has indicated before, we have a large fund today. I mean,
23 it's embedded in our implicit rates.

1 The issue for the -- that we believe for the
2 Commission to deal with is how to size the interstate
3 component, the amount of support that the interstate
4 jurisdiction will provide. Our argument there is to take as
5 a starting point the combined CCL, pixie and the existing
6 explicit support that is currently in the system, translate
7 that into a support mechanism that than flows to the states.
8 The states can than flow that to the truly high cost wire
9 centers, providing a specific portable interstate component
10 to offset the state burden.

11 CHAIRMAN KENNARD: Mr. Shiffman?

12 MR. SHIFFMAN: Thank you. The lynch pin of the ad
13 hoc approach is its ability to net high and low cost areas
14 within any given state or study area. And to that extent,
15 it does not Federalize or require additional Federal funding
16 for those areas where the state has the ability throughout
17 their internal rate structure to provide service at
18 affordable comparable rates to high cost areas.

19 And in some ways, our approach is similar to the
20 Bell-South approach. That they made the comment that most
21 of the universal service support in the country is not
22 explicit, but it's implicit within the internal rate
23 structures of any given company.

1 What we're proposing to do is keep that support
2 within the intrastate rate structures of any given company.
3 And on the state level, have states make that support which
4 is now implicit, explicit but competitively neutral, but
5 only to provide the Federal support where the state, when it
6 balances its own high and low cost areas, comes wanting and
7 needs funds from outside the state jurisdiction to meet the
8 comparability test meant by the Act.

9 CHAIRMAN KENNARD: Let me just follow up briefly
10 on that comment. I'm familiar with your proposal, and I
11 think it has a lot to commend it. But I'm also familiar
12 with your efforts to try to get more state support for it.
13 And I understand that it has not been embraced by a number
14 of states. Can you give us a sense of sort of what the
15 dynamic is, how that breaks out? Why some states are
16 supportive and others are not? And again, follow the money.
17 Who pays? Who's advantaged, and who's disadvantaged?

18 MR. SHIFFMAN: Let me just actually follow the
19 money. And I guess I can look at the U.S. West plan versus
20 the ad hoc plan.

21 The ad hoc plan benefits those states with
22 uniformly above average costs, but which are not -- don't
23 have costs that are heavily skewed. And by heavily skewed,

1 I mean there are states like California which have some very
2 high cost areas in the Sierras, but moderately very low cost
3 in the urban areas. There are states like Colorado who have
4 very high costs in the Rocky Mountains and in eastern
5 Colorado, but relatively low cost in Denver.

6 Those states would make out very well under the
7 U.S. West approach of a high benchmark, because they have
8 some very high cost areas. They're above the benchmark.

9 There are other states in the Appalachians and
10 primarily in the Appalachians and other areas of the
11 northeast, some in the midwest, who do not have very high
12 skewed costs, but they have relatively high costs
13 everywhere, but not in the astronomical level. Maybe they
14 have costs in the \$49 levels, but they don't have any costs
15 that are very low in the \$10 level. And they don't have any
16 costs in the \$100 level.

17 Those states will not get sufficient support under
18 the U.S. West approach unless the benchmark is sufficiently
19 low as to have a very high fund. So, if you look at who is
20 supportive of the various plans, those states which have --
21 which are high cost -- relatively high cost, but are
22 relatively high cost all over the place, but who have very
23 few low cost areas, have been supportive of the ad hoc

1 approach.

2 Those states which understandably will not get
3 anything, which will have to create most of their explicit
4 subsidies to replace their implicit subsidy in the state
5 plan, don't find the ad hoc approach very attractive because
6 it will not provide a lot of Federal dollars.

7 You're absolutely right. You follow the money and
8 you see who is benefitted by the ad hoc approach, who is not
9 benefitted by the U.S. West-type approach. And that's who
10 we've got.

11 The other important thing is that we surprised a
12 lot of people but we have the one low cost state or
13 relatively low cost state in New York supporting the high
14 cost approach. And part of the reason why, I believe,
15 they've signed on with us, is that they believe the fund
16 should be relatively small, there not should be significant
17 dollars exported.

18 But I think they also realize that of the plans
19 that provide for a small fund, that the ad hoc plan is the
20 only one that provides sufficient dollars to those high cost
21 areas like Maine and Vermont and West Virginia. And that
22 the U.S. West approach attempts to make a plan, which is
23 relatively small, by raising the benchmark. But in the

1 process of doing that, they don't provide sufficient funds
2 to the outlying states. And for that reason, I think they
3 recognize that the U.S. West approach to provide enough
4 money for Maine or Vermont or West Virginia, would result in
5 a plan which would be too -- which would have too high a
6 price tag.

7 So, I guess it's the combination of meeting both
8 criteria, sufficiency and efficiency. And I think they
9 recognize looking at our -- at the various approaches that
10 are out there that only the ad hoc approach both balances
11 both a sufficient plan in a deficient size.

12 CHAIRMAN KENNARD: Thank you. I'd like to hear
13 from some of my other colleagues. Commissioner Ness?

14 COMMISSIONER NESS: Thank you, Mr. Chairman. How
15 many of you -- this is going to be a quiz. Okay?

16 How many of you believe that one of the
17 significantly distinguishing characteristics of your plan is
18 to put downward pressure on cost, given that it is a
19 declining cost industry, which we're all engaged? Can I see
20 a show of hands? Okay. All right.

21 How many of you believe, similarly, that your plan
22 would significantly spur efficient, not efficient
23 investment? Okay. You guys really believe in your plans.

1 Okay.

2 How many of you believe that your plan is
3 competitively neutral and the funding comes from
4 competitively neutral sources? Well, this is getting
5 interesting. Okay. Let's put it this way. Is there
6 anybody who disagrees with any of those top things? Now, be
7 honest about it.

8 CHAIRMAN KENNARD: Let's put them under oath.

9 COMMISSIONER NESS: All right. There we go. I'll
10 throw a wild card in here. How many of you have factored in
11 wireless solutions into your equations? A couple of --
12 questionable answers there. Okay.

13 How many of you believe, fundamentally, that the
14 high cost fund should fund the lines to Ted Turner's ranch?
15 And Time-Warner, you don't have to answer that question.
16 Okay. There was no one who believes that the high cost --
17 yes. Okay. GTE, Mark Cooper believes that it should be.
18 Bell South, the ad hoc committee, that we should be -- Jim
19 Sichter from Sprint. Okay. That we should be funding the
20 lines to Ted Turner's ranch. Okay.

21 MR. SICHTER: Depends on how much.

22 COMMISSIONER NESS: Okay. How many of you believe
23 that the funding should be based on both interstate as well

1 as intrastate, or intrastate as well as interstate revenues?

2 MR. BROWN: Together or separately?

3 COMMISSIONER NESS: That we should be tapping from
4 the Federal fund -- that we should be tapping both the
5 intrastate as well as the interstate revenues. Show of
6 hands. Okay. GTE believes that's the case. Bell-South
7 believes that's the case.

8 MR. WENDLING: Colorado Commission goes on the
9 record. We have a footnote to that.

10 COMMISSIONER NESS: Okay.

11 MR. SHIFFMAN: The plan -- our plan doesn't do
12 that, as Maine and Vermont have so said. As individual
13 states, we believe it.

14 COMMISSIONER NESS: Okay. Did I see any other
15 hands? Sprint believes that it should be for both. And I
16 believe your testimony reflects that. AT&T?

17 MR. SICHTER: Inter only. But it's a function of
18 how big the account is.

19 COMMISSIONER NESS: Okay.

20 MR. SICHTER: If the fund gets huge, than it's a
21 different answer.

22 COMMISSIONER NESS: Okay. How many believe that
23 we should look at the revenue generated by the lines, not

1 just the cost of the lines in determining how much should be
2 funded? Okay. We have CFA. We have Time-Warner. We have
3 AT&T. Anyone else? We have Colorado Commission.

4 MR. WENDLING: Just Colorado.

5 COMMISSIONER NESS: Okay. And the others believe
6 that it should only be based on costs so that if you can
7 generate a tremendous amount of money from vertical services
8 from the lines, from other data services or other services,
9 that that should not count towards the determination as to
10 whether or not the lines should be supported. GTE, you have
11 an answer on that.

12 MR. WELLER: The problem is that it's not all the
13 same revenue from the same lines. If everybody bought
14 the -- exactly the same mix of services, I think you might
15 get away with doing that. You'd send bad price signals, but
16 the system would be sustainable. But the distribution is
17 very highly skewed. You have high and low income people,
18 both all buying toll and access services. Nationwide, I
19 think 45 percent of the bill of people whose incomes are
20 below \$10,000 is toll.

21 COMMISSIONER NESS: Okay.

22 MR. WELLER: But it's still true that the majority
23 of customers, the 78 percent that I mentioned don't buy

1 enough of that stuff to get up to some average benchmark
2 that you had said. So, if you do it that way, you wall off
3 78 percent of the customers from competition.

4 MR. COOPER: Commissioner, could I respond on the
5 other side?

6 COMMISSIONER NESS: Okay. Let me get U.S. West
7 first, than if you would respond. Go ahead.

8 MR. BROWN: In our plan, we focused more on the
9 affordability and for the high cost area we set it high
10 enough so that revenue benchmark almost becomes irrelevant,
11 because the first cut in the Commission's May order had it
12 about \$31. And if we're -- you know, if we -- if
13 affordability is above that, than it becomes a moot point.

14 COMMISSIONER NESS: Okay.

15 MR. COOPER: It's quite clear that for several
16 decades now, we have been using all of these revenues to
17 create just and reasonable rates at the state level. So,
18 when every state commission decides rates that look at
19 vertical services, they say, "We count that in. And those
20 rates are just and reasonable. We've included call waiting
21 and other kinds of revenues." So, it's clear that the
22 notion that they can't be relied upon is simply not a legal
23 fact. They can be relied upon.

1 Second of all, I'll be perfectly willing to
2 identify the lines that don't generate enough when you
3 include all the other revenue and fund them through
4 universal service. That was the logic of 3151. And that's
5 fine. We don't quibble with that.

6 The difficulty is the chart he keeps showing you
7 where he's got the big shortfall, he's included 100 percent
8 of the loop costs in that chart, which is contrary to your
9 assumption, and I believe the correct policy.

10 COMMISSIONER NESS: Okay. Yes, Mr. Shiffman.

11 MR. SHIFFMAN: There's some confusion about the
12 counting of revenues from vertical services or not. And
13 that is one of the reasons why the ad hoc approach does not
14 appear -- does not use a revenue benchmark at all, but uses
15 an average state cost benchmark -- an average national cost
16 benchmark. By using average costs, you're implicitly
17 recovering all revenues that are recoverable from those
18 services that provide those facilities.

19 So that, for example, if you're looking at Maine
20 versus the national average of Vermont versus the national
21 average, you're not excluding vertical service revenues.
22 You're essentially assuming that the mix of vertical
23 services coming in from each state that is the same as from

1 another state. And you're not assuming a way or including
2 explicitly those revenues, but you're not excluding them
3 either.

4 COMMISSIONER NESS: Okay. Last comment on that?

5 MR. BROWN: I'd just like to add one thought. And
6 that is, if you do include them in a benchmark, than you
7 have to make certain that the cost model that you use
8 includes the cost for those. Now, in HAI model and the
9 BCPM, we have tried to get kind of a bare bones, so if we
10 put more of the vertical in, that's another consideration
11 that has to be taken into account.

12 MR. COOPER: I have no comment.

13 COMMISSIONER NESS: Okay. Last question, and that
14 is for me, at least. Who believes that the FCC has the
15 authority, when the statute says that contribution to
16 universal service should be from all telecommunications
17 carriers serving interstate on a competitively neutral
18 basis, that we can impose a end user fee in lieu of charging
19 specific categories of carriers for universal service.

20 Does anyone support that position? You believe
21 that we can statutorily do that, and that that would be
22 sufficient with respect to carriers contributing to
23 universal service.

1 MR. WELLER: Yes. I believe if you could
2 establish a fee as the mechanism through which the carriers
3 would recover their contributions, ultimately, the carrier
4 contributions have to come from somewhere. And the more and
5 clear and explicit those contributions are, the better, I
6 believe.

7 COMMISSIONER NESS: If one were to -- I kind of
8 fibbed out it being my last question. But following up on
9 that question, if one were to impose an end user charge,
10 what would put downward pressure on the amount that would be
11 imposed? In other words, how could that be computed away?
12 Would it be competed away, or could it be computed away?

13 MR. WELLER: Commissioner, several ways. First, I
14 think that you haven't taken the money out of the system.
15 You've attached it to a different transaction. Today it's
16 attached to access transactions, but the cost is really
17 determined -- generated by local service. So, what you've
18 done is you've take the money and you've attached the
19 universal service support to the local service transaction,
20 and the support's portable. So, I lose local customers, I
21 lose that money, which I should do, because it's the money
22 that supports those local customers.

23 What shouldn't happen is for me to lose the

1 revenue that supports the local customers when I lose access
2 minutes which is what's happening today.

3 The other thing I'd mention to you is that, as you
4 remember, I've also proposed that the support amount itself
5 not be left as static. I think that a competitive bidding
6 process over time is the way to make sure that we have --
7 you've heard enough different opinions around this table, I
8 think, to know one thing for sure, which is that you're not
9 going to get exactly the right number when you finally do
10 this. So, just in case we're wrong about this, we need to
11 have another mechanism that will enforce market discipline
12 on an amount. And I think competitive bidding is the way to
13 do that.

14 COMMISSIONER NESS: Mr. Cooper, did you want to
15 respond?

16 MR. COOPER: I think we know that auctions don't
17 always produce the right number. It depends on who's
18 available, which competitors can enter the market. I'm fine
19 with auctions after there's competition, but not before.

20 COMMISSIONER NESS: Thank you, Mr. Chairman.

21 CHAIRMAN KENNARD: Chairman Johnson?

22 MS. JOHNSON: Yes. My question is directed back
23 to some of the questions that Mr. Lubin made, and perhaps,

1 Mr. Brown, you'd like to follow up.

2 Mr. Lubin, I guess under your analysis of what
3 truly costs to serve are one, you've concluded that the
4 revenues generated from R-1 plus CLEC covers costs,
5 generally. And that we could, in fact, reduce access by --
6 substantially, immediately, and the world would be a better
7 place.

8 Now, let's go to your world being a better place.
9 So, what would that mean? And I don't mean to be flippant,
10 but how will rate payers benefit? Who guarantees a flow-
11 through, or will it be flow-through, or is there an
12 obligation to flow it through? Could you respond?

13 MR. LUBIN: Sure. First of all, let me just ask
14 one question. R-1 -- what is that?

15 MS. JOHNSON: Residential -- I think residential
16 service. I'm sorry.

17 MR. LUBIN: Right. Okay. All right. I want to
18 clarify something and then answer the specific question.

19 When we -- when I cited in my comments and then
20 restated, and I said that if I look at the major LEC's and I
21 look at the 69 -- I think it was 62 of 71 study areas had
22 revenues in excess, that was looking at all revenues in
23 terms of residents and business.

1 MS. JOHNSON: Okay.

2 MR. LUBIN: My belief is if I structured it, just
3 for residents, you would see a similar thing, but you
4 wouldn't see \$23 billion. You would see still a number
5 that's greater.

6 MS. JOHNSON: I'm sorry. You said you would still
7 see a number that's greater?

8 MR. LUBIN: I believe the answer is yes, you'd
9 still see -- but the \$23 billion was really driven because
10 business was included in that, and they looked at all local
11 revenues including the interstate subscriber line charge.

12 The answer to your specific question in terms of
13 follow the money and who will benefit, my view is
14 ultimately, the consumer is going to benefit because those
15 monies are going to be flowed through to lower prices for
16 the consumer. And so, that's what I would expect to happen.
17 That's what I would strongly see would happen.

18 MS. JOHNSON: Is that happening now?

19 MR. LUBIN: In my opinion --

20 MS. JOHNSON: With respect to access going down?

21 MR. LUBIN: Yes. With regard to AT&T, that's all
22 I can speak for, is that we have continued to see that our
23 revenues have declined significantly more than the access.

1 We've seen that for the last several years, and we expect to
2 see that on a continual basis.

3 So, the bottom line in terms of who benefits, I
4 believe the consumer will benefit. And I believe the
5 consumer will benefit by billions of dollars.

6 And by the way, I think ultimately, all of that's
7 going to stimulate the pie so that the pie is simply bigger
8 and bigger and bigger.

9 MS. JOHNSON: Is there a check and balance, or is
10 there a mechanism by which the FCC can measure or the states
11 or some regulatory body could measure the flow-through?

12 MR. LUBIN: Well, what we've done up to this point
13 in time is respond to a Chairman letter that asked us, in
14 terms of what has happened. We responded and showed that
15 the revenue net of access has declined, at least for AT&T,
16 significantly above and beyond access.

17 MS. JOHNSON: Should a regulatory body, FCC,
18 states, be able to structure or require certain reduction,
19 that the flow-through certain percentage must be applied to
20 residential customers? Certain percentage should be applied
21 to R-1 customers? Should we be able to do that? Or can
22 regulators do that, either Fed or states? And if the answer
23 is yes, should they be able to do that?

1 MR. LUBIN: It's always hard for me to say what a
2 regulator should and shouldn't do or what the legal
3 ramifications are saying one should or shouldn't do. Since
4 I'm not a lawyer, I can't attest to the legal ramifications
5 of that. But in terms of the spirit of the question, it
6 seems to me that we have over the last -- I don't know, 10,
7 15 years, moved to create competition in the LD marketplace.

8 And someone earlier said -- I think it was
9 Commissioner Power, who at least alluded, at least if I
10 understood it correctly, is that competition gets to be a
11 very messy process. And when you're in a competitive
12 marketplace, prices move toward costs. And as they move
13 toward costs, then we access reductions. My view is those
14 will get flowed through. And as you see more and more
15 competition, at some point you may see in certain particular
16 areas, prices move up.

17 And I'm not suggesting right now that an IXE is
18 going to raise prices. All I'm saying is competition is an
19 extremely messy process. And ultimately, it seems to me
20 some questions should be asked in terms of -- you know, what
21 are the most efficient ways of recovering some of these
22 costs? And when I talk about efficiency and sufficiency of
23 collection, efficiency of distribution, we talk about an end

1 user surcharge.

2 Other people talk about other mechanisms to do it.
3 But the question is, what's most efficient, and where should
4 the regulator be spending his or her time in terms of trying
5 to create competition?

6 From where I sit, I see all the long distance
7 companies. I see the revenue per minute declines on both
8 business and residents, in the aggregate at least for AT&T,
9 continually dropping of revenue per minute by billions of
10 dollars, in excess of access.

11 My hope is that with your finite resources, that
12 we try to figure out how to create local exchange
13 competition and implement the rulings that have come out in
14 August and in May of last year to try to create local
15 competition. You know, sometimes I wake up in the morning
16 and I say, "You know, we've got this huge debate. You know,
17 is all the access being flowed through?" And I'm not
18 suggesting this, because right now I don't have authority to
19 suggest it.

20 But sometimes I wake up and I say, "Goodness
21 gracious. We've got all these issues, universal service,
22 local exchange competition." Sometimes I ask myself, "Are
23 we just better off putting access on the bill and just

1 letting that be on the bill? And as access comes down or
2 goes up, just let it rip in terms of lower access."

3 Now, my fear is if that if somebody ever did that,
4 you know, they would see rates in terms of various parts of
5 the country that people really wouldn't want to see. And
6 so, you know, I wake up sometimes saying, "Boy, I wish I
7 could get out of this dilemma and this food fight." And
8 that's how I see getting out of it.

9 And then I say, "But you know, if people really
10 wanted to do that, you know, are they willing to accept the
11 consequences of those actions?" Because, you know, in
12 certain areas, it would really look nice. In other areas,
13 it wouldn't look nice, because currently access is
14 significantly de-averaged in this country.

15 MS. JOHNSON: Well, one of the points that Mr.
16 Brown raised as we look at this, and you're right. The
17 competitive market can give us some surprises. And as we
18 transition into a competitive market, what should be the
19 role of the legislator -- or regulator? Mr. Brown had
20 suggested, "Well, maybe we shouldn't be so concerned about
21 getting access to cost immediately, because having higher
22 access will actually promote innovation and creativity and
23 the market, and people will want to build these facilities."

1 As a transitional step, maybe we shouldn't go directly to
2 costs because maybe that will be your distance in it.

3 Could you respond to that?

4 MR. LUBIN: Wonderful question from my point of
5 view. And it's a tough question because it basically gets
6 to the heart of, how do you want to manage the public policy
7 issues? And you know, in May of 1997, the Commission came
8 out with an order, a set of orders that addressed USF and
9 access, and said, "Hey, let's go to that soft-landing
10 approach, and let's get this checklist implemented." And
11 thereby, giving everyone the opportunity of buy unbundled
12 network elements disaggregated, and maybe even matching USF
13 consistent with the level of geographical deaveraging of the
14 loop, and let's be on with it.

15 Quite candidly, I thought that was a very rational
16 approach. The dilemma is we put all of our eggs in one
17 basket. That is, the basket of making the checklist truly
18 operational. And for whatever reason, it's hard to
19 legislate cooperation or to regulate cooperation. And I'm
20 not saying anybody's doing bad things. It's just hard.

21 And my bottom line is, it's not working. And so,
22 now you say, "Well, should I -- it's not working. Local
23 competition isn't working. Should I keep access umbrella

1 high to create the incentive? But what's the incentive if
2 the piece parts aren't truly operational. What you do is
3 the small CLEC will come in and slowly enter the market, but
4 it's years and years. And so, I come back to the Chairman
5 in terms of follow the money. You know, people will say,
6 "Well, you're just going to pocket the money, and you're not
7 going to flow it through." You can debate that.

8 But my view is follow the money and get it into
9 the consumers hands sooner rather than later, and from my
10 point of view, again, the key most critical area in terms of
11 defining USF is the level of aggregation. If you go to the
12 study area, my view is you're going to see a small fund. If
13 you go below that, you're going to see, potentially, a
14 larger fund. And then, bottom line is from my point of
15 view, is to get access prices down, consumers will be far
16 better off.

17 Sorry for taking the time.

18 CHAIRMAN KENNARD: Could I just tie one thing down
19 from your answer, Joel? Am I to take from that response on
20 flow-through, that you're not flowing through access
21 reductions on a proportionate basis? That you're flowing
22 them through, but you're not flowing them through to the R-1
23 consumers, necessarily?

1 MR. LUBIN: No. I'm glad you clarified the
2 question. And my answer is and what we have shown is that
3 we're flowing through more than the access reductions that
4 we see. And my view is, that has been true for the last
5 several years. In my view is the residential market also
6 has seen access reductions and seen the benefit of those
7 reductions. But when I said in aggregate, the aggregate --
8 I can't remember the number offhand. But the letter I think
9 we highlighted was well in excess of a billion dollars.

10 I will say that this proportion amount of that in
11 excess of the access reductions went into the business-side
12 of the equation, but that isn't to say their fair share.
13 And I would also highlight to this Commission and the Joint
14 Board members, is that when we got price caps in the --
15 whenever -- I lost track, the mid-80s, late '80s, what we
16 found is the price cap was disproportionately lowering the
17 residential side of the equation.

18 That isn't to say, you know, that's bad or good.
19 That's just simply to say, make the observations that when
20 there was regulation in the heavy hand even though it was
21 price-capped, the way in which it was implemented
22 disproportionately lowered that into the residential
23 marketplace. But my view is -- bottom line is, well in

1 excess of access in both for business and residence, but
2 disproportionate to business.

3 CHAIRMAN KENNARD: Thank you. Commissioner
4 Furchtgott-Roth?

5 COMMISSIONER FURCHTGOTT-ROTH: Thank you, Mr.
6 Chairman. This has been just a wonderful session. I've
7 learned a lot. And I see we're probably going to miss our
8 break for lunch. But I will keep my comments very short.

9 In part, because in setting up this meeting, I
10 know Chairman Kennard was very sensitive to the concerns of
11 the states who very much wanted an opportunity to address
12 questions to the panel that's here today. You've all done
13 just a wonderful and very thoughtful job in making your
14 presentations today, probably more than I have completely
15 absorbed in the past couple of hours. But I look forward to
16 trying to absorb them more in the coming weeks.

17 I just want to make a couple of points. There are
18 too many of you for me to ask questions, and while I'm
19 attempted to follow Commissioner Ness's lead, I'm probably
20 not as good at asking the questions.

21 I hope all of you will leave today with two
22 salient memories. One is that you addressed your comments
23 to presentation before both Federal and state commissioners.

1 And that a lot of the issues related to high cost ultimately
2 involved consumers. They ultimately involved consumers in
3 local telephony.

4 And the first point of Government oversight of
5 local telephony is today. And I think what will remain in
6 the dim and distant future, state regulators. It is to them
7 and probably not to the Federal Communication Commission,
8 that consumers will look first on matters of local telephone
9 service. And frankly, just probably to the state regulators
10 that telephone service providers will look first on matters
11 of local telephone service.

12 We have a very difficult job before us, both at
13 the Federal level and at the state level. I would urge all
14 of you to work closely both with the Federal and state
15 regulators. We've heard today presentations of 11 different
16 plans, each of which, frankly, have a lot of merit.

17 At the end of the day, I am not at all certain
18 that a single plan is going to be the best for every state
19 or is going to be the best for every consumer. And it's
20 quite possible that different states may, ultimately, adopt
21 different plans. And that is entirely consistent with the
22 Act, which envisions state universal service plans.

23 And I think it is entirely consistent with the Act

1 that those issues need to be resolved before any of the
2 other elements of universal service and 254 can be fully and
3 adequately addressed. Thank you, Mr. Chairman.

4 CHAIRMAN KENNARD: Thank you, Commissioner.
5 Commissioner Schoenfelder?

6 COMMISSIONER SCHOENFELDER: How many questions can
7 I ask? Are we going to have time this afternoon for some
8 questions?

9 CHAIRMAN KENNARD: Yes, we can continue on this
10 afternoon.

11 COMMISSIONER SCHOENFELDER: Because I have
12 several. But one of the things that I'd like to ask all of
13 you who are local exchange carriers is -- and you can answer
14 it one at a time or collectively. But I quite often hear
15 and I've been hearing since we started this process that
16 there's definitely a subsidy flow from business to
17 residential, from business to local, however you want to
18 call that.

19 I want to know if anyone -- and I'm looking at Mr.
20 Brown now and since that's my local RBOC, he's going to get
21 picked on, but I really want to know if anytime during your
22 calculations you've ever taken traffic use or minutes of use
23 into account when you talk about that subsidy flow, because

1 if I am -- and I'm going to use my own state as an example.
2 Citibank in Sioux Falls, South Dakota, and I'm Joe Sixpack
3 on the corner, my traffic is going to be a lot different.
4 And when you calculate, do you ever calculate minutes of use
5 or traffic into that equation, and how you would you do it
6 if you did it?

7 MR. BROWN: In the cost studies that we would file
8 with the South Dakota Commission, yes, usage would be a
9 component. It tends to be a relatively small component
10 because we've switched to large switches. It tends to vary
11 between customers. If you looked at my daughter's
12 residential usage, who's a teenager, you'd probably find
13 that she rivals many businesses. So, there's a mix.

14 But if I were to come to you and present a study
15 for business and residents, it would have the usage built
16 in, based upon averages, of course. And that's one of the
17 problems with studies.

18 In the models that Joel's company and mine and
19 actually several others on this panel have been working on,
20 we tend to look more at what drives high cost. And that's
21 the loop cost. So, there is usage in there but not with the
22 granularity to answer a question like you just asked.

23 COMMISSIONER SCHOENFELDER: Anyone else? Okay.

1 Then, as long as you're in front of me, in your new
2 proposal, what is the size of the fund you're advocating?
3 Can you quantify that?

4 MR. BROWN: Yes. Let me give you some numbers.
5 These are going to be based on the common inputs. When
6 model sponsors filed their models, they had default inputs.
7 And frankly, we haven't looked at the inputs until just now
8 because over the past year, we've been looking at the
9 platform of the model. But the staff, I think, did a very
10 good job of kind of looking at what we had both put on the
11 table, and they came up with what I think are some middle
12 ground estimates, cutting the baby in half, in many
13 respects.

14 If you look and you run the benchmark cost proxy
15 model or at the national aggregate, if you run the HAI
16 model, you come up with a fund of roughly \$4.5 billion to
17 cover 100 percent of the cost above \$31 for residents and
18 \$51 for business. Those are the numbers that were in the
19 May decision.

20 That would say, under the 25/75, the Federal fund
21 would be about \$1.1 billion or 25 percent. When you run the
22 IHCAP or the two benchmark at 30 and 50, what you get is an
23 interstate fund of \$2.8 billion. That is 1.7 higher than

1 existed under the 25/75. And the genesis for that is taking
2 75 percent of all of the costs over 50 dollars and moving
3 them into the interstate jurisdiction.

4 In a sense, it's like the USF works today. When
5 costs exceed 115 percent of the nationwide average, they're
6 removed from the state jurisdiction and moved to the
7 interstate jurisdiction and recovered through the fund.

8 What we're proposing is very analogous to that,
9 and instead of 115 percent, you put loop costs from
10 forwarding looking proxy model at a small area of geography
11 above \$50. But the mechanics beyond that are similar.

12 COMMISSIONER SCHOENFELDER: Let me follow up.
13 Now, we're focusing today on non-rural companies. Are these
14 non-rural numbers?

15 MR. BROWN: This is non-rural only.

16 COMMISSIONER SCHOENFELDER: And so, you still
17 haven't added the rural component into the figures?

18 MR. BROWN: No. But I think the current fund for
19 rural companies -- see, the whole name of the game in
20 universal service funding is targeting to the areas where
21 the high cost customers are. By historical accident if
22 nothing else, and I think it's the reason why a small
23 company is this in many places. They are small. They don't

1 have urban areas to offset costs on, so I think the current
2 funding for the rurals is a reasonable benchmark for what
3 they would need.

4 COMMISSIONER SCHOENFELDER: Mr. Lubin, yes?

5 MR. LUBIN: Commissioner, I'd just like to make an
6 observation in terms of the various plans relative to the
7 current fund. The current fund is about \$1.7 billion.
8 That's the high costs, LTS and DEM. And then you have the
9 various proposals that are being presented, and you have
10 people looking at, calculating at a, let's say a serving
11 wire center or a state average or, if you listen to us, it
12 would be a study area. Just to give you a reference point.

13 The current FCC plan, the 25/75, would probably
14 raise the money by about \$400 million relative to the
15 current plan. If you went to study area instead of serving
16 wire center, it would be roughly comparable.

17 If you look at the majority member plan or the
18 U.S. West plan, what we see is that if you use either --
19 again, the U.S. West Plan or the majority plan, you would
20 still see about a billion dollar increase if you were at the
21 serving wire center. So, instead of 1.7, you're at 2.7.

22 The interesting -- I'll use the word phenomena.
23 This stuff always amazes me -- is that if you use the study

1 area on the U.S. West plan, you come back to roughly the
2 \$1.7 billion number. If you use the majority plan, you come
3 back at a study area level, roughly \$2.2 billion. So, that
4 case would be roughly \$500 million.

5 My only message is that a key, key component are
6 the input parameters and the level of aggregation that you
7 use when you determine the fund, because you can use a level
8 of aggregation that all of a sudden greatly changes that
9 overall level of subsidy.

10 MR. BROWN: But whenever you hear the word
11 aggregation, think implicit support. Think averaging. And
12 the Act says you need to rely less on implicit support. The
13 reason for that is that the urban areas --

14 COMMISSIONER SCHOENFELDER: I don't think the Act
15 says that. I think the Act says that universal service
16 should be explicit. I don't think it says anything about
17 implicit support.

18 MR. BROWN: But in terms of measuring for explicit
19 support is what we're talking about, the competition is
20 going to hit first in the urban areas. You're going to have
21 to reduce your prices toward costs faster there so you're
22 not going to be able to average across the study area as
23 Joel is suggesting when you use study area aggregation.

1 I have concerns even at the wire center, because
2 within the wire center, you've got customers on Main Street
3 that cost \$10, \$20 a month, even in an exchange that might
4 cost on average, \$100 a month. Do we want to throw, you
5 know, a \$70 or a \$50 subsidy at a customer that costs \$10 or
6 \$15 or \$20 a month? I think that -- this whole area of
7 aggregation deserves some very thoughtful consideration.
8 But you can't just change your level of aggregation and not
9 have other consequences.

10 COMMISSIONER SCHOENFELDER: Joel?

11 MR. SHIFFMAN: One thing that I think has been
12 said which is somewhat confusing and might give the wrong
13 idea is that the existing fund with its existing level of
14 aggregation as Mr. Lubin talked about, meets the objectives
15 of the Act.

16 And I guess that's one of the ad hoc's serious
17 concerns is that the existing fund or even if the -- if the
18 FCC went ahead and said, "We're just going to forget about
19 this whole thing. Just leave the fund exactly like it is,"
20 we don't believe that even with that -- notwithstanding, the
21 issue of competition, that the existing fund provides
22 sufficient funds to afford comparable and affordable rates.
23 And the reason that that is, is that -- and we did

1 considerable regarding this.

2 That areas like Vermont and Maine and West
3 Virginia, which have large companies serving predominantly
4 rural areas, get only pennies on the dollar to the extent
5 that their costs exceed the national average, compared to
6 similarly situated states that are served by small
7 companies.

8 And that the combination of 200,000 line problem,
9 the lack of switching recognizing really high switching
10 costs are now being tied to company size, and the lack of
11 anything in the high cost current fund recognizing high
12 interoffice trunking costs, that those three factors put
13 together create a situation where the existing fund, the
14 status quo can't meet the standards and the objectives of
15 Section 254.

16 Although, we've argued in pleadings that the 25/75
17 cannot meet the comparability and affordability objectives.
18 But similarly, that even if we don't change the aggregation,
19 the existing fund, the status quo, cannot comply to comport
20 with the requirements of the Act.

21 COMMISSIONER SCHOENFELDER: Mr. Chairman, I have
22 more, but I'll quite right now.

23 CHAIRMAN KENNARD: Okay. Well, you'll have some

1 more time this afternoon. Commissioner Powell?

2 COMMISSIONER POWELL: In the interest of your
3 schedule, I'll be happy to defer my questions until later.

4 CHAIRMAN KENNARD: Okay. Thank you. And with
5 that, why don't we take our lunch break, and we'll reconvene
6 here at 2:30. Thank you all very much.

7 (Whereupon, at 12:45 p.m., the meeting recessed,
8 to reconvene this same day, Monday, June 8, 1998, at 2:30
9 p.m.)

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1 MS. HOGERTY: Yes.

2 MR. LUBIN: Okay. I appreciate the question
3 because some people ask us, have we changed our position
4 with regard to the proxy tool? And our answer to that is
5 no. We would hope, quite candidly, that the Commission make
6 a decision on the proxy tool. We think the Hatfield, HAI,
7 tool is a very flexible tool. We think it's very open. And
8 it's using information that's public such that as more
9 public information becomes open, you can modify and update
10 the answers if better data becomes available.

11 It's also a tool that attempts to geocode the
12 locations such that it's looking at a hundred million
13 customer's specific locations, and it's attempting to
14 geocode as many of them as humanly possible. Geocoding
15 simply means looking at latitude and longitude of a customer
16 location.

17 All that being said, we think it's right, quite
18 candidly, to make a decision on the proxy tool. We would
19 hope that it would be the Hatfield tool.

20 Where there is a difference in terms of what we
21 have said in the past, I'll say a year ago versus today, is
22 given the state of local exchange competition, we would
23 suggest that the level of aggregation be the study area,

1 again, because we don't see UNE's disaggregated at a wire
2 center, or some states only have one unbundled network
3 element rate. And so, I want to separate the issue of
4 aggregation versus selection of a model, and a proceeding
5 that I believe the FCC has under way in terms of trying to
6 figure out what are the other input parameters to go into a
7 model that hopefully is open and people could evaluate, et
8 cetera.

9 All that being said, the next question we said is,
10 "You know what? Even if you pick the proxy tool, even if
11 you select study area, you really don't have to implement
12 this until you see local exchange competition." And so, the
13 final, at least the question I think I'm hearing you, you
14 know is, when is that?

15 We've identified a set of metrics that we have put
16 in our May 15 comments that would suggest, from our point of
17 view, is again, the Commission has a series of orders trying
18 to implement unbundled network and OSS's, et cetera, because
19 we would hope those things get implemented. And that,
20 ultimately, now a test we would say is, "Okay. Get it
21 implemented." Once we see some penetration, I think we've
22 put in a number of 15 percent penetration. That's
23 indicative that this process is working.

1 But we would even go one step further in our
2 comments. We said that, "By the way, even if you lose 15
3 percent, there's still may not be an earnings problem, and
4 you ought to evaluate whether there's truly an earnings
5 problem before you implement." And we suggested that the
6 earnings problem could be evaluated based on the FCC's low
7 end adjustment on price cap regulation.

8 So, those are the things we have said in the
9 record.

10 MS. HOGERTY: Okay. And you've also said that,
11 based on your study, you believe that local revenues when
12 you look at all the revenues, are greater than the forward
13 looking costs in those areas as you have aggregated --

14 MR. LUBIN: Yes. For the major local companies,
15 we have put in the record, we --

16 MS. HOGERTY: For the large companies?

17 MR. LUBIN: Right. Sixty-two out of seventy-one
18 study areas, that is true when you include local revenues
19 including the interstate subscriber line charge.

20 MS. HOGERTY: Okay. And from that you have said,
21 therefore, access is not necessarily a subsidy.

22 MR. LUBIN: Correct.

23 MS. HOGERTY: Well, what is it?

1 MR. LUBIN: Well, I mean, you can hear Lubin's
2 view or AT&T's view is that we think there's a lot of excess
3 that is in access. We would urge the FCC to immediately
4 lower those prices, set a proceeding. We believe that the
5 productivity factor, even though it's at 6.5, and we commend
6 the Commission for going up from where it was to 6.5. We
7 think using the own FCC data, could support a 9.3 or 8.4
8 percent productivity offset, reinitialize that to 1995 would
9 produce approximately \$3.8 billion access reduction. And we
10 think the UNE data would support that.

11 We also think, based on the record, in terms of
12 what the local exchange companies filed in April of 1998,
13 suggest that their rate of return each year has been going
14 up by a significant amount even after each year money is
15 taken out of the system. And the last it was, the aggregate
16 rate of return was over 15 percent. Some LEC's it's 20
17 percent.

18 And that's what happens. And I'm not saying this
19 is a pejorative way, is when you're a monopoly and you're
20 growing at the industry, and we have a wonderful
21 telecommunications industry that has double digit minute
22 growth and has significant line growth, significant second
23 line growth, it's a wonderful industry. And so, what you

1 see is unit prices being cut, but the aggregate industry
2 demand growing at a healthy clip. Thus, more revenues being
3 produced.

4 MS. HOGERTY: Okay. Mr. Brown, you had suggested
5 that essentially, rebalancing is necessary because you fear
6 that competition -- in fact, I think you said that
7 competition is beginning to take place. And that is going
8 to compete away some of your rates requiring more support
9 for universal service.

10 MR. BROWN: Yes.

11 MS. HOGERTY: What if this competition does not
12 develop and a large fund is developed?

13 MR. BROWN: Okay. As I mentioned this morning,
14 where competition isn't developing is for residential
15 customers. And my hypothesis is because they are priced
16 less than cost.

17 I was reading a report last week written by Jack
18 Grubman, an analyst for Solomon, Smith Barney, where he
19 noted that in the first quarter of 1998, the CLEC's
20 collectively gained more access lines than the ILEC. I'm
21 going from memory, but it's something like 490,000 versus
22 460,000. And he also noted in the long distance business,
23 it took 10 years before the incremental growth rate of the

1 MCI and the new entrants approached the growth rate of AT&T.

2 So, I think we've really got two markets going on
3 here. We've got the residential market that everybody's
4 wondering why aren't we seeing the competition. But you've
5 also got the business market, the dense downtown areas. Go
6 down on M street, you can see stenciled on the street where
7 MFS and others are cutting the streets to lay their fiber.
8 These are the rich veins of war in the telecommunications
9 market, and they're where a lot of the implicit support is
10 coming from.

11 And the competition is doing very well there, I
12 think, as Mr. Grubman's analysis shows. And frankly, that's
13 where most of the implicit support is coming from today. As
14 I mentioned earlier, you take western states, we've got
15 access charges that are six, seven cents a minute on each
16 end, and the interstate we're now down two or lower. So,
17 the business rates are three to four times the residential
18 rate. That's where we're seeing the damage right now. And
19 that's what is supporting, you know, the over \$50 and over
20 \$100 customers.

21 And that's, you know, why we've kind of sent up a
22 flare and said, "There's a problem here that somebody's got
23 to do something about because we're two years into this

1 thing, and you know, we've drilled holes in the bottom of
2 this bucket, and pretty soon we have to start putting
3 something back in the bucket or we're going to have
4 trouble."

5 MS. HOGERTY: If it's true that returns are above
6 normal levels, as many have alleged, I mean, why is there
7 any rush to do this?

8 MR. BROWN: Okay. Joel referenced the 1997
9 earnings level for U.S. West that happens to be 15.4 percent
10 for the whole year. In the middle of 1997, we had
11 collectively for the industry, a \$1.7 billion rate cut.
12 Looking just at my company, that drops to 13.6 roughly. And
13 regulatory returns could be a little misleading if you
14 recompute that second half using the same depreciation rates
15 that we used for financial reporting purposes. Just make
16 that change. It drops the earnings down to 11.24 percent.

17 So, I mean, it's debatable. Are we earning too
18 much? But I would suggest that under price caps, even that
19 isn't the relevant question. Price caps were supposed to
20 spur innovation, productivity, investment, new services.
21 And I think, frankly, price caps are working pretty well.

22 MS. HOGERTY: Joel?

23 MR. SHIFFMAN: Yeah. Both Mr. Lubin's comments as

1 well as Glenn Brown's comments seem to be making the
2 assumption that additional USF money either is or is not
3 needed for companies. And I guess our point is that, we're
4 not proposing to the extent that additional monies received
5 that those go to companies. We're proposing that there not
6 be any influence. But we believe that this money is needed
7 to keep rates comparable.

8 The simple fact that rates in most jurisdictions,
9 revenues exceed forward looking costs does not in any speak
10 to the issue as to whether or not rates are comparable. You
11 could have rates -- you could have every jurisdiction having
12 revenues exceed forward looking costs or even revenues
13 exceed embedded costs. That does not, in any way, speak to
14 the issue of comparability or reasonableness at the rate
15 levels.

16 So, when we talked about the need for extra
17 universal service money, we're talking about it's basically,
18 not being needed by the companies, but it's needed by the
19 customers of those companies as an offset against existing
20 rate levels to keep their rates in rural areas comparable
21 with rates in rural areas.

22 MS. HOGERTY: Mr. Cooper, you have talked about --
23 Dr. Cooper, you have talked about -- the only one who talked

1 about possibly reducing the subscriber line charge. Isn't
2 it true that when that was put into effect, the common line
3 and the interstate jurisdiction was divided 50/50? That the
4 interexchange carrier is directly charged and the other half
5 is charged to the customer?

6 MR. COOPER: Yes.

7 MS. HOGERTY: Okay. Is that division still exist?

8 MR. COOPER: Well, one of the things that's clear
9 about loop costs since we arrived at the number of 350 is
10 that they've been declining. I think it was last year
11 around this time that I said that the -- it's quite clear
12 that the ugly duckling of the industry for decades had been
13 the loop. Everything else is getting cheaper. Switching
14 was getting cheaper, and the loop was just sort of assumed
15 that it's cost never went down.

16 Over the past three or four years, I've been in
17 proceedings in which telephone company witnesses have
18 admitted that with digital and loop gain and a variety of
19 technologies, the cost of the loop has been declining
20 dramatically, 30, 40 percent at least, and maybe even more.

21 The SLC has not. It's actually, probably, the
22 only element since 1985 or 1986 that's gone up in the bill
23 after the first round of rate increase post-divestiture,

1 when everything else has gone down. So, that if you look
2 back over the past decade, the SLC has been stuck there and
3 not been the beneficiary of any rate reduction.

4 The way -- and the Chairman asked me this or I
5 mentioned this during the break. The fundamental point I
6 want to make about the SLC is that if you find as Mr. Lubin
7 has suggested, increased productivity, which means the price
8 of the loop could come down, and therefore the price of the
9 SLC could come down, that creates the room that you're
10 looking for to raise some universal service funds. So, that
11 we can have all of these good programs.

12 And let me be clear. CFA supports all these
13 programs, and we support the programs. We need to find a
14 way to fund them so that people don't end up with an
15 increase in their bill. And that's the way I have suggested
16 is that you can lower the SLC and tell people, "Stop writing
17 to those checks to the local companies, and start writing
18 them to the universal service fund administrator." I end up
19 with the same bill and I get my good programs.

20 MS. HOGERTY: Isn't that also true that the
21 portion that's charged to the interexchange carrier just in
22 relevant terms of the entire cost -- of the embedded cost,
23 is much less now than it was when the 50/50 was put into

1 place?

2 MR. COOPER: Yes. As we continually reduce access
3 charges and don't reduce the loop, the 50/50 split goes
4 away, and it becomes a larger share of course allocated of
5 being recovered directly from the end user.

6 MS. HOGERTY: So, the customer is paying a larger
7 --

8 MR. COOPER: Yes. Directly as a line item, he's
9 paying a larger share.

10 MS. HOGERTY: There's been a lot of talk about
11 rebalancing, and you seem to take the same view on
12 competition. When is it appropriate to rebalance?

13 MR. COOPER: Well, one of the points I'd like to
14 make is the Chairman asked this question about how do we
15 move forward in terms of preserving universal service. And
16 Mr. Lubin emphasized the forward looking economic costs.

17 I prefer to emphasize the loop. If we treat the
18 loop as a common cost, the example I like to use is every
19 one of the major companies at this table has committed that
20 the next generation of technology and application will be
21 XDSL. They've asked you to declare that a non-common
22 carrier service. They want to move billions of bits over
23 the telephone network using this new technology.

1 This technology is really interesting as described
2 Spring's recent announcement. All they're going to do is
3 put a module on the switch and a splitter on my house. And
4 they're going to use that whole network in between. But
5 they don't want to pay for it.

6 That's directly contrary to Smith v. Illinois,
7 which is the principle that we've used in this country for
8 70 years. If they share those costs, when they move those
9 millions of data bits over that network, not one change to
10 the copper in between or the fiber in between. If you make
11 them contribute to the facilities they use, you won't have a
12 universal service proper, because they'll sell more and more
13 bits, and they'll spread the costs over more and more uses.

14 That's the fundamental principle, I think, is
15 crucial. We don't need to rebalance rates if we constantly
16 force all services that use the loop to share the costs of
17 the loop. A principle that this Commission has applied
18 since 1930 at the insistence of the Supreme Court. And
19 nothing change in the Act or in the court to prevent you
20 from continuing to spread those costs.

21 So, that's where I see -- no need for rate
22 rebalancing, but to tap the gold mine of the
23 telecommunications network. As more and more applications

1 are available, than more and more services can help pay for
2 the fundamental infrastructure that we all use.

3 MS. HOGERTY: Mr. Wendling, could you explain to
4 me the difference between your proposal and the U.S. West
5 proposal?

6 MR. WENDLING: Yes. On the variable benchmark
7 approach, in that one the scheme is not just a \$30 or \$25
8 benchmark and a \$50. It is a more continuous spectrum of
9 variability of benchmarks on that particular one. Wherein,
10 any time you draw a single line, they're going to be -- it
11 is a sudden shift at that one point. And it may not be
12 equitable right at that place of where you changed.

13 A variable benchmark would smooth that curve out.
14 Let's say one of your goals in deciding on what the variable
15 benchmark ought to be is that the intrastate surcharge on
16 revenues should never exceed four percent. By varying the
17 benchmark in increments from one state to the next, you
18 could more approximate, never exceeding that intrastate
19 surcharge.

20 On the other hand, you could -- where you picked
21 conversely the opposite proposal on the variable percentage,
22 is to set the benchmark which is completely different from
23 theirs, at one -- say, affordable benchmark nationwide, and

1 than vary the percentage. Instead of being 25 percent, it
2 could be 26 percent, maybe even 80 percent for a state like
3 Wyoming where they really don't have a population density
4 center to generate the necessary revenues to keep a
5 intrastate surcharge down below that five percent or four
6 percent critical mass number you might decide upon.

7 MS. HOGERTY: So, it pretty much kind of follows
8 the same concept, but has more variables in it to deal with
9 your equity concerns?

10 MR. WENDLING: Exactly.

11 MS. HOGERTY: I think that's all I have for now.

12 CHAIRMAN KENNARD: Okay. Thank you, Martha.
13 Commissioner Tristani?

14 COMMISSIONER TRISTANI: As I said in my opening
15 remarks, I'm interested in the way that each plan allocates
16 responsibility between the FCC and the states. And because
17 of that, I'm interested in the variable support approach
18 that the Colorado Commission has put forth. And I'd like to
19 hear from others if this could be a useful tool to allocate
20 responsibility between the FCC and the states. And I'd like
21 particularly to hear from Mr. Shiffman. I'd like to hear
22 from the Arizona Commission and also from Mr. Cooper on
23 that.

1 And also, I'd like to hear if Colorado has any
2 responses to all of that.

3 MR. SHIFFMAN: The variable support of the
4 Colorado petition is not -- is really a variant of the 25/75
5 rule except for the fact that it divides the responsibility
6 between the FCC and the state commission on the ability to
7 pay -- of the state to raise funds, rather than on the basis
8 of a fixed national standard which may actually be
9 impossible for states to pay in certain instances.

10 In a way the variable support, not the variable
11 benchmark portion of the Colorado plan is remarkably similar
12 to the ad hoc approach with one difference. The variable
13 benchmark -- not the variable -- the variable pay approach,
14 not the variable benchmark, uses a fixed benchmark to
15 calculate the size of the fund. And it does that at a
16 fairly smally defined or non-granular level, while the ad
17 hoc approach does that -- does -- uses averages, not only
18 over the study area but over the entire state to determine
19 its support.

20 The results of the two plans are not terribly
21 dissimilar because the Colorado approach does use statewide
22 average costs to determine the percentage of the payout
23 between the FCC and the states. Part of the reason why we

1 use statewide average costs to determine the amount of the
2 fund rather than use something like the variable payout as
3 Colorado uses, the variable payout is kind of confusing
4 average in one step but also by CBG analysis in another
5 step. And we believe that that creates, in some instance,
6 anomalous results.

7 And that is if you did modify the 75/25 plan, we
8 thought to reflect the state ability to pay, that the
9 results should determine -- that that result should not just
10 determine the percentage of costs determined in other way
11 that's paid out, but also should determine the total
12 aggregate amount of costs which a state receives.

13 But they're not the -- at least the variable
14 payout method of Colorado, and the ad hoc approach are not
15 totally dissimilar. They vary with regard to the fact that
16 the details such that what cost basis you use is better to
17 forward looking, has not been analyzed in the variable
18 payout approach. And some other factors. I've not been --
19 it hasn't been priced out as the ad hoc plan has been. But
20 it's probably worth continued analysis of study.

21 MS. SCOTT: Maureen Scott, I am legal counsel for
22 Arizona Corporation Commission, and I am sitting in on
23 behalf of Chairman -- this afternoon. Unfortunately I

1 would have to say I am not familiar enough with the Colorado
2 plan to make a comment at this time, but our Commission will
3 be submitting some late filed comments on the various other
4 proposals that have been filed with the FCC, probably within
5 the next week or two.

6 MR. COOPER: CFA has tried to stay a little bit
7 out of the battling model, but I think there a couple of
8 principles that we do support and have clearly been
9 articulated by other consumer advocates in this proceeding.
10 And I can speak to those.

11 And it is worth starting from the history of 115
12 percent, because 115 percent which was the old way of doing
13 things was a fundamental recognition that between 100 and
14 115, the states were responsible. So, it clearly shared the
15 responsibility for the above average costs between the
16 Federal jurisdiction and the state jurisdiction.

17 On the other hand, there was no upper limit. As
18 has been pointed out, if you went way above 115, you got
19 more from the Federal jurisdiction. It did use statewide
20 averages, and that kept the fund smaller since every company
21 within the state was expected to average within that state.

22 And if you stayed below 115 or actually, I've been
23 in a number of proceedings over the past decade where states

1 have fallen below the 115, and been asked, "Will you ever
2 get any money back from the Federal jurisdiction?" And the
3 companies would say, "No, because aggregate suburbanization,
4 et cetera, are costs go down, and we're never going to draw
5 from the Federal fund." And that was a pretty good program.
6 I mean, it required some responsibility.

7 Does the Federal Act require us to change that
8 program? Probably not, but the FCC has actually decided it
9 would. It said it would stop averaging rates within the
10 states.

11 If you are going to do that, I think you
12 absolutely have to have a hold harmless. It would be an
13 ironic twist of fate in the statute for companies to come
14 forward over statute that had 15 paragraphs on universal
15 service and lose support for companies that really need
16 support, high cost companies. So, I think that's important.
17 And you cannot let the decisions on 25 and abandoning 115
18 impose harm on those states.

19 Second principle I think is important is that
20 universal service funds should support the core services
21 you, yourself, have defined as eligible for support in the
22 universal service support policy. I don't think the
23 decision on access accomplishes that goal, because it's not

1 part of the core services.

2 Thirdly, I think if you apply good principles of
3 the cost model we're talking about between those three
4 principles, hold harmless, a good cost model and only
5 support the core services, I think you end up with a
6 manageable fund. Whether it's variable -- I think the
7 notion of variable and choosing different basis is an effort
8 to keep the fund manageable, rather than apply principles.

9 I think we ought to do it the other way. We ought
10 to apply the principles of building a good analysis of the
11 network, apply a hold harmless principle and apply the other
12 -- the principle of supporting of core services. And I
13 think the responsibilities will jiggle out differently.
14 I've not supported or opposed any of the individual models.

15 MR. WELLER: I think I would just like to add, GTE
16 is certainly very sympathetic to the concerns that have been
17 raised by the states in terms of achieving a reasonable
18 distribution among them. And I think that the approach that
19 we proposed of using a series of benchmarks and different
20 percentages in between them is essentially designed to give
21 the Commission enough policy tools to hit the policy goals
22 that it wants to achieve in terms of both the size of the
23 fund and also the distribution of the fund among different

1 states.

2 I think with respect to the state interstate
3 division, the first thing to do is to ask yourself what
4 portion of the support, both implicit and explicit is coming
5 from interstate rates and/or mechanisms today. And that
6 provides a starting point as to what portion of the
7 responsibility the Federal mechanisms would need to step up
8 to in a new environment.

9 As Mr. Cooper says, there's a certain amount
10 that's coming from the explicit funding today that's coming
11 from the Federal side. And that ought to be maintained.
12 So, that's one item.

13 The second thing is there's a very large amount
14 coming from implicit sources through interstate access
15 charges. And there's no state program that's going to act
16 to remove those implicit subsidies and replace them with
17 explicit ones.

18 So, the remedy for that has to be a Federal
19 program. When you add those together, I think that puts a
20 floor underneath how large the Federal fund needs to be in
21 order to accomplish goals that can only be accomplished
22 through a Federal program.

23 Then, the third question is, in addition to that,

1 how much funding does the Federal program supply the states
2 that have particular distributions of costs. And we've
3 heard various discussions of those. And again, I think
4 that's a reasonable choice. Once an amount has been
5 determined that represents a reasonable balance between the
6 interest of low and high cost states that you've been
7 hearing from the in the last few weeks, than I think those
8 three targets can be rolled together, and a set of
9 benchmarks that could be chosen that hit those targets.

10 MR. WENDLING: Just if I might, one or two
11 clarification. Under the variable approach, where there are
12 benchmark support, it does use different measures
13 differently. It is a forward looking economic cost model.
14 First, the presumption for non-rural carriers. And it is
15 done by density zones or CBG's, something less than a wire
16 center. I think earlier someone took a -- made a comment
17 about providing support for condos in Beaver Creek.

18 We're not interested in providing support for
19 condos in Beaver Creek or the zillion dollar homes in Aspen.
20 The Colorado high cost fund that we just adopted doesn't
21 support those things either. And that's why targeting the
22 USF is very important, and doing it by those areas smaller -
23 - certainly smaller than study areas, certainly smaller than

1 wire centers, down to truly high cost geographic areas the
2 important way to target it.

3 The notion of using the average cost or the
4 average revenue on a state was really to look at the states
5 internal ability to generate an internal state high cost
6 fund. It wasn't an attempt to mish mash costs and revenues
7 by another one of those factors of how do you vary the
8 amount of, either the benchmark or the support. Thank you.

9 COMMISSIONER TRISTANI: I'm glad you brought up
10 the condos in, I think, Beaver Creek and Aspen. It reminds
11 me of Commissioner Ness's question this morning about should
12 we be funding lines out to Ted Turner's ranch? And I saw
13 very few hands that went up. If we change the location and
14 the owner of the piece of property, let's say, to the Navajo
15 reservation and said -- we said, "Should we be funding lines
16 out to the Hogan?" I'd like to hear what the answers could
17 be.

18 But more importantly, do any of the plans here
19 target underserved or unserved areas? Mr. Cooper?

20 MR. COOPER: Since I was one of the people who
21 said I did believe Ted Turner's line should get support, let
22 me explain that. It's quite clear, and Joel has pointed
23 this out that it's not that I want to support Ted Turner's

1 line, but under Section 253(b) of the Act, I have to have
2 reasonably comparable rates in areas that are rural and
3 urban. And so, Ted Turner is eligible for reasonably
4 comparable rates. He's eligible for just and reasonable
5 rates even though I don't think he sets my cable rates that
6 way.

7 But he is not eligible for the lifeline program.
8 He's not a low income consumer. His rates are affordable,
9 and I don't have to support him.

10 And the thing that concerns me about the effort to
11 target assistance in rural areas, is we create a witch hunt
12 for rich people or middle income people. And we figure out,
13 how much can they afford? And that's not the way we
14 designed some programs. And our universal service program
15 has, in fact, included everybody, including rural areas.
16 And I think that's an important public policy.

17 But I assure you I will oppose Ted Turner's effort
18 to get lifeline assistance.

19 COMMISSIONER TRISTANI: Mr. Wendling?

20 MR. WENDLING: Yes. The notion of underserved or
21 unserved customers, in the past in very rural high cost
22 areas, there's been a thing called the line extension policy
23 or construction charge the customer may be asked to pay.

1 And quite often when you're several miles away from the
2 nearest facility, that can be very, very expensive.

3 But currently in the models before the Commission,
4 there are caps on the investment, a \$15,000 per line or some
5 kind of capital investment that might be capped there or
6 wireless equivalent. But we looked at on an intrastate
7 side. And I know New Mexico had a fund for customers who
8 lived, met a specific income level that couldn't come up
9 with the \$40,000 or \$50,000 of line extension charges that
10 the utility may requested to get that back. And that was
11 only under a fairness test about what is an obligation of
12 the general body of rate payers to support a very high cost
13 line.

14 One of the things you might think about in
15 developing a high cost fund like we've done, is the free
16 construction allowance that a utility must offer or a common
17 carrier must offer a new customer, is tied to the amount to
18 the support they're getting from USF, so that the customer
19 at least gets that amount of free construction. If the
20 model says it costs \$100,000, they get \$100,000 of free
21 construction.

22 The next step that we haven't yet taken, is to
23 address the issue that Arizona brings up. And is, should

1 there be a separate funding available for customers for that
2 equivalent of a construction allowance support to get them
3 into part of the network? We didn't have enough information
4 at that time to know how big a fund that would require, but
5 we are continuing to investigate whether that should be part
6 of our high cost fund.

7 COMMISSIONER TRISTANI: Mr. Brown?

8 MR. BROWN: We were impressed with the comments of
9 the Arizona Commission and as a result of that, we included
10 with our reply comments a copy of a paper we shared about a
11 year ago with the FCC staff authored by Alfred Kahn,
12 essentially looking a few years out when we really do have a
13 competitive marketplace going. And we've got the right
14 level of monthly support for high cost lines.

15 And the question is, if it costs \$20,000 to extend
16 the line and someone looks at that and says, "Okay. I get
17 \$100 a month of support," which would support that line
18 extension if I knew it was going to be in service for 20
19 years.

20 But we also have a competitive market, and the Act
21 tell us that support must be portable. So, we may have
22 created a situation where we need to think about how, in the
23 future, new line extensions in high cost areas, even for

1 non-rural companies that today can cross-subsidize, need to
2 be handled.

3 In talking with some of my friends from RUS, maybe
4 there is a need to provide some financing or guarantee of
5 financing. And in that case, the loop or at least the loop
6 above some benchmark investment level itself becomes a
7 public good. But otherwise -- and we've kind of put this on
8 the backburner because we have some issues we got to work
9 our way through here that are very important. But we ought
10 to think those next few steps of how in the future, we are
11 going to fund the construction in high cost areas, because
12 it's a different ballgame.

13 COMMISSIONER TRISTANI: Mr. Shiffman?

14 MR. SHIFFMAN: There are two attributes that the
15 ad hoc plan objectively address the underserved areas. And
16 one, the embedded costs limitation -- the dynamic embedded
17 cost limitation. That being, that if a company invest
18 dollars to provide service in underserved areas, and that
19 raises their average investment per loop or per line, that
20 that will raise the standard by which the limitation on the
21 fund is measured. So that, potentially, to the extent that
22 there are embedded costs in those areas, don't get above the
23 forward looking costs on the average throughout their

1 territory. That will provide them with the financial
2 incentive to make those investments.

3 The second way that the ad hoc plan addresses that
4 issue is the dynamic hold harmless. The hold harmless is
5 not a dollar value hold harmless but is a hold harmless
6 which, for all companies, adopts the old high cost fund
7 rules and gives them at least as much monies as they would
8 have gotten under the operation of the old rules.

9 And to that extent, that they place new loops in
10 service, raise their average investment per loop under the
11 operation of the old USF or old high cost fund. They will
12 get more money and therefore, they'll have at least some
13 incentive to make those investments since they will be
14 toward under the dynamic -- what I call the dynamic hold
15 harmless provision of the ad hoc plan, the recovery of those
16 dollars.

17 COMMISSIONER TRISTANI: Ms. Baldwin?

18 MS. BALDWIN: Yes. After we finish discussing the
19 unserved and underserved areas, I would appreciate an
20 opportunity to respond to some of Dr. Cooper's concerns
21 about the Time-Warner proposal?

22 COMMISSIONER TRISTANI: Yes.

23 MS. SCOTT: Our plan -- the Arizona Corporation's

1 Commission plan, of course, is directed to the discreet
2 issue of the unserved and underserved customers. And that,
3 in large part, is because it is such a big problem in
4 Arizona. I think as the Chairman's written comments
5 indicates that just in Citizens Navajo service area alone,
6 they estimate conservatively, that there are at least 18,000
7 customers -- potential customers, living in areas without
8 facilities. Now, that's a conservative estimate. That's
9 just one service area of the state.

10 We also do not -- we do not believe that existing
11 plans or any of the proposed plans are adequate to address
12 this. We found in Arizona, at least, that existing
13 incentives under the existing high cost fund and other
14 proposals before the Commission now are not enough. And
15 some additional incentive is needed now to get facilities
16 into these areas, more in the nature of an up front
17 incentive.

18 One other point I want to mention in this regard.
19 There's so much focus on comparably reasonable rates. And
20 there's another major element, I think, in the Federal Act
21 that we're losing sight of. And that if, if you look in the
22 same provision of the Act, it also says there must be
23 sufficient service or reasonably comparable access to

1 services available in all areas of the country.

2 And this is what our plan focuses on. Somehow
3 these people -- this big group of people, have fallen
4 through the cracks, and they can't get the services that --

5 COMMISSIONER TRISTANI: At any price. Right?

6 MS. SCOTT: Right. That other customers can.
7 Thank you.

8 COMMISSIONER TRISTANI: Mr. Cooper?

9 MR. COOPER: Within the past two weeks, our
10 comments and obligations to serve in the State of
11 Washington, I guess a U.S. state. And we made the point,
12 and it is consistent, actually, with the U.S. West statement
13 here and Joel's.

14 Again, go back traditionally. How have we handled
15 unserved areas? We've handled them in the averaging
16 process. If I had a line that cost me \$10,000, and I
17 incurred those costs, if my revenues weren't adequate, I
18 came in and I averaged my rates. I raised rates. And as
19 long as I had an obligation to serve, and as long as I had a
20 monopoly, I could always make that stuff come out. And more
21 or less Joel said, we sort of incorporated that by if you
22 have a lot of high cost loops you drive up the state costs.

23 U.S. West says, "But if there's competition, I

1 can't do that anymore." And the answer is when there's
2 competition, we'll have to change the system. And that's
3 exactly the answer we gave them in Washington.

4 We understand that a day is coming when we will
5 not be able to engage in this averaging. But it's not here
6 yet. We should think about it, and we have offered comments
7 to think about it. But until it's here, we don't have to do
8 anything precipitously.

9 COMMISSIONER TRISTANI: Ms. Baldwin -- and you'll
10 be the last because I would like my fellow Commissioners to
11 be able to ask questions.

12 MS. BALDWIN: First, I do agree with Dr. Cooper on
13 the last point about when competition arrives, than we can
14 be concerned about the cost of obligation to serve. But
15 backtracking a little bit, Dr. Cooper referred to an income-
16 based approach to distributing high cost fund as a potential
17 witch hunt. And I just would like to point out a few things
18 that possibly respond to that.

19 One is, the fact that there's a variable discount
20 that's based on community incomes for the schools and
21 libraries program to insure that funds are appropriately
22 targeted, where they're needed, I don't believe has been
23 characterized as a witch hunt.

1 Secondly, perhaps I have more faith than Dr.
2 Cooper does, in both state public utility commission and the
3 FCC to establish objective guidelines. I'm not saying it's
4 easy.

5 And that's my third point. Just because it's hard
6 to do, I don't think it's necessarily a bad idea to engage
7 in a plan whereby one considers affordability as well as
8 comparability in designing a high cost program.

9 Thank you for the opportunity to respond.

10 COMMISSIONER TRISTANI: Thank you.

11 CHAIRMAN KENNARD: Thank you, Commissioner. We'll
12 go now to Commissioner Baker.

13 MR. BAKER: Thank you, Mr. Chairman. Mr. Reiman,
14 I'm going to start with you on the end there.

15 I saw your notes for your presentation really as
16 you were making them, and certainly, you didn't see my notes
17 before you made your speech this morning. But suffice it to
18 say, you made several points that I agree with. And I want
19 to go through some of those as a preface to my question.

20 If I misstate any of these, I'm sure you'll
21 correct me.

22 MR. REIMAN: Well, if you agreed with me, just go
23 right ahead.

1 MR. BAKER: I want to make sure we have them right
2 here.

3 First, size does matter, and smaller is better.
4 Second, subsidies must be competitively neutral. You stated
5 the case a little more strongly that subsidies in free
6 markets are natural enemies. I don't know if I'd go quite
7 that far, but we'll leave that for the moment.

8 Third, it is the public policy to keep telephone
9 service affordable. And of course, this is stated in
10 Section 254(b)(1). You also go on to say, and I also agree,
11 that we would not design a system that subsidizes rates that
12 have been kept far below any rational definition of
13 reasonable, so, like \$5 a month. And that stating the
14 obvious, customer rate increases are politically unpopular.

15 The issue I'd like to discuss with you, and I'll
16 take your comments first and than anyone else on the panel
17 who cares to comment. I'd like to discuss the somewhat
18 sensitive issue of rate rebalancing as it relates to reform
19 of high cost fund support.

20 Section 254(b)(3) refers to rural services and
21 rates which are reasonably comparable to those in urban
22 areas. But this is a two edge sword, because I don't think
23 that section of the Act, nor I, nor anyone else would

1 suggest that if you had a customer with a \$7 rate and a \$70
2 cost, that the rates go all the way up to the costs. But
3 again, a reasonably comparable to urban rate, might suggest
4 that that \$7 go to \$17. That rural rate payers pay
5 something more along the lines of a city rate, if you will,
6 setting aside the question of what the costs are for those
7 urban rate payers, which may be below what they're actually
8 paying.

9 So, all of which is a pretty longwinded preface to
10 the question of, how do we address rate rebalancing in this
11 context, because while there -- if we want to set up an
12 efficient -- sufficient and efficient fund to use Mr.
13 Bluhm's characterization earlier, if that requires rate
14 rebalancing, though, how are we going to avoid a situation
15 where we see some people's rates rise dramatically all in
16 the name of high cost fund support?

17 MR. REIMAN: I forgot who this morning talked
18 about that maybe what we need this first go around is a B
19 minus. Since I have two kids still in school, I'm not
20 willing on public record, to say that a B minus is ever
21 acceptable. But I do think that that's a fair concept.

22 In the spirit today of trying to find common
23 ground, I've been listening to the question, trying to find

1 something from each presentation that I would agree with,
2 and I'm still working on some of it. But one of the things
3 that really stood out was Mr. Weller's chart this morning
4 with all the yellow stuff on the left, and that's where
5 we're really concentrating on some solutions, and this huge
6 gap of rate imbalance on the right.

7 So, really the thrust of my comments this morning
8 is we can't ignore that huge gap on the right, which I'll
9 conveniently call the rate rebalancing question, because if
10 we only concentrate on the left-hand side of his chart, than
11 we get into engineering an answer that seems to come out
12 with right numbers without having tried to fix the problem.

13 Now, specifically, to your question, I do think
14 that there is a limitation on what we fixed in some
15 locations because of the need for reasonable comparable
16 rates. But there's a lot that the states can do before you
17 get to that location.

18 And the example I use in my remarks about our
19 Ameritech region, we have a number of companies --
20 independent telephone companies that have rates not at \$5
21 but under \$5. I don't think that anyplace in the country
22 should be subsidizing the difference between the \$3.50 or \$4
23 a month rate and whatever either the statewide average is or

1 whatever we could take it up to before we run into the
2 problem of reasonably comparable.

3 I do think for almost all of the issues we've
4 talked about, like it or not, rate rebalancing is a
5 fundamental issue and it's best addressed, in fact, has to
6 be addressed by the states. We've talked -- I could argue
7 with Mr. Lubin all day as to why we don't have more
8 residential competition. And he would say, "It's because
9 I'm a bad monopolist making too much money." Of course, in
10 trying to find common ground, I'm assuming that all of his
11 remarks were geared to RBOC's other than Ameritech because
12 we don't receive high cost funds.

13 And I would say it's because his company is
14 getting assistance, keep us out of long distance. If I
15 throw both of our arguments aside and just looked at it as
16 an economist would, I'd say that in many of our areas, it
17 would make no sense whatsoever for a company to come in and
18 try to compete with such highly subsidized rates.

19 So, the Commission's, state and federal, need -- I
20 think, need to balance some of these principles that Mr.
21 Cooper -- Dr. Cooper talks about, be guided by the
22 principle, yet we want universal service support to keep
23 rates affordable. We want competition. We want investment

1 in infrastructure, but we have to balance all three. So, I
2 do think there is a limitation of how far we can go in rate
3 rebalancing.

4 By the way, for Mr. Lubin, in our states, we see
5 access charge reductions a key part of rate rebalancing.
6 It's not just rebalancing rates between res. and bus. We
7 think that's the place where access charges will be reduced
8 as part of the three-legged stool of access charges,
9 business rates and residence rates.

10 And by the way, as an aside, since I haven't got
11 to answer a question yet, I think Commissioner Johnson, your
12 question about, can a Commission -- can a regulator insure
13 that reductions are flowed through to end users? I would
14 maintain there's a much easier job doing that at the state
15 commission level on a state by state basis, than it is for
16 the FCC on a national level.

17 MR. COOPER: Let me try the \$7 rate, which is one
18 that I frequently encounter. When you look at that \$7 rate,
19 I want you to ask yourself, what do they get? And the
20 question is, if you live in a rural area and you incur
21 extremely high intraladder long distance bill, than you
22 ought to factor that in when you're comparing. And so, if
23 the average person in that \$3 area ends up with a very large

1 intraladder, than the argument can be made that when we look
2 at those two things together, the \$3 rate is misleading you.
3 And actually, the cost of telephone service to do the things
4 that people do on a daily basis, is about the same.

5 Now, if you could look at that \$7 rate and say,
6 their intra -- their total is \$10, and the urban bill is \$25
7 for that, than I can say, "Yes, maybe there's a
8 justification for rebalancing." But you can't just look at
9 that \$7.

10 MR. REIMAN: Dr. Cooper, I would not disagree.
11 And I think Ameritech's point is we don't want to establish
12 a large federal fund that tries to fix the whole problem,
13 because you want the state commissions to continue to have
14 the incentive to make that kind of investigation. And then,
15 after the states have had an opportunity and have done what
16 they can, than if there's a shortfall, we'd look at it, but
17 the Federal Government should not pick it up in the first
18 instance. The state should have the first shot at their
19 responsibility.

20 MR. BAKER: Mr. Sichter?

21 MR. SICHTER: An example was given, and I think
22 it's a good example of what's wrong with the system today is
23 the way we do rate making today is sit down with a map, and

1 we draw circles around it, and we tell the customer, "You
2 call anybody within that circle, it's free. You go outside
3 that circle and the bottom drops off because we charge
4 exorbitant toll rates because we build subsidies -- access
5 subsidies into those toll rates."

6 Now, the answer -- the issue of the small calling
7 scope in these areas is let's charge -- set up a regime in
8 which these customers are charged cost-based toll rates, and
9 it becomes much less of an issue. Let's not devalue their
10 service because we built the subsidies in the toll rates and
11 than give them another subsidy because devalued their local
12 service. That makes no sense.

13 MR. BAKER: Mr. Chairman, are you sure you want to
14 get up while I've got the mike? That might be a dangerous
15 thing. Mr. Weller?

16 MR. WELLER: I think I am headed along the same
17 lines as Mr. Sichter. I think we get into a circle where we
18 try to use toll and access rates to raise subsidies, and
19 than find that those high toll and access rates hurt a lot
20 of the very people that we're most trying to help, people in
21 rural areas and people with low incomes, who, as I said,
22 spend half their bills on toll calls.

23 So, then we, according to Mr. Cooper, we go and

1 make a further adjustment in their local rate to compensate
2 them for the subsidies we're requiring them to pay to these
3 toll rates. It would seem to be -- make much more sense to
4 attack the problem more systematically and get the subsidies
5 out of the toll and access rates than those customers
6 wouldn't be hurt by them and everybody can pay on a much
7 more uniform basis for subsidies instead of having these
8 pockets of harm that we do with these out of line rates.

9 I'd also observe that the FCC doesn't have
10 jurisdiction over local rates. And so, we can't really take
11 specific actions to direct states as to what to do about
12 their local rate making. But it does have control over some
13 portion of the implicit subsidy flow, the part that comes
14 from interstate.

15 And if we were to take a significant action to
16 reduce that flow and lower interstate charges dramatically,
17 I think that would create a significant incentive for states
18 to address their own subsidy flows because they would be
19 concerned about arbitrage between the relatively high access
20 and toll rates, they would still be relying on, and the very
21 low ones that the FCC would have been put in place.

22 So, I think this is a positive step that the FCC
23 can take that's good in an of itself, and that also creates

1 good incentives for the states and doesn't rely on any sort
2 of plan that tries to direct states to do anything.

3 And the final thing I'd say is, in addition to
4 these sort of incentives that could be built into a cost-
5 based plan, one of the things I like about ultimately
6 transitioning to a competitive bidding process, is that I
7 think it makes any regulator face up to the costs of the
8 requirements that that regulator establishes. So, if a
9 given Commission says, "I want to have \$7 rates," that
10 Commission knows that it's going to get higher bids from the
11 carriers that could possibly supply that service as a
12 result.

13 If it's willing to have higher rates as part of
14 its universal service requirement, you will get lower bids.
15 I think that moves the determination of universal service
16 support levels out of the hearing room and into the
17 marketplace. The Commission still has control about what
18 it's asking for. It doesn't have control about what it
19 costs anymore.

20 If you think about it, it's a very funny process
21 where you're doing public procurement, which is really what
22 this is. You're asking for a function to be performed. And
23 you have one agency that has control of what's being bought

1 and also what's being paid for that. And that wouldn't like
2 right in any sort of other procurement that you might do,
3 and I think the incentive system is not very good.

4 I think that a bidding system corrects those
5 incentives. It allows the Commission to have any sort of
6 universal service that it's willing to pay for. And I think
7 that's helpful.

8 MR. BAKER: Mr. Bush?

9 MR. BUSH: Yes, Commissioner. I think I would
10 agree with a lot of what was said here, but you made a good
11 point early on. In the final analysis, it's a political
12 problem. I mean, as we talk about the difference or the
13 size of the universal service fund determined based on the
14 differential between the price that is paid for that service
15 and the forward looking cost model to charge the service --
16 to offer the service, that is, at least in our opinion, the
17 root implicit universal service fund obligation. That's
18 where the funding need is created.

19 Clearly, steps in reducing costs and/or increasing
20 the price that's paid by the universal service subscriber,
21 can address that fund. Rate rebalancing is a way and one
22 that we certainly don't object to. But it is certainly a
23 difficult process to go through. And it is just the reality

1 of the situation. So, to the extent that you've got the
2 political problem in front of you, we need to also move
3 forward with a funding mechanism that deals with the entire
4 implicit subsidy absent any action to rebalance rates. The
5 two solutions to the same problem.

6 MR. BAKER: If I could just make a little response
7 to that, see, I think Dr. Cooper made a very good point of a
8 few moments ago, that you sort of have to compare apples to
9 apples and look at the, you know, total bottom line on the
10 bill. And if a higher local rate goes hand in hand with
11 access charge reductions to get flow-through, which means
12 lower toll rates and at the end of the month, the customer's
13 got, you know, better service for a lower price, than
14 obviously, we've done the right thing.

15 And you know, I hope I'm not wavering on my
16 commitment to free markets but I think that if we end up
17 with a situation where we say, "Well, we've got a much more
18 economically efficient model, and oh, by the way, your
19 average consumer is paying, you know, 10 or 20 percent more
20 on his bill every month, and that's something that would
21 appear a victory." Hopefully, we're not headed in that
22 direction.

23 Mr. Shiffman?

1 MR. SHIFFMAN: That's exactly the reason why the
2 ad hoc plan moved off of revenues from any specific bucket
3 of services and back to costs, because we struggled,
4 actually, with the idea of trying to look at what amount of
5 shortfall toll was comparable with big EAS areas. And after
6 struggling with it and looking around the country to
7 determine there was no real way of creating a standard
8 benchmark, so we were forced back to looking at the
9 divergence of costs.

10 And that is, that costs is -- because the
11 aggregation of costs equals the total amount of revenues, in
12 aggregate, that the only good surrogate for creating equal
13 calling areas or equal rate packages was to compare the same
14 bucket of costs from one jurisdiction -- from one company to
15 another and between jurisdictions.

16 MR. BAKER: Thank you all very much.

17 COMMISSIONER NESS: Chairman Wood?

18 MR. WOOD: One of the down sides about going last
19 is I think Gloria you asked all my questions about how do
20 you turn the volumes up and down for Mr. Wendling's plan,
21 and I was really intrigued by the answers. And we'll just
22 kind of go on the record saying I think that an interesting
23 way we ought to maybe conserve going forward.

1 But let's move from methodology and allocation to
2 the end point, which is how do you collect, or do you
3 collect it? Do you absorb it as a cost of doing business or
4 as a carrier, you're being assessed your payments here, or
5 not? And I think I speak from, I think, Dave Baker's answer
6 just right there at the end it's free market credentials for
7 all of us little young bucks that came with the '94
8 elections or at question in light of recent events in the
9 industry, that have attempted to increase costs to consumers
10 -- to customers.

11 And in Texas, we tried to make this transfer of
12 the subsidy from implicit to explicit a user-friendly type
13 thing, but that had a shelf life of about a hot cup of
14 coffee. I wonder if you folks who are smart enough to think
15 this stuff through, have a better way than what we've
16 experienced. Certainly, my colleagues at the Federal and
17 we, at the state level, probably on around the bend, about
18 letting the customer know where the rates went down so that
19 they're not so unhappy with where the rates are going up.

20 And let me just start with Mr. Lubin here on AT&T
21 IXC, and Mr. Sichter, if you have a Sprint answer on that,
22 as well. It seems to me from putting the bill together,
23 that it's just as easy to show a revenue credit for access

1 going down as it is to show a revenue increase for a pixie
2 or for SLS assessment going up.

3 Have any of the IXC's consider this idea? Your
4 access goes down a nickel, say. Nickel times 500 minutes is
5 a \$25 credit on the consumer's bill. Why don't you just
6 leave your rate structure alone and show the credit?

7 MR. SICHTER: If I understand what you're talking
8 about, you'd have a uniform reduction for all customers.

9 MR. WOOD: Is access not assessed in a uniform
10 manner?

11 MR. SICHTER: Yes, but there's -- there's,
12 obviously, a lot of other factors that probably Joel is
13 better able to explain than I am in the pricing of the
14 interexchange services. That we can, for example in our
15 Sprint cents plan, it's 10 cents a minute. I mean,
16 consumers understand that.

17 When we pass access reductions here, we don't pass
18 them through uniformly to all customers. We're not going to
19 change our dime a minute, nine and a half cents a minute or
20 whatever that might turn out to be. You know, there's a lot
21 of variables in the interchange market that require us to
22 use more rates than others.

23 The answer is, no, we do not agree with a uniform,

1 across the board, pass through of access reductions. In
2 aggregate, yes, we pass them through and more. But it's a
3 competitive market and pressure to reduce rates to
4 particular customers and particular services varies quite a
5 bit. A uniform pass through makes no sense in a market
6 context.

7 MR. WOOD: Mr. Lubin, I assume you would agree?

8 MR. LUBIN: Yes, but let me clarify at least in
9 terms of AT&T's point of view. And that is, once regulators
10 restructure be it access, be it implicit to explicit
11 subsidies, from my point of view the price structures that
12 we put in the marketplace are going to follow that.

13 Now, let me spend a moment as to why that is.
14 Right now you see AT&T, other competitors marketing very
15 heavily various marketing plans in terms of 10 cent minutes,
16 15 cent minutes, nickel a minutes, whatever. When we saw
17 this coming in late '97, it was clear to us at the time that
18 universal assessments are going to be changing over time,
19 starting out one way, potentially changing July of '98,
20 potentially changing of January of '99, potentially changing
21 subsequent after that.

22 As those percentages change, that potentially has
23 a significant impact if we just bury into the unit rates, as

1 we are marketing. And that's what was just said, is we're
2 spending a lot of dollars in terms of marketing and
3 campaigning particular plans. We're going to continue to
4 market those plans and don't want to create -- maybe this is
5 tongue and check here, customer confusion in terms of
6 changing those rates.

7 MR. WOOD: I think you passed that.

8 MR. LUBIN: Yeah. That's probably the case. But
9 the fact is in January of 1998, we put a line item on the
10 bill for business. We publicly said we were going to do it
11 for residents. And again, the point was, as these things
12 are becoming explicit, to make them explicit, whether that
13 is the universal service recovery, whether that is a
14 restructure of access into flat-rated charges or usage-
15 related charges. You know, my view is what's going to
16 happen is however those structures come about, they are
17 going to be driven into the marketplace.

18 But then you raise another question. I think it's
19 a fair question. Well, that's only half the equation. That
20 half of the equation is where there have been effective,
21 moving of making things implicit to explicit, restructuring.
22 And as those things occurred, there were other access
23 reductions such that -- in fact, I think the FCC wrote to

1 the Hill, and had a nice chart. And in that chart, showed
2 the aggregate impacts of January 1998. And I think the
3 number was a minus number, maybe \$35 million if put in all
4 the puts and takes of it.

5 And I think what was legitimately said associated
6 with that, was that on average, customers are better off.
7 And I think that was the impact of that chart. I think that
8 was --

9 MR. WOOD: And as a regulator, I've run the
10 numbers, too. But I think you guys have got to help these
11 guys and me out here on the perceptions game, because we are
12 losing that battle. Customers think that rates are going
13 up, when, in fact, they are not.

14 MR. LUBIN: Right.

15 MR. WOOD: Let me ask a question. If an access
16 charge is, say, reduced by -- well, interstate is -- I don't
17 know, kind of low. But just saying tax is reduced by a
18 nickel. Would it be possible in a LEC bill to just show a
19 nickel credit on the LEC bill and keep billing these guys
20 what you've been billing them, but show the customer that
21 your rates have gone down by the amount that you're getting
22 from the universal service fund? Make the same question
23 applicable to the interstate. I think it's easier since

1 that's what we're here -- interstate rates.

2 Say, you get a hundred million bucks out of the
3 interstate kitty. You got to drop your rates a hundred
4 million bucks somewhere. Assume that equates to a two cent
5 reduction in your total -- or just say, two cent reduction
6 in CCL terminating. Could you show that on your customer's
7 bill as a credit to his LEC bill since it is, after all, LEC
8 revenues that access represents?

9 MR. WELLER: Commissioner, perhaps I'm not
10 absorbing the idea, because often we're not the same people
11 billing. You know, in other words, if we --

12 MR. WOOD: Same minutes.

13 MR. WELLER: -- were seeing the same minutes and
14 providing the customer the same bill for the same minutes,
15 we might be able to do that. But a lot of the IXC's for a
16 lot of their customers have taken the billing to themselves
17 and for higher use customers we may not use all of the
18 minutes in a consistent way. Or access billing system
19 certainly aren't going to track those minutes on a per
20 customer basis. And it's certainly not designed to turn
21 them into a end user bill.

22 MR. WOOD: So, your switch does not count -- just
23 assume inter and intra were irrelevant. Anybody that dials

1 a one plus, yours doesn't count the number of minutes that
2 represents?

3 MR. WELLER: We might be able to do that. I would
4 have to check, frankly. But you know, you've got minutes
5 going to different IXE's possibly.

6 MR. WOOD: But you wouldn't care which IXE it went
7 to because you're -- the rates you're charging them just
8 went down by two cents. So, whoever you're charging it to,
9 that's a different part of the billing department than what
10 you're -- the bill that you're sending your retail customer.
11 Isn't it? I mean, you send him a billion minutes but you
12 sent her -- you know, you spoke on the phone for 75 minutes
13 this month.

14 MR. SICHTER: A short answer here, and you're
15 probably familiar with this one having been in industry for
16 a few months anyways, is that it would require massive
17 changes in our system.

18 MR. WOOD: I was told that about adding something
19 on a bill long ago, but if that happened real fast --

20 MR. SICHTER: The way we capture minutes is we do
21 not capture them. We just capture them real time. So, you
22 make a call, he makes a call, and it's all in one tape. The
23 way you have to do this is, and we've done it to do studies,

1 is you have to write special programs for your toll tapes
2 off and associate with them with individual telephone
3 numbers, and than you've got to, you know, have billing
4 system modifications, too.

5 So, one, it's possible. Two, it's expensive. And
6 three, it'll probably take our data people five years to do
7 it.

8 MR. BROWN: One of the things -- I've already said
9 a number of times and I kind of quantified this morning how
10 much implicit support we have in access. Access is a big
11 part of our revenue stream. That revenue is very variable
12 because Joel and Jim are -- have today and in the future,
13 will have more sources of buying access. So, I need to
14 reduce my prices.

15 MR. WOOD: I know you do. You two have an
16 incentive to solve this problem.

17 MR. BROWN: And it's also unfortunate that our
18 first experience in funding universal service with schools
19 and libraries which was new money into the system. That
20 system was not there. That money was not in the system
21 before. So, it is an increase on somebody's bill and that
22 may be we why --

23 MR. WOOD: Didn't your access drop at the same

1 time? Didn't you drop the access by a corresponding amount?

2 MR. BROWN: Yeah, and unrelated, totally different
3 thing. You're absolutely right. And I hate the part of my
4 job where I have to explain all that, because it doesn't
5 make any sense to the consumer.

6 On high cost, that is going to be a dollar for
7 dollar swap. And you know, one of the reasons we want the
8 rebalancing as much as possible to go on the states, because
9 I think you are in a better position to kind of match those
10 up, so consumers can see.

11 On the interstate side, I do see a problem. We
12 are regulated for our rates. They are not regulated for
13 their prices. It's a squishy system.

14 MR. LUBIN: Chairman?

15 MR. WOOD: Sure. I'll let you have the last word.

16 MR. LUBIN: I'm just curious in terms of, if
17 people put on their bills that said, "Here's the amount of
18 access that has come down over the last few years, and
19 here's the benefits that have been flowed through," is that
20 something that you view would be helpful or not?

21 MR. WOOD: Generally, but -- yes, as informational
22 matter. But I think when people are writing a check each
23 month, they don't want information. They just want to know

1 that their rates went down or at least held even. And I'm
2 not sure they're getting that message at all now based on
3 the calls we get on our consumer hotline.

4 I mean, I thought the pixie was supposed to drop
5 minutes of use rate on access, but I think the other of the
6 big three is not sitting on this panel, through a big charge
7 in the first three months of this year on their consumer's
8 bill but didn't adjust the MOU rate one penny. So, you had
9 a net increase of real dollars that real people had to pay
10 with real dollars. And that's not what I think this whole
11 game is about.

12 So, I look forward to working with the Commission.
13 I appreciate Chairman Kennard your inclination and that on
14 the part of your colleagues to involve the Joint Board in a
15 formal way later on. I hope by that time that all the
16 bright minds in this room can work on a more effective way
17 to let the customer know that this is something we're all
18 doing on their behalf because I don't think they're getting
19 that message yet.

20 CHAIRMAN KENNARD: Thank you, Mr. Chairman. Did
21 you want to clarify something?

22 COMMISSIONER NESS: I just wanted to clarify one
23 point which I believe needs to be focused on at that moment.

1 Mr. Brown, you just mentioned that while schools and
2 libraries with brand new funding, first time weren't doing
3 anything for universal service. We've been collecting and
4 funding universal service for way many years now.

5 We've been collecting and funding for high cost.
6 We've been -- your organization receives a portion of it
7 all. I'm sure you believe too low, but you've been
8 receiving it nonetheless. And we've been collecting for low
9 income consumers for a long period time. We've expanded
10 that program, in fact -- and incorporated all of the states
11 so that everybody has an opportunity to collect that if they
12 are in low income.

13 The fact that we added the additional program to
14 the mix does not detract from the fact that we've been doing
15 this other fundings for a real long time.

16 MR. BROWN: Well, perhaps my point was
17 misunderstood. New funding for high cost areas will be
18 offset dollar for dollar by reductions elsewhere. So, it's
19 easier to show those --

20 COMMISSIONER NESS: If we do it right.

21 MR. BROWN: And I'm sure you will.

22 CHAIRMAN KENNARD: Mr. Powell, I'm not sure if
23 you've got into the mix here.

1 COMMISSIONER POWELL: I'm just learning.

2 CHAIRMAN KENNARD: You're just learning? Okay.

3 COMMISSIONER POWELL: I'll jump in when I need to.

4 CHAIRMAN KENNARD: Okay. Please go ahead.

5 MS. JOHNSON: Mr. Brown, could you explain to me
6 again when you were -- the last point that you made. You
7 said the high cost fund will be offset -- those universal
8 service dollars will be offset dollar for dollar and that
9 the other programs will not, or you didn't add that by I'm
10 assuming --

11 MR. BROWN: Yeah. The point that I made to
12 Chairman Wood, was that when the school and libraries
13 program began, we had two and a quarter billion dollars of
14 new discounts that were new to the system, that were not in
15 the system before.

16 MS. JOHNSON: Right.

17 MR. BROWN: And I'm contrasting that to take
18 interstate high cost funding. If that's increased by a
19 hundred million dollars, we'll be able to decrease the
20 interstate access by a hundred million. So, the net should
21 be zero.

22 I think what happened at the same time the schools
23 and libraries funding went in, the access charge reductions

1 also kicked in about the same time for a different reason.
2 And there were -- I think that might have been part of what
3 -- not being a long distance company, wanting to be one, but
4 not being one, that explaining -- because here they had --
5 they were expecting a cut on their bill, and instead they
6 had this new funding for something that hadn't been there
7 before.

8 MS. JOHNSON: But didn't they get the access
9 reduction so they did get the cut in their bill?

10 MR. BROWN: They did, but they were expecting
11 that. What -- the schools and libraries wasn't in the
12 system prior to the beginning of the fund this year.

13 MS. JOHNSON: And the reductions weren't either?
14 They both came on line at the same time, didn't they? Maybe
15 Mr. Lubin --

16 MR. LUBIN: I'm probably using poor judgment to
17 interject here, but -- I should let you handle this.

18 The observation that I want to make is that in
19 terms of how competition has evolved, right or wrong, over
20 the last several years, access charges have come about.

21 MS. JOHNSON: I said access charges have gone
22 down.

23 MR. LUBIN: Access charges -- every year that

1 access charges go down. I'm focused at the Federal level.
2 I mean, states are a lot more complicated with so many
3 different issues going on.

4 All I'm saying here is that over the last five
5 years and before that, access charges continued to go down.
6 We expect that. We continue to advocate that it should be
7 greater. Sometimes it is, sometimes it isn't. But bottom
8 line is, we forecast that. We build that into our plans.
9 We make decisions.

10 And so, the point that was just being made is that
11 a lot of that was expected. A lot of that was flowed
12 through in terms of promotions, in terms of all sort of
13 different things, in terms of the way the competition works
14 in the long distance marketplace.

15 There was also another point.

16 MS. JOHNSON: Let me follow back on that one. Did
17 you receive -- and this is just for my edification. Did you
18 receive access reductions than you probably planned for in
19 the last round? I know you were saying traditionally access
20 was going down, but did not the FCC reduce them by even more
21 than had been anticipated?

22 MR. LUBIN: I'm opening up another can of worms
23 here in terms of at least what we forecasted in July and

1 January. And I would say no to you. I mean, the Commission
2 did a yeomen's job, but I'm saying to you in terms of what
3 we were working for, what we were trying to get was less.

4 MS. JOHNSON: Gotcha.

5 MR. LUBIN: But there's a second point. And the
6 second point is the industry in aggregate, come January, was
7 net a wash. They were actually, according to the last chart
8 I saw of the FCC is about \$35 million to the good. Meaning,
9 access came down \$35 million more than the USF went up.

10 MS. JOHNSON: Even including the schools and
11 libraries?

12 MR. LUBIN: Yes. Yes. And I mean, that to me,
13 when you think about it, was a huge, huge accomplishment in
14 terms of a net -- you know, lot of new money \$300 million on
15 lifeline, you know, \$600 million or whatever or however you
16 want to annualize that. I mean, that was a huge
17 accomplishment to achieve that and still put in more money
18 into the system.

19 That being said, my point is, even though in the
20 aggregate it was minus \$35 million. AT&T was not a net
21 saver. AT&T net was a positive number. More to the point,
22 though, you can't just say, "Well, AT&T whatever or business
23 residents," because that relevant question is the residents

1 portion of my business. And the residents portion of my
2 business had a net increase.

3 And that's not to fault anybody. That's just the
4 fault of the numbers in terms of how the process worked, and
5 it's not counterintuitive if you say in the most aggregate
6 IXC is zero, you don't expect everyone to be at zero. I
7 don't think so.

8 And all I'm saying to you is if I looked at my
9 resident's business, I was not a net zero. I was a net
10 positive. But that, in and of itself, is not the key point,
11 either, even though I'm saying to you I had, you know,
12 significant increase in terms of the residential market.
13 That's not the relevant point.

14 CHAIRMAN KENNARD: Well, it may be the relative
15 point from our perspective, Mr. Lubin, because those
16 residential consumers happen to be the most vulnerable
17 consumers in America. And we have no assurances to this
18 day, that those access charge reductions were passed through
19 on a proportionate basis, so that those residential consumer
20 have enjoyed the benefits of these access charge reductions.

21 Maybe the Commission made a mistake in
22 deregulating your marketplace and relinquishing control over
23 the basic scheduled customers, because from everything I've

1 heard, those customers are still vulnerable today per your
2 acknowledgment a few minutes ago.

3 MR. LUBIN: When I said per my acknowledgment
4 where I said that the residential market net had an
5 increase, I'm not talking about the prices that I have set
6 in the market. What I was talking about was the net access
7 savings versus USF obligation. That was where there was a
8 net increase. It had nothing to do with my rate settings.

9 And the reason why that occurred is because the
10 restructure of access disproportionately put the access
11 benefit into the business side of the equation. And I'm not
12 saying that's bad or that's good. All I'm saying is that
13 was the fact of the situation.

14 Why did that occur is because there was an
15 originating, terminating rate differential. The terminating
16 rate went down significantly more than the originating rate.
17 And business has proportionately more terminating rate --
18 minutes.

19 So, I realize this is a very controversial issue,
20 and I realize everybody's working trying to do the best they
21 can, but I am saying that as a result of the restructure and
22 the combination of everything else on January of 1998, the
23 residential -- it has nothing to do with my prices. And we

1 can debate that and discuss that. But I'm saying the net
2 USF access obligation in the residential market that I have
3 went up. And all that is because of the nature of the
4 restructure that caused terminating access minutes to go
5 down in terms of the unit rate a lot more than residents.

6 CHAIRMAN KENNARD: Okay, well, can you tell me
7 whether that was a good thing or a bad thing for those
8 residential consumers?

9 MR. LUBIN: All I could say to you is that the net
10 expense in terms of -- that I incur on behalf of the
11 residential customers net went up. Right now, I'm not
12 making a judgment whether that was a good thing or a bad
13 thing. I'm just stating a fact is that because of the
14 nature of the restructure, even though that the IXE in
15 industry in aggregate had a net savings based on the last
16 analysis that I saw from the Commission.

17 All I'm saying is if you looked at the
18 residential, from what I see, our net expense was not down,
19 but it was up. And I'm also saying is, whether that's a
20 good thing or a bad thing, we can debate. All I'm saying is
21 it was the net result of the combination of a lot of
22 different facts.

23 CHAIRMAN KENNARD: Okay.

1 COMMISSIONER NESS: If we could get back to a
2 point that Mr. Brown was making where we have explicit --
3 where on the Federal level, we have explicit funding for
4 universal service. The point was, what should be reduced?
5 What correspondingly should be reduced?

6 MR. BROWN: Well, in interstate service as you
7 increase funding, for example, using the numbers I was using
8 before. If we have a \$2.8 billion fund which is the
9 interstate share of the 4.4, 1.125 of that would be
10 reflected in interstate access reductions.

11 COMMISSIONER NESS: Okay. So, in other words to
12 the extent that there's an increase in explicit funding --

13 MR. BROWN: Yes.,

14 COMMISSIONER NESS: From the interstate
15 jurisdiction.

16 MR. BROWN: Yes.

17 COMMISSIONER NESS: That should result in a
18 concomitant reduction in the interstate access charges. Is
19 that right?

20 MR. BROWN: Yes.

21 COMMISSIONER NESS: Does everyone on the panel
22 agree with that? Is there anyone who disagrees with that
23 concept? Mr. Wendling?

1 MR. WENDLING: Under the variable benchmark and
2 the variable support method for certain states where their
3 internal intrastate revenues are inadequate to support the
4 super high costs of their high areas, the -- those extra
5 dollars which would be, in our opinion, necessary to keep
6 rates reasonably comparable, would be an offset to
7 intrastate side.

8 COMMISSIONER NESS: But basically, the concept is
9 that if you pay in the interstate explicitly, that in order
10 to avoid double counting, you would be reducing the
11 interstate access unless you wanted to shift more burden to
12 intrastate -- not burden, but benefit to the intrastate
13 side.

14 MR. WENDLING: Yes.

15 COMMISSIONER NESS: But under a normal set of
16 circumstances, you make explicit here, and then you reduce
17 by a concomitant amount and then you're even as far as the
18 funding's concerned. Is that right?

19 MR. WENDLING: Under the 25/75, yes. Every dollar
20 of every increased funding would be offset by a reduction in
21 interstate access.

22 COMMISSIONER NESS: And it would also be logical
23 than if we were to on the state side make explicit funding

1 for universal service on the state intrastate side. That
2 that would result in a concomitant reduction of implicit
3 subsidies or should result in a concomitant reduction of the
4 implicit subsidies on the intrastate side.

5 Does everyone agree with that, or does anyone have
6 a problem with that? Would that be logical? Again to avoid
7 double counting?

8 MR. WENDLING: Or windfall as we call it.

9 COMMISSIONER NESS: Or windfall. Okay.

10 MS. BALDWIN: The only problem is that the rates
11 are being readjusted if there's an elastic service for which
12 the price is reduced and it's stimulating demand, that may
13 need to be fed into the equation.

14 COMMISSIONER NESS: That's a good one.

15 MR. WELLER: Commissioner, I think what we've
16 suggested is really sort of a cascading approach that's
17 similar to what the Commission's already use with the SLC's
18 and pixie charges.

19 In other words, a company gets money from the new
20 fund, first to the extent that it's getting money from the
21 existing high cost fund today. It simply replaces that.
22 There's money left over from that, which there should be.
23 It applies to reductions in interstate access. Interstate

1 access gets driven down to some objective rate that the
2 Commission would set.

3 And then, when you reach that level if you have
4 additional funds left over and in the high cost states that
5 some of these gentlemen are worried about, we would try to
6 set the benchmarks so that that does happen. The additional
7 money would be flowed through the Part 36 process to the
8 states, where I fully agree there would be a requirement
9 that they wouldn't use that money on the state side that's
10 sent there to make offsetting reductions in contributing
11 state rates today.

12 CHAIRMAN KENNARD: Let me just follow up on that
13 for a moment. How much money do you estimate is in implicit
14 universal support today?

15 MR. WELLER: On the interstate side, what I've
16 estimated is \$6.3 billion. That's a fairly simple
17 calculation, taking the reported revenue for switched access
18 leaving the SLC's aside, and subtracting an estimated cost-
19 based rate with a average amount of contribution at eight
20 tenths of a cent.

21 And that's a fairly robust number if you change
22 eight tenths to seven tenths or nine tenths. It's not going
23 to change dramatically.

1 So, that is the estate of what's in interstate
2 access today. Now, a certain portion of that is the
3 recovery from the schools and library fund. If there were
4 another recover mechanism for that fund, and I know there's
5 been discussion of that recently, than the number would come
6 down correspondingly to five point something depending on --

7 CHAIRMAN KENNARD: But that number doesn't include
8 the explicit interstate support like DEM weighting and long
9 term support in the high cost fund. Correct?

10 MR. WELLER: The explicit interstate support to
11 non-rural companies, as Mr. Sichter said earlier today, just
12 over \$200 million, about \$217 million.

13 So, if you put these pieces together, you have
14 five point something billion dollars to get down to eight
15 tenths of a cent for interstate access, plus \$217 million to
16 maintain the current level of high cost funding to non-rural
17 companies, plus whatever it is that as a policy judgment,
18 you decide represents a reasonable balance, the money that
19 you should send to the high cost and/or low revenue based
20 states to use for reducing intrastate subsidies.

21 CHAIRMAN KENNARD: So, on top of that number,
22 there's still some amount that would have to go to defray
23 intrastate costs, as well. Correct?

1 MR. WELLER: Yes, depending on the amount that you
2 choose to sent there. I believe in Mr. Shiffman's plan that
3 would be in a range of maybe \$600 to \$800 million, if you
4 want to take his estimate as a guide.

5 CHAIRMAN KENNARD: Okay. Let's hold on Joel's
6 estimate for a minute and add up the costs. You said \$6.3
7 billion in implicit support plus the \$600 million. That's
8 \$6.9 billion. If we were to recover that amount -- and
9 plus, of course, than you have the explicit support, the
10 high cost fund, DEM weighting and LTS. If we were -- how
11 much in addition is that?

12 MR. WELLER: Again, it depends on what you do with
13 the schools and libraries.

14 CHAIRMAN KENNARD: Put that aside for a moment.

15 MR. WELLER: If we put that aside, than we're
16 starting from about 5.2 instead of 6.3, if we assume just
17 over a billion dollars. So, than add Mr. Shiffman's \$600 or
18 \$700 million and gets us up to about six. Add \$200 million
19 or so for the current high cost funding, and you're back to
20 about 6.2, 6.3 percent. I'm sorry \$6.3 billion.

21 And I said earlier, a fund of that size could be
22 financed with a uniform percentage surcharge on state and
23 interstate revenues of about three percent, just over three

1 percent.

2 CHAIRMAN KENNARD: About three percent?

3 MR. WELLER: Yes.

4 CHAIRMAN KENNARD: So, you'd be talking about an
5 end user charge of approximately three percent?

6 MR. WELLER: Yes. So, if you think about it this
7 way, someone with an average amount of toll, would actually
8 slightly benefit. They'd start out by breaking even, but
9 then there'd be stimulation as was suggested earlier. So,
10 actually, about half of what -- there would be significant
11 stimulation, I think, that would produce an additional
12 benefit.

13 If you think of a worse case scenario where
14 somebody makes no toll and doesn't benefit at all, take
15 someone with an \$18 average residents rate, add a SLC, you
16 get up to \$21.50. Take three percent of that, you're
17 talking about 60 some cents. That's the worse that anyone
18 could be hurt by this program. And most people would
19 benefit.

20 CHAIRMAN KENNARD: Okay. Now, if we were to take
21 that 60 cent amount, have you done any calculations on what
22 the effect of competitive bidding would be on that amount of
23 support, to the extent which it might go done? Tough

1 question.

2 MR. WELLER: No, I haven't. In fact, to my mind
3 the whole point of competitive bidding is that we don't try
4 to do calculations. We let the bidders do the calculations.
5 So, no. My presumption is that competitive bidding, and I
6 think it's demonstrable logically, will give us the best --
7 the right number. Some places that may be more, and others
8 it may be less. But what we can say is that they'll be
9 competitive pressure over time to the extent that it can be
10 driven down.

11 CHAIRMAN KENNARD: Okay. Thank you.

12 COMMISSIONER NESS: Just following up on your
13 calculation, are you assuming that everything that is in
14 access except the actual cost of access -- of interstate
15 access, goes to subsidize universal service, or might there
16 be included within that maybe some other funds slushing
17 around? Maybe it goes to the corporate bottom line. Maybe
18 it goes to other investments that GTE has abroad, whatever
19 it might otherwise be.

20 MR. WELLER: I'll go back to the picture. And as
21 I said before, you have to either imagine a leak in the
22 system or a completely different cost level to say that that
23 support isn't universal service funding. All right? So,

1 there are no major flows in or out of the system that aren't
2 depicted on this chart. So, I've accounted for all of the
3 local business. So, there are major leaks, sinks or sources
4 in the system that I haven't accounted for.

5 And as far as the cost level is concerned, as I
6 said earlier, you know, if you assume a low enough cost
7 level, I mean, I could make the Ford Foundation show a
8 profit. But I think you have to start with a reasonable
9 assumption that if you've arrived at this rate level by your
10 price cap system, that's the mode of regulation you're
11 employing. By the way, it's not dependent on embedded
12 costs. You've been off of an embedded cost system for the
13 last seven or eight years now, as far as access is
14 concerned.

15 So, either that's the right starting point or it's
16 not. But you have to make a heroic assumption that it's not
17 in order to say that the margins above the normal margin
18 that are in access are not contributing to universal
19 service.

20 And I think if you look at this chart, it seems
21 fairly obvious where the money's going.

22 COMMISSIONER NESS: I don't mean to be heroic, but
23 I think one could make a very easy argument that when we

1 went to price caps, we just switched over without really
2 probing and testing what was in those numbers. And we were
3 told, certainly, by the local exchange carriers who were
4 subject to price cap, "Don't worry about it, because it's
5 price capped. It doesn't matter what our costs are. It
6 doesn't matter how much we spend for the infrastructure.
7 We're going to the invest -- we're going to do all the rest
8 of the stuff. The price cap keeps it down, and you don't
9 have to worry about how much profit is included within that
10 level."

11 So, I'm not sure that I necessarily, therefore,
12 reach your conclusion that everything that would be included
13 on that side solely goes to support universal service within
14 the system.

15 I don't know. Mr. Lubin, do you have a viewpoint
16 on this? I can't imagine that you do, but perhaps you do.

17 MR. LUBIN: Yeah. I'll be brief because I just
18 repeat what I've said is that from our point of view, we
19 think that, in particular, there are some local companies
20 that have rates of return and the interstate jurisdiction of
21 20 percent in excess. There are various audits that go on
22 that try to search the rate base and whatever can identify
23 it.

1 There's all sorts of questions. And that's why
2 the perception is if we took all of the access out and drove
3 it to the costs -- Dennis's number was .8 cent, that it has
4 to be zero sum, and it has to go somewhere else. My point
5 of view is challenging the point, does it have to go
6 somewhere else?

7 Again, if you take a study area as the level of
8 aggregation of the subsidy, we conclude from the analysis
9 we've seen, it's not the case. But I mean, that's the issue
10 that will be debated.

11 I do have one question if I could just pose it to
12 Dennis. I'm just curious just so -- because I was trying to
13 follow the numbers of the 5.2, the .6 and the .2, which
14 added to roughly \$6 billion or \$6.2 billion. Does that
15 include the existing high cost subsidy of about, let's say,
16 1.7 minus the \$200 million? So, say, 1.5 for the rural
17 guide? I was just trying to understand where that is.

18 MR. WELLER: No. We've been talking exclusively,
19 I think, generally, in this session about support for non-
20 rural companies.

21 MR. LUBIN: So, these are non-rural companies.
22 Okay. Thank you.

23 MS. JOHNSON: I have a question for Mr. Lubin, and

1 it goes to the paragraph 381 issue. The issue being whether
2 universal service dollars should be used to reduce
3 interstate access, or at least that's how some people
4 interpreted 381. And maybe the FCC staff can help me here a
5 bit.

6 But looking at the principles, one could interpret
7 the principles to mean, well, at least for the \$220 million
8 that is currently recoverable, we will continue to let
9 universal service dollars flow to that. But whatever's left
10 over will go to reduce interstate access.

11 Now, my question to you is, you have articulated
12 that access dollars aren't used for universal service. That
13 the revenues cover the costs. So, I know in a general way,
14 we should always try to make sure that rates are as low as
15 possible in looking at the market, of course. But to the
16 extent that we're in a universal service docket and we're
17 dealing with universal service issues, and you tell me that
18 those dollars -- those access dollars have nothing to do
19 with local rates low, why should I be concerned? Should
20 that be a priority for using the dollars in that way?

21 MR. LUBIN: Meaning the \$220 million or what's
22 included in access?

23 MS. JOHNSON: Both.

1 MR. LUBIN: Okay. It's a complicated issue, but
2 before I answer, I just want to take 20 seconds and thank
3 the Commissioners and the Joint Board for having a session
4 like this in terms of having the expertise on the panel to
5 engage and listen to your questions and respond.

6 I, personally, found it very helpful. I,
7 personally, learned things that I didn't know before, in
8 particular, on Joel Shiffman's presentation, because it was
9 always unclear. And I'm going to relate it to your
10 question, is that it was always unclear to me how you get to
11 argue that you want a bigger fund and it shouldn't be used
12 to lower access. I mean, I just didn't understand that.

13 I don't agree with it, but at least now, for the
14 first time, I appreciate and understand the logic. And I'm
15 one for trying to understand the logic of what's going on.
16 And what I did not understand before, is that they're
17 looking at it from the point of view of comparability. And
18 so, that doesn't mean that it's a zero sum, meaning, "Hey,
19 figure out the access and lower access prices." They're
20 saying that there's certain states or certain areas for
21 which there needs to be more subsidy to lower the existing
22 local rate.

23 I didn't understand that before. And so, we can

1 debate whether the law, you know, wants that to occur. But
2 at least I, for the first time, understand how they get to
3 argue, create more money, don't use this to lower access,
4 use it to lower somebody's local rate. I mean, it never
5 dawned on me before. At least now I understand that. I
6 mean, I don't agree with the point, but at least I
7 understand the logic, whereas before I thought it was just
8 being arbitrary. Now, I see that they're saying that, you
9 know, there are certain local rates that aren't comparable
10 and need to be lower.

11 MS. JOHNSON: And from a universal service
12 standpoint, if the goal is to keep local rates low or
13 comparable, you can follow that argument. You still may not
14 agree, but --

15 MR. LUBIN: Right, right. But again, to me, I
16 always thought the Telecommunications Act was, "Okay. We've
17 got the subsidies somewhere." Identify them and make them
18 explicit to keep rates kind of where they were, which I
19 always deemed as affordable rates. I mean, they were --
20 they exist. You have some lifeline. You have penetration
21 94 percent, and you have other ways to get it up. So,
22 anyway, I don't want to belabor it, I just thought, at least
23 I understood now the logic.

1 But now I go to the heart of your question. The
2 \$220 million or the 110 for which large companies get --
3 okay? So, the 200 is all non-rural. Of that 220, roughly
4 110 goes to the very largest companies. There's about, you
5 know, RBOC, GTE and SNET cover about 90 percent of the
6 lines, and they get the money.

7 And from our point of view if revenues for local
8 are covering costs, and you're at the study area level, our
9 point of view was they shouldn't get the money. There's no
10 need for the money. The money is simply going to the bottom
11 line by virtue of looking at the interstate rates of return
12 for GTE and other companies who are getting the money.

13 MS. JOHNSON: Why should you get the money?

14 MR. LUBIN: Okay.

15 MS. JOHNSON: Because we're not -- a lot of
16 states, we aren't looking at their rate of return, just like
17 we're aren't looking at yours. So, if the money isn't going
18 -- I mean, why should you get the money? How do we make the
19 policy decision that AT&T should get the money?

20 MR. LUBIN: I wish --

21 MS. JOHNSON: Because typically you're not passing
22 it through.

23 MR. LUBIN: Right. Well, I mean, that --

1 MS. JOHNSON: But maybe you are.

2 MR. LUBIN: Right, right. The question here is,
3 you know, and -- I mean, I understand the dilemma that the
4 regulator has. The regulator has, "Why should take billions
5 of dollars out of access and trust the middleman or
6 middlewomen to flow it through?"

7 And certainly, that is the dilemma that I hear --
8 the paradox I hear, because I keep coming back to the point
9 that the reason you take these access down is the consumer
10 is going to benefit, be it high cost. That I say, there's
11 \$110 million too much. Or be it that there's, you know, six
12 billion, 10 billion, 12 billion. Pick the number have the
13 investigation. From our point of view, that gets lowered
14 and that flows back into the customer's hands.

15 Now, one of the things I take it that people would
16 like is, it should uniformly flow into all customers hands.
17 And unfortunately, that is an issue.

18 My answer earlier was I sincerely believe that
19 business and residents are getting their fair share. That
20 doesn't necessarily mean that every customer is getting
21 their fair share as maybe you wish to define it. And that
22 is because there are some customers whose cost or margin is
23 extremely thin. And there are other customers whose margin

1 is bigger.

2 And so what you compete away is you compete away
3 margin. You compete away us trying to drive costs out of
4 our businesses, such as our overhead, our sales, our
5 marketing, our administration. We try to drive those up.
6 But I'm hard pressed to drive out a USF assessment. I'm
7 hard pressed to drive out a pixie charge unless there was
8 local competition. And if there was local competition, I
9 still can't drive out the USF line item, but maybe I have
10 the opportunity to drive out the pixie.

11 Anyway, so I'm taking probably more time than is
12 warranted here. Thank you.

13 MS. JOHNSON: Thank you.

14 MR. WOOD: Consumer information is what lubricates
15 the market period. There are a number of areas that are not
16 passing this through. And I wonder if there's a role -- I
17 know you all have access to a lot of resources as to what
18 people are charging on tariffs. But -- and we're trying to
19 figure this out in Texas, too, is -- you know, in a market
20 place, which the long distance market is arguably there in a
21 competitive marketplace, consumer information is what really
22 lubricates the market.

23 And you know, there's still people in Texas who

1 think there's only one phone company. As Mr. Lubin's
2 employer, it would be nice to let them know that there are
3 companies who don't choose to pass these through. We choose
4 to internalize that in a minutes of use rate or in a flat
5 structure that looks different than what they're charging.

6 And the truth shall set you free philosophy leads
7 me to think maybe rather than, you know, beating these guys
8 over the handbags and shoes, we ought to just out there and
9 tell the public, "Hey, here's a 1-800 number company who
10 doesn't charge all this stuff." I mean, that's what I would
11 like to do. And I think in Texas, we might talk about doing
12 that sometime later this month.

13 But there are a lot of little companies out there.
14 One of them found me one rainy night when I was mad at my
15 carrier, who's not on this panel, but -- and I moved. And I
16 asked them every three months, "Are you going add
17 surcharges?" They said, "Federal excise tax, state sales,
18 911 fee and that's it." And as long as they kind of hold to
19 that pledge, that's who I'm staying with.

20 But I mean, I think that's an effort that maybe
21 the consumer affairs division of the FCC can help us with is
22 getting the word out to who these -- you know, make
23 available information out there as to what these people, and

1 the customer can decide if they want to do that or not.

2 CHAIRMAN KENNARD: I think you make an excellent
3 point, Pat. Mr. Lubin argues passionately for the fact that
4 all of the consumers that he serves are getting their fair
5 share, but those consumers don't know that. Indeed, we
6 don't even know that. And unless consumers get that
7 information, one way or another either from us or from you
8 in your billing disclosure, they'll have no confidence that
9 they'll have that information. And that is, information is
10 power. That's what they need to exercise the choice that
11 Chairman Wood is talking about.

12 Commissioner Furchtgott-Roth?

13 COMMISSIONER FURCHTGOTT-ROTH: Chairman Wood, with
14 all due respect, there are millions of Americans who switch
15 their long distance carrier every year without the benefit
16 of a Federal regulator or a state regulator telling them who
17 to go change to. American consumers are the brightest, best
18 informed consumers in the world. And I think they do an
19 awfully good job of sorting through this.

20 If they want to go to a carrier that embeds new
21 Federal taxes in the rate, they'll go that one. If they
22 want to go to one that's going to make it an explicit line
23 item, they'll do that. If they want to go to one that's

1 going to make it a line item somewhere else, they figure it
2 out. But I am completely unconvinced given the rate at
3 which consumers churn in the market in one of the most
4 competitive markets in the United States, that there's any
5 shortage of customer information out there. I find it,
6 frankly -- I find it unfathomable that we could even have a
7 discussion about this at this stage.

8 But that's probably just a reflection of my
9 concern about an earlier statement of possibly going back to
10 regulating rates of long distance carriers. I haven't quite
11 recovered from that one yet.

12 CHAIRMAN KENNARD: Fasten your seatbelt.

13 MS. JOHNSON: Let me make one comment in response
14 to the Commissioner's statement. I agree that the consumers
15 -- American consumers are some of the most informed. Often
16 times, they have the 1-800 number for the Florida Public
17 Service Commission, and they call us to tell us how
18 confusing this all is for them, how they don't understand
19 the pixie, how they don't understand what's happening, how
20 they do, in fact, need some help in sorting all of these
21 issues out. That's not to say that they aren't intelligent
22 beings, but this is a very complicated process.

23 And often times, there's a lot of churn, because

1 there's a lot of slamming. Now, that's another issue we
2 need to deal with. And I say that somewhat joking, but
3 somewhat seriously, too. I've been on the road show for
4 several months meeting with consumers, consumers that we
5 regulate, and the number one issue is customer confusion.

6 So, to the extent that we can come up with
7 policies, and we've been working with our industries to --
8 so that they can help develop policies, not necessarily
9 Commission policies and Commission procedures to make sure
10 that the users understand their bills, understand the
11 issues, understand the increases and the savings that they
12 may achieve. But it is a difficult process and I deal with
13 it every day.

14 CHAIRMAN KENNARD: Commissioner Tristani? Oh.
15 Ms. Hogerty?

16 MS. HOGERTY: I had a question about the access
17 reductions and the 381 question. If my memory serves me,
18 the universal service docket dealt with universal service.
19 There was a separate docket that dealt with access
20 restructure. And there were discussions today, and I
21 know -- I think Commissioner Ness if anybody disagreed that
22 the fund should be used to lower access. Well, I recall
23 that Dr. Cooper, before he left, stated that it should not

1 be used to reduce access.

2 And the question that keeps occurring to me is,
3 how -- if the purpose of the fund is to maintain affordable
4 rates in high cost areas, how does a general reduction in
5 interstate access target affordable local rates, those rates
6 that have defined as universal service rates in high cost
7 areas? Those reductions will go to -- I don't know where,
8 wherever you decide to put them. But how can that be
9 consistent with the statute when the purpose is to support
10 affordable basic local rates in certain designated high cost
11 areas?

12 MR. SICHTER: I would respond first. I'll tell
13 you the answer is that, as I said in my opening comments, we
14 don't need new revenue to support USF in this country. We
15 need to move from the implicit subsidy structure we have to
16 an explicit subsidy. And that's all that's occurring.
17 You're moving the subsidy dollars out of the access charges
18 where they create all kinds of distortions in the
19 marketplace and eventually become competitively vulnerable
20 to a competitively neutral universal service fund. One that
21 is both explicit and portable and available to CLEC as well
22 as the ILEC's

23 MS. HOGERTY: And what cost are you moving out of

1 access and placing on the end user are you proposing? What
2 cost?

3 MR. SICHTER: Well, we take a little bit different
4 tact than, I think, others. In sorting through this issue,
5 there's really two things going on. One is, the subsidies
6 to support universal services as a result of historic rate
7 making practices, as well as --

8 MS. HOGERTY: I'm just asking, what particular
9 costs are you moving from the access to the end user?

10 MR. SICHTER: I'm trying to get to that. I'm
11 trying to differentiate the costs that were put into access
12 to explicitly support universal service. And those are
13 primarily the non-traffic sensitive costs, as opposed to the
14 above cost rates for access that are really a function, I
15 believe, of the difference between forward looking costs and
16 embedded costs.

17 MS. HOGERTY: So, you are saying, essentially, the
18 loop?

19 MR. SICHTER: Yes. The loop, the non-traffic --

20 MS. HOGERTY: The carrier common line?

21 MR. SICHTER: The carrier common line, and we
22 would like to see the pix moved into universal service for,
23 I think, obvious reasons.

1 MS. HOGERTY: Okay. When a person provides --
2 when a company provides toll, is the loop part of the plan
3 necessary to provide that service to the customer?

4 MR. SICHTER: Oh, absolutely. It's necessary.
5 It's not an issue of whether or not it's used or it's
6 necessary. It's a matter of how you recover those costs.

7 MS. HOGERTY: If you were to provide long distance
8 service on a stand alone basis, could you eliminate the cost
9 of the loop?

10 MR. SICHTER: No, absolutely not. And again,
11 we're not talking about an issue of whether it's used or
12 useful or necessary for the provision of a toll service. We
13 are talking about a pricing issue on how those non-traffic
14 sensitive costs did recover.

15 The issue, if I may be permitted, that we're
16 dealing with today, is a recovery of those costs through a
17 usage sensitive element, somewhat on the interstate side,
18 but particularly, on the state side. And we have this
19 phenomena, and I can relate the numbers for Sprint local
20 companies. They're not dissimilar from other companies, as
21 we find that for example, 40 percent of the revenues -- CCLC
22 revenues generated just by our residential come from 10
23 percent of the customers.

1 What's that translates into is that we've got
2 customers that are paying nothing because they make no toll
3 calls towards the contribution of those costs. And we've
4 got others that pay as much as \$40 and \$50 a month. Now,
5 people paying \$40 and \$50, if you're a smart competitor in a
6 market, and there are smart competitors out there, figure
7 out that if you can buy an unbundled loop for \$20 to \$25 and
8 pull off to \$40 to \$45 in CCLC revenues, that's a pretty
9 good start in the marketplace.

10 That's the type of arbitrage that we have set up
11 through the permanent recovery of the non-traffic sensitive
12 costs. Eventually, those costs have to be borne in a non-
13 traffic sensitive manner, and indeed, they have to be borne
14 by the customer who causes those costs to be created by
15 subscribing to the network.

16 MS. HOGERTY: That is the position you're in right
17 now, deciding how you want to recover any of your costs as
18 an interexchange carrier, but that's a different question as
19 to whether the universal service fund should be collected
20 and distributed to interexchange carriers to do with
21 whatever they wish, as opposed to targeting high cost areas
22 to insure that rates are affordable.

23 MR. SICHTER: The subsidy that flows to the high

1 cost areas today is via the mechanism of the interstate as
2 well as intrastate subsidies such as the CCLC, and that's
3 what we are trying to replace. We're not trying to create
4 new money. We're trying to more specifically, identify how
5 a cost area --

6 MS. HOGERTY: Since you have stated that the loop
7 is required to provide your service, I don't think that you
8 can demonstrate a subsidy. I think all this deals with is a
9 question of how you're going to allocate a joint and common
10 cost. And I think we do need to pay attention to the
11 statute that says joint and common costs must be reasonably
12 allocated between universal service and other services.

13 MR. SICHTER: You can allocate the costs all you
14 want, but they have to come back on the consumer's bill.
15 Now, if you want to do it through a local service charge and
16 pix and a SLC, we can divide it up and put it back on the
17 bill. But when the dust settles on this, if it costs \$20 to
18 provide a loop to a customer, you either get that \$20 from
19 the customer or you get it from somebody else. If you get
20 it from somebody else, you've got a cross-subsidy problem.

21 MS. HOGERTY: Joel?

22 MR. SHIFFMAN: For many ways I've listened to this
23 argument, I find the discussion of differences of position

1 between Mr. Sichter, Sprint, GTE and Bell-South, and myself,
2 to be somewhat more semantic than substantive. And your
3 question, I think, raised that point very well. And that is
4 that, we -- I, personally, have no objection to removing
5 from the common line charge and the pixie those costs and
6 replacing them with a surcharge on carrier revenues. But
7 that's access reform. That's something that may be
8 desirable and is to be looked at as access reform. It's not
9 universal service reform. And your question raised that.

10 Universal service reform is providing funds, as
11 Mr. Lubin suggested, to make rates comparable, to make rates
12 affordable. And that there are different things that --
13 don't object to what you are doing Mr. Sichter, but it's not
14 -- but it is not -- it doesn't come under the rubric of
15 Section 254 or universal service. It probably is a
16 desirable objective. You can't continue to sustain per
17 minute recovery of costs that are not incurred on a per
18 minute basis.

19 I don't disagree with you, but call it for what it
20 is, a spade a spade. Access reform hasn't got far enough,
21 and access reform needs to be -- go further to recover those
22 costs in a way that will not distort the marketplace. But
23 don't call it universal service reform and don't make -- and

1 don't cheap out on universal service reform because you need
2 both of them. Fund both of them.

3 MR. SICHTER: You misunderstand. We either
4 move -- have to move those costs back to the end user, which
5 I'm hearing you agree with in terms of a flat rate charge,
6 or we're going to have to fund them through universal
7 service. And we need to get it out of the carrier charge.

8 MR. SHIFFMAN: You need to pull it out of the
9 carrier charge and either move them back to the end user
10 through a surcharge on carriers, not dependent upon use or
11 through an end user charge. But that doesn't make that a
12 universal service fund issue.

13 MR. SICHTER: It makes it a rate rebalancing
14 issue, which is exactly the right answer.

15 MR. SHIFFMAN: It is a rate rebalancing issue, but
16 --

17 MR. SICHTER: And that's fine. I said at the
18 opening, that the universal service subsidy implicit as well
19 as explicit we have today is huge. And the only way to
20 reduce it is rate rebalancing, which we are in favor of.
21 So, I mean, that's fine. That's --

22 MR. SHIFFMAN: But those are not new dollars as
23 you said.

1 MR. SICHTER: Absolutely. There aren't any new
2 dollars, Joel. We're shuffling existing dollars. We don't
3 need new dollars. We don't need bills to go up in
4 aggregate. We need to reshuffle the dollars we have today.

5 MS. HOGERTY: Can I ask another question? This
6 \$200, that -- do I understand it to be the current high cost
7 distribution to the large -- the non-rural companies? Is
8 that correct?

9 MR. WELLER: \$200 million.

10 MS. HOGERTY: \$200 million. What'd I say? \$200?
11 Okay. What is the 110 that you are referring to in your
12 statement?

13 MR. LUBIN: The number I was referring to was
14 there's \$110 million for what we call major LEC's. These
15 would be the RBOC's plus GTE and SNET. That is \$100 million
16 that goes to that classification.

17 Then, there's another classification which is
18 their -- we view as their non-major, but there also non-
19 rural. That number that we estimate, it's about \$230
20 million. So, we believe that the high cost -- well, I'll
21 say it this way. The high cost plus LTS and DEM for that
22 group, meaning non-rural, is approximately \$330, \$340
23 million.

1 So, again, it's \$110 million for the major LEC's.
2 Those are the top, say, GTE, SNET and the RBOC. It's \$110
3 million, \$230 is the next rung down of non-rural. And the
4 total, if you added it all up in terms of what happened on
5 January 1, 1998, is about \$1.72 billion.

6 Am I confusing?

7 MS. HOGERTY: Well, I'm familiar with -- I was
8 just trying to compare the 200 and your 110.

9 MR. LUBIN: Okay. My 110 is purely the amount for
10 major LEC's, the top seven companies. The next rung, which
11 is non-rural but not major is 230. That's our estimate.

12 CHAIRMAN KENNARD: Mr. Lubin, could I just get a
13 point of information for the record? How many basic
14 schedule customers does AT&T have? Roughly, ball park?

15 MR. LUBIN: I mean, offhand, I don't know that
16 number. I'm sure we would be glad to find that and give it
17 to you. I'm not sure I would want to publicly state that to
18 the world.

19 CHAIRMAN KENNARD: Do you know what the churn rate
20 is, in general, for your basic schedule customers? That is,
21 how many times they switch carriers?

22 MR. LUBIN: No. I know what the aggregate
23 estimate is for the industry. The last I heard it was about

1 50 million for the industry.

2 COMMISSIONER TRISTANI: How many?

3 MR. LUBIN: Fifty million.

4 CHAIRMAN KENNARD: I'm talking about for your
5 lowest volume consumers, your basic schedules what I'm
6 interested in. You don't know that?

7 MR. LUBIN: Don't know that.

8 COMMISSIONER TRISTANI: That's 50 million total
9 for all the industry.

10 MR. LUBIN: Yes. All the industry, the IXC
11 industry. That was the last number that I was familiar
12 with.

13 CHAIRMAN KENNARD: Okay. I think we're going to
14 have to wrap up soon. Commissioner Tristani, did you have
15 further questions?

16 COMMISSIONER TRISTANI: No, I'd like to give this
17 opportunity to the state commissioners if they have
18 something to add or to discuss?

19 CHAIRMAN KENNARD: That's a good idea. Any other
20 questions from the bench? Okay.

21 I just had a couple of questions really in the
22 nature of sort of housekeeping questions as we proceed from
23 here. We've talked about the process for proceeding from

1 this point. And I have talked about discussing with members
2 of the Joint Board the possibility of a referral to the
3 Joint Board if we can agree on the scope of the referral and
4 the timing. And if we are to take a referral of some of
5 these issues to the Joint Board, it will implicate our
6 schedule for resolving this matter.

7 I'd like to ask Mr. Weller from GTE if GTE would
8 be amenable to pushing off the January 1 deadline to afford
9 us more opportunity to get input from state members of the
10 Joint Board.

11 MR. WELLER: Mr. Chairman, I appreciate the
12 dilemma here because you want to get input and yet on the
13 other hand, we're all concerned about delay, because we
14 realize the importance of moving ahead with the program.
15 I'd answer the question, I think, by drawing a distinction
16 among the different purposes of the Federal fund or the
17 different objectives for the Federal fund. But I think
18 several have talked about -- Mr. Bush, I think is listed, a
19 similar set of objectives.

20 To my mind, the biggest single source of funding
21 that the Federal fund has to deal with is the implicit
22 support that is coming today from interstate access. And I
23 don't believe that you need -- that the FCC needs to refer

1 questions about the magnitude of that funding source to the
2 Joint Board. It's really about rates that are within your
3 jurisdiction. And I think that it should be possible to
4 arrive at a component of the fund that deals with that
5 problem by the end of the year.

6 Similarly, I think we all know what the current
7 amount is that's in the high cost fund today. So, we don't
8 really need to ask questions about that. We know what those
9 dollars are.

10 The third item that I've talked about is the
11 amount that would -- of new funding over and above the
12 current high cost fund that would be sent to the states to
13 deal with states with high cost and/or low funding basis.
14 There, I recognize that there are different interests of
15 different states around the table and that some Joint Board
16 activity must be a way at arriving at some reasonable
17 balance among these considerations.

18 So, if we were to consider a delay, I would
19 suggest that it would apply only to that portion of the
20 funding. In other words, you could adopt a fund that
21 addresses most of the funding that the Federal fund needs to
22 supply by the end of the year, and either defer that third
23 item or put some sort of plug in place to say, basically,

1 "Look, we're doing this much now. We'll refer that amount
2 to if we want it to be more or less. Give us input back
3 again."

4 So, I think that a referral might be a useful
5 process. I understand the problem with scheduling. But I
6 think we ought to craft it so that it does the least
7 possible harm in terms of delay of implementation to the
8 fund.

9 CHAIRMAN KENNARD: Mr. Brown, would you like to
10 address that point?

11 MR. BROWN: Yes, Mr. Chairman. I spoke at the
12 beginning about 200,000 customers that we serve that cost
13 over \$100 a month. These are the most vulnerable customers
14 in the system, another half a million that are over \$50.
15 And competition is here in the business markets where we get
16 most of the support.

17 I go back to what Chairman Wood said earlier about
18 we do not have to have the perfect solution initially. And
19 I'm not sure that we want the perfect solution to be the
20 enemy of moving in the right direction.

21 If -- I would make a couple suggestions to the
22 Commission as perhaps a way to move this along. One would
23 be there's been a lot of debate on the cost models. There's

1 probably going to be more debate about the cost models, but
2 both models indicate that there are a number of very high
3 cost customers that are going to need, under any system that
4 we come down with, support.

5 The second suggestion I would make is maybe you
6 address that high end first. You set the high end benchmark
7 high enough that you built a safety net under those
8 customers. And knowing that you've not solved the whole
9 problem there, but that as you refine the models as they
10 become more precise, as you find where the affordability or
11 revenue or whatever benchmark is going to be firmly be put
12 in place on the low end, you at least have begun to address,
13 you know -- what I hear, you know, coming out of a number of
14 the Congressional representatives from the area we serve,
15 that we've just got to get moving to make sure that we don't
16 lose this important thing we have of universal service.

17 So, my suggestion would be we find an interim cut
18 of the models. Maybe the staff common inputs. Maybe that's
19 a starting point. We find a high level benchmark that
20 addresses the needs of the states that face the most
21 difficult problem, and than work on fine tuning the low end
22 funding benchmark.

23 That would be my suggestion.

1 COMMISSIONER NESS: If your concern is the loss of
2 some of the business customers, wouldn't that be a function
3 of the intrastate implicit subsidy? That is, the difference
4 between business and residential or some of the other
5 elements that go in there, rather than on the interstate
6 side of the coin?

7 MR. BROWN: Well, Commissioner Ness, these are --
8 the states that are, you know, we've identified through the
9 modeling processes are the ones that have a lot of the very
10 high cost customers and don't have, you know, the large
11 concentrations of low cost customers.

12 COMMISSIONER NESS: Okay. But I thought your
13 concern had been that you're losing your business customers
14 to competition, and therefore --

15 MR. BROWN: And we're losing that implicit subsidy
16 within that state, and we can't wrap the state subsidy up,
17 or if we did, you get the kind of relationships we're
18 showing here, where in Commissioner Schoenfelder's state,
19 you've got a disproportionate --

20 COMMISSIONER NESS: Is it your testimony that a
21 six month delay would be extraordinarily detrimental? That
22 these people would -- that your highest cost customers would
23 fall off of your system? Are you suggesting that we would

1 lose them as participants in our telephone system?

2 MR. BROWN: I'm suggesting that we started
3 draining out the implicit support back in August of '96 --

4 COMMISSIONER NESS: But I'm asking you, if we were
5 to delay from January -- the implementation date from
6 January 1, to say, July 1, a six month period of time, in
7 order to give all of us, and we have right now 60 percent of
8 the Joint Board is new, or actually, not even the Joint
9 Board. Sixty percent of the folks here did not participate
10 in the prior decisions. Okay?

11 MR. BROWN: Yes.

12 COMMISSIONER NESS: Would it not make sense for us
13 to take that extra six month period of time and get it
14 right, rather than try to do something piecemeal in order to
15 make a January 1 deadline? Or is it such that if we delay
16 by six months in implementing this, that there would be a
17 whole bunch of folks in U.S. West territory that would fall
18 off the face of telephony? Is that your testimony?

19 MR. BROWN: I'm not prophesying the end of the
20 world. However, I think beginning to address the problem
21 this January, even though it's a B minus or even maybe a B
22 solution to take care of the most needy customers is
23 something that in six months, if the industry and the state

1 and Federal regulators roll their sleeves up, we can make a
2 good start at.

3 I would hate to see that date go by. I under your
4 reasons for wanting to do a complete thing, but I'm --

5 COMMISSIONER NESS: So, in other words, we should
6 put into effect some pieces of it, than begin to change
7 those pieces. Don't you think that would result in a lot of
8 confusion in the marketplaec?

9 MR. BROWN: What I'm saying is take the high end
10 where there's absolutely no question that these are
11 customers that will need explicit support and begin
12 providing that.

13 COMMISSIONER NESS: Mr. Shiffman?

14 MR. SHIFFMAN: Yes. I'm very concerned that we use
15 even in the high end from the -- as suggested by Mr. Brown,
16 because of the fact that we still don't believe that the
17 models are reliable yet. And we believe that moving forward
18 on something that relies on those models, even taking the
19 high ends of those models, there's some demonstrated
20 reliability of the models would be premature.

21 At the same time, we believe -- I tend to agree
22 with Mr. Brown that there are certain problems with the
23 existing high cost fund.

1 And what we would ask that, it may be appropriate
2 to let the Joint Board look at these issues. It may be
3 appropriate to wait until the models are more reliable. But
4 at the same time, where we know that the existing plan has
5 certain deficiencies that are inconsistent -- that are
6 discriminatory towards some outlying jurisdictions, that it
7 may be -- that we would ask if you consider delaying the
8 program, to perhaps put in place an interim fix to take care
9 of these existing demonstrated anomalies in the existing
10 high --

11 COMMISSIONER NESS: So, in other words, we would
12 place -- work to put in place a regime -- go through the
13 regulatory process of putting in place a regime for January
14 that we would then change in July. Is that your
15 recommendation?

16 MR. SHIFFMAN: No. What I'm suggesting is you
17 modify what's in place, minimally, to take care of the
18 manifest problems with it. So, you don't put -- don't start
19 from anew. Start with the existing high cost fund program.
20 Make very, very minor changes with minimal as possible
21 around the edges to building on the existing program before
22 you move forward with something that replaces the whole
23 thing.

1 COMMISSIONER NESS: Ms. Baldwin?

2 MS. BALDWIN: I simply don't think there's enough
3 evidence to suggest that universal service is the least bit
4 jeopardized. And I don't think that there's -- I think it
5 would be a big mistake to rush forward on such a complicated
6 issue and would fully support the Commission's taking the
7 ample -- the time that's necessary to allow for a deliberate
8 decision, and thus giving the Joint Board opportunity to
9 give feedback to the Commission on the various complicated
10 proposals that are before it.

11 CHAIRMAN KENNARD: Let's hear from Sprint on this,
12 as well, from Mr. Sichter.

13 MR. SICHTER: Obviously, it's more important to do
14 it right and do it right the first time, than do it quickly.
15 We would support a limited extension till July of next year,
16 an additional six months, simply because, you know, at this
17 point, nobody can do any quantification because we don't
18 have the models finished. We don't have the inputs
19 finished. And that's only the beginning of that process of
20 doing the tweaks to really size the fund. The time is very
21 short.

22 On the other hand, I would remind the Commission
23 and the state members that, universal service fund is an

1 important, critical element in the development of local
2 competition. We've got to fix the economics of entry into
3 the local network. And a six month delay in revising that
4 system is a six month delay in creating the conditions that
5 we need to create for the introduction of local competition.

6 But given that, we've got to do it right when we
7 do it the first time. And let's get on with it and get it
8 done by July of next year at the latest.

9 CHAIRMAN KENNARD: Would any of our state
10 colleagues like to address this question?

11 MS. JOHNSON: I can address it and I guess it
12 addressed in my opening remarks. I do believe that the
13 deliberative process is necessary, that the Joint Board --
14 the state commissioners and the public advocate that we have
15 a lot to contribute to the process. I'd like to see the
16 process unfold in a very formal manner to allow more of this
17 dialogue, debate, even a written recommended order that
18 would allow those FCC Commissioners that are not on the
19 Joint Board, an opportunity to be full participants and
20 reflect on whatever might be recommended.

21 So, to the extent that -- and I understood, too,
22 that the Joint Board process is a cumbersome process. And
23 that it will take additional time. But at least, in my

1 personal view, to have the opportunity to have the
2 collective thought and the debate and the discussion with
3 the state members and the state advocate is not only the
4 best way to proceed, but it is consistent and proper under
5 the Act.

6 CHAIRMAN KENNARD: Yes?

7 MS. SCHOENFELDER: I would just like to add that I
8 really, really feel that referral to the Joint Board would
9 be beneficial to everyone. And let me tell you why.
10 Because as I sat here today and I go back a year and a half
11 or almost two years to where we started to hear this debate
12 originally, there have been -- a lot of us have learned a
13 lot, on this side of the table, as well as on that side of
14 the table. And I can tell you that there's some positions
15 on that table that have changed at least 180 degrees. And
16 some of them -- and I compliment you for that.

17 I also believe that by referring it to the Joint
18 Board, that I honestly do not believe anyone will be harmed.
19 We're not talking about suspending or taking away the support
20 for the rural companies out there that now exist in
21 extremely high cost areas. I don't see consumers being
22 harmed, which is my first criteria.

23 Secondly, even though Mr. Brown thinks that we

1 should hurry along, I happen to come from a U.S. West state,
2 and the RBOC in that state -- U.S. West in that state, does
3 not receive any cost funds now. I would tell you that we
4 would not allow them to let anybody fall off the system.
5 And I'm a state regulator, and believe me, I'm not going to
6 let you, Mr. Brown.

7 So, at this point in time, I believe everyone
8 would benefit from the continued deliberation and from the
9 continued input. This isn't an easy business. It's not an
10 easy business for regulators or for some of you to
11 understand. And we're in a changing -- it's important to
12 get it right.

13 I think Commissioner Powell told me that the first
14 time I visited with him, it's more important to get it right
15 than to do it quickly. And I will guarantee you that we
16 will move as quickly as we possibly can and still try to get
17 it as right as possible.

18 CHAIRMAN KENNARD: Thank you. If there aren't any
19 further comments from our side, I'd like to wrap up given
20 the time. Any other comments? Hearing none -- Chairman
21 Wood?

22 MR. WOOD: As one from a state who hopes to get
23 competition on the sooner rather than the later end, I do

1 think the gentleman from Sprint made some good points about
2 the need to get the structure in place as soon as possible
3 so that the defensive part of the frame can be in place.
4 So, I would maybe urge that the state board, if you all move
5 ahead, that the Joint Board do as soon as possible, get
6 together and move forward on some of these things. That
7 would keep the heat on the model developers very hot to get
8 that wrapped up.

9 Again, the B minus is got to be the standard for
10 us. It's a defensive fund we're talking about at this stage
11 of the game. And that we try to get back in that, maybe
12 rather than assume it's going to be July, say it's no later
13 than July. But as soon as we can get our work done from the
14 Joint Board part up here, than we can get it back to you
15 all. And hopefully -- and Joel, you're in charge of that,
16 so I'll leave that up to you.

17 CHAIRMAN KENNARD: That's very helpful. Hearing
18 no further comments, I think, I would like to echo comments
19 of a number of my colleagues today, to compliment this
20 panel. You've done a terrific job and have really shed some
21 light on some very difficult issues. And the proposals that
22 you described today are very thoughtful, and I know a lot of
23 work went into them, and we're very grateful to that,

1 particularly to you, Mr. Lubin. You certainly earned your
2 pay today, on behalf of AT&T. And I thank you for being a
3 good sport here today.

4 I'd also like to thank a number of people who
5 helped put this program together today. Chuck Keller, Jane
6 Wong, Martha Contee, Jeff Rudin, Cheryl Todd, Emily Hofner,
7 Craig Brown, Lisa Gelb, and of course, Jim Schlichting from
8 the Common Carrier Bureau.

9 And I look at this as sort of the end of the
10 beginning. We've got a lot of work to do. I think we, by
11 the spirit of our discussion today -- I think we've
12 recommitted to making sure that we can work together to get
13 these very difficult and vexing problems solved. They are
14 not easy. I think that the little skirmish that we're
15 seeing over schools and libraries foreshadows a lot of the
16 difficulties that we're going to see as we move to resolve
17 the high cost fund. In order to get through this, we're all
18 going to have roll up our sleeves and really work together
19 to make this happen.

20 Thank you all very much.

21 (Whereupon, at 4:54 p.m., the meeting was
22 concluded.)

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