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October 18, 1999

BY HAND DELIVERY

David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

Re: *Universal Service*
Docket No. 97-00888

Dear Mr. Waddell:

Pursuant to the Authority's Interim Order on Phase I entered on September 16, 1999, in the above-referenced case, enclosed for filing is an original and thirteen copies of Comments of AT&T.

Thank you for your assistance in this matter. If you have any questions, please do not hesitate to call me.

Sincerely,

Jim Lamoureux

Jim Lamoureux

Encls.

cc: Richard Collier, Esq.

FILE

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

In Re: Universal Service Generic)
Contested Case)

DOCKET NO. 97-00888

COMMENTS OF AT&T

On September 16, 1999, the Tennessee Regulatory Authority ("TRA") issued its Interim Order on Phase II in the above-captioned proceeding requiring the parties to file revised cost studies consistent with the TRA's findings and allowing comments to be filed regarding the revised cost studies. In accordance with the Interim Order on Phase II, AT&T, BellSouth and United all filed revised cost studies on September 30, 1999. In further compliance with the Interim Order, AT&T submits the following comments on: 1) the size of the fund that might be created under the cost studies as submitted on September 30, 1999; 2) the United and BellSouth cost study filings; 3) the alternative approach being considered by the Federal Communications Commission ("FCC"); and 4) the next steps the TRA should consider.

THE SIZE OF THE FUND

Using either cost model, the HAI Model or the BCPM, the revised studies submitted by the parties on September 30, 1999, in conjunction with the revenue benchmark information filed by BellSouth and United on September 23, 1999, result in a total Tennessee universal service fund of extraordinary and troublesome proportions. For example, using the BCPM, BellSouth would require a fund of over $95 million, and United would require approximately $7 million, for a total Tennessee fund of over $102 million. A universal service fund of this magnitude would equate to $3.05 per customer access line per month for BellSouth and $2.47 per customer access line per month for United.

The results from the HAI model are lower, but nonetheless still substantial. The corresponding numbers using the HAI Model are a fund of $52.6 million for BellSouth ($1.68 per customer access line per month) and $5.1 million for United ($1.70 per customer access line per month). AT&T does not believe that a fund of this magnitude would be consistent with the intent of the TRA, as indicated in its May 20, 1998, Interim Order on Phase I of Universal Service, of "maintaining a smaller fund, at least in the initial phases," in order to best promote "market entry and a competitive market." *Interim Order on Phase I of Universal Service* at 7 Docket No. 97-00888 (May 20, 1998).

Although the cost models obviously account for differences in the amount of potential funds, one of the primary reasons the projected fund is so large using either model is the requirement that the fund be calculated based on a "sum of the negatives" wire center cost basis, without taking into consideration the wire centers where revenues exceed costs. In other words, the TRA's method for determining the size of a fund adds the deficits of all wire centers where costs exceeded revenues, but does not deduct the surplus amounts from wire centers that generate revenues in excess of costs.

Using such an approach in which only the "positives" are added together, without correspondingly deducting the "negatives," ensures a sum of some amount. In this case, given the revenue information and cost models submitted by the parties, it produces not only a positive fund, but an overwhelmingly large fund.

"Netting" of wire centers is clearly more appropriate in the absence of robust competition in the local exchange market (as currently is the case in Tennessee) and would result in substantially reducing the size of the fund. The Federal State Joint Board on Universal Service effectively supports this approach in its Second Recommended Decision, released on November

25, 1998, in which it recommended that given the current extent of local competition, it is appropriate to determine costs on a study level basis rather than on a wire center basis.[1] The Joint Board recommended "measuring costs at the study area level at this time because [it believes] that support calculated at this level will properly measure the support responsibility that ought to be borne by federal mechanisms *given the current extent of local competition.*"[2]

AT&T supports the rationale of the Joint Board, and also believes, given the current state of local competition, that such an approach would be more consistent with the intent of the TRA as set forth in its Interim Order on Phase I.

BELLSOUTH AND SPRINT FILINGS

Although AT&T has discovered what appear to be certain discrepancies in both BellSouth's and United's cost study filings, for the most part, both BellSouth and United have revised their cost studies in accordance with the TRA's Interim Order on Phase II. BellSouth's revenue benchmark filing also appears to conform to the TRA's Order. United's revenue benchmark filing, however, does not appear to comply with the TRA's Order.

The TRA decided in Phase I that the revenue benchmark should include all revenues from basic local service (including extended area service), toll service, directory assistance, all vertical features, touch tone, zone charges, long distance access (intrastate/interstate), the interstate Subscriber Line Charge (SLC), and white and yellow page revenues. The revenue benchmarks developed by United do not fully comply with this requirement.

In its development of the per line revenues, for most components (e.g., custom calling revenues, touch tone revenues, toll revenues), United identifies the total revenues for the component, develops the average monthly revenues, and then the average revenues per line in

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1 Second Recommended Decision, FCC 98J-7, released November 25, 1998, in CC Docket No. 96-45, ¶ 32.

2 Second Recommended Decision, FCC 98J-7, released November 25, 1998, in CC Docket No. 96-45, ¶ 33.

each exchange. For the SLC revenues component and the Basic Local Service revenues component, however, United has merely used the tariff rate, which understates the revenues. For example, by using \$3.50 as the per line SLC revenue, United totally ignores the \$6.07 SLC that is applied to second lines. Similarly, by using only the tariff rate for residence service, Sprint ignores local service revenues from such items as non-recurring charges and expanded calling. These components of the revenue benchmark should be developed using the same process to develop custom calling revenues per line.

FCC ACTIVITY

Since the Phase II hearing was held and the TRA voted on the issues, the FCC has further refined the process it will follow in determining federal universal support. In November 1998, the FCC adopted a cost model structure that combined the attributes of both the HAI Model and BCPM. This cost model structure is referred to as the Hybrid Cost Proxy Model ("HCPM").

In addition, on May 28, 1999, the FCC issued its Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45 and Fourth Report & Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking ("FNPRM"), FCC 99-119. In this Order, the FCC, consistent with the Joint Board's Second Recommended Decision,[3] adopted a new framework for federal high-cost support. Under the new framework, the entire concept of a revenue benchmark was replaced with a framework of a cost benchmark. Under this approach, federal universal service mechanisms will provide support for non-rural carriers' forward-looking costs that exceed both a national cost benchmark and the individual state's resources

[3] Second Recommended Decision, FCC 98J-7, released November 25, 1998, in CC Docket No. 96-45.

available to support those costs. A cost-based benchmark methodology was adopted because it provides a better gauge with which to identify areas in need of support than does a revenue-based benchmark.[4]

The Commission decided to replace the 25/75% federal/state jurisdictional responsibility for high-cost support adopted in the FCC's May 8, 1997 Universal Service Order,[5] with a two-step process that would require the FCC to determine: (1) whether forward-looking cost of serving a given area is significantly above the national average, as determined by a national cost-based benchmark, and (2) if so, whether the state has sufficient intrastate resources to provide the support needed to non-rural carriers with costs that exceed the benchmark.[6] This two-step approach takes into consideration the ability of a state to fund its share of universal service support.

In quantifying the need for support, the FCC reaffirmed that federal universal service support should be based on forward-looking economic costs. In determining whether the costs of a given carrier exceed the national average, the FCC will use a "national, cost-based benchmark set at a percentage of the national average forward-looking cost of providing the supported services as the first step in determining the amount of support to be provided. That is, federal mechanisms will support areas with per-line costs in excess of this benchmark unless . . . an objective indicator of state resources reveals that the state possesses the ability to achieve reasonable rate comparability in the state without federal support."[7]

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4 In the Matter of Federal-State Joint Board on Universal Service, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking, Released 5-28-99. (Seventh Report & Order).

5 Federal-State Joint Board on Universal Service, CC Docket No. 96-45,Report and Order, FCC 97-150, released May 8, 1997 ("Universal Service Order").

6 Seventh Report & Order ¶ 61.

7 Seventh Report & Order ¶ 11.

As to the second step, states' ability to provide for their own universal service needs will be evaluated based on the assumption that each line within the state is capable of bearing an intrastate support burden equal to a fixed dollar value assessment.[8] Thus, the "state's ability to achieve reasonable rate comparability will be estimated by multiplying a dollar figure by the number of lines served by non-rural carriers in the state." [9]

At the same time, to ensure that the "transition to a revised federal support mechanism does not cause sharp or sudden reductions in the level of support," the FCC adopted a hold-harmless principle as a transitional mechanism to be reviewed no later than January 1, 2003. Hold-harmless amounts would be provided in lieu of the amount computed by the two-step forward-looking methodology whenever the hold-harmless amount exceeds the amount indicated by the forward-looking methodology.[10]

The FCC requested, and has received, comment on various implementation issues regarding the new forward-looking mechanism. The FCC will address issues such as: the specific level at which the cost based benchmark should be set; whether the federal support mechanism should calculate support levels by comparing the forward-looking costs of providing supported services to the benchmark at either (1) the wire center level, (2) the unbundled network element (UNE) cost zone level, or (3) the study area level; methods for ensuring that

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8 Seventh Report & Order ¶¶ 11 and 13.

9 Seventh Report & Order ¶ 6.

10 Seventh Report & Order ¶ 68.

11 In the Matter of Federal-State Joint Board on Universal Service, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking, Released 5-28-99. (Seventh Report & Order).

12 The FCC found that the permissive language in the Act [§§ 254(b)(5) and 254(f)] demonstrates that Congress did not require states to establish explicit universal support mechanisms. It also acknowledged the Joint Board's position that states "possess the jurisdiction and responsibility to address these implicit support issues through appropriate rate design and other mechanisms within the state." (Seventh Report & Order ¶¶ 45-46).

13 Seventh Report and Order ¶ 62.

support is distributed and applied consistent with the 1996 Act; and whether the hold-harmless provision should be implemented on a state-by-state basis or on a carrier-by-carrier basis.

THE TRA'S NEXT STEP

Given the change of direction the FCC has taken regarding the development of a federal universal service support mechanism, the TRA should defer any further Tennessee universal service activity until the FCC has released its final decision. As the FCC notes, there is no federal requirement for states to implement a universal service fund at this time.[14] Upon conclusion of the FCC proceedings, the TRA will have an opportunity to evaluate the approach adopted by the FCC in reaching a final determination as to a universal service mechanism for Tennessee.

Respectfully submitted,

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October 18, 1999

[14] Seventh Report and Order ¶ 45 states: "the 1996 Act does not require states to adopt explicit universal service support mechanisms. Section 254(e) does not specifically mention state support mechanisms. Section 254(b)(5) declares that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service." Section 254(f) provides that states "may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service." The permissive language in both of these sections demonstrates that Congress did not require states to establish explicit universal service support mechanisms."

CERTIFICATE OF SERVICE

I hereby certify that on October 18, 1999, a copy of AT&T's Comments was served on the following parties of record, via hand delivery, fax, or U.S. Mail, postage pre-paid, addressed as follows:

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