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June 1, 1998

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TN REGULATORY AUTHORITY
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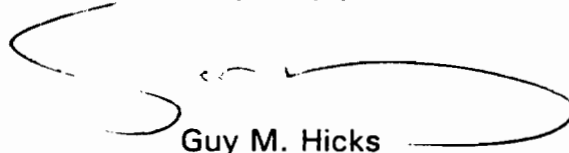
David Waddell, Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37238

Re: *Universal Service Generic Contested Case*
Docket No. 97-00888

Dear Mr. Waddell:

Enclosed are the original and thirteen copies of BellSouth Telecommunications, Inc.'s Motion for Rehearing and Reconsideration. A copy has been provided to counsel of record.

Very truly yours,



Guy M. Hicks

GMH:ch

Enclosure

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
Nashville, Tennessee**

**In Re: *Universal Service Generic Contested Case*
 Docket No. 97-00888 (Phase I)**

**MOTION FOR REHEARING AND RECONSIDERATION
OF BELL SOUTH TELECOMMUNICATIONS, INC.**

Pursuant to Tenn. Code Ann. 65-2-114, BellSouth Telecommunications, Inc., (“BellSouth”) respectfully moves the Tennessee Regulatory Authority (TRA) for a rehearing on Issues 8 and 9 of its Interim Order on Phase I of Universal Service (“Interim Order”) dated May 20, 1998. BellSouth seeks reconsideration of these issues pursuant to Tenn. Code Ann. 65-2-116(2), because of material errors of fact and law.

PRELIMINARY STATEMENT

The purpose of Phase I of the Universal Service docket was to “establish an intrastate universal service funding mechanism pursuant to Tenn. Code Ann. § 65-5-207 (Universal Service), 47 U.S.C. § 214(e)(2) of the Communications Act of 1934, as amended, the federal Telecommunications Act of 1996 (the “Telecom Act”), and Federal Communications Commission (FCC) Order 97-157, 12 FCC Rcd 8776 to 9616 (1997),” Interim Order at 1, “that will be sustainable in an increasingly competitive marketplace.” *Id.* at 2, quoting Report and Order, FCC Order No. 97-157. BellSouth believes the TRA erred in its findings on the following issues:

Issue 8: Implicit and Explicit Subsidies

Issue 9: Revenue Benchmark

9j. Which revenues should be included in the revenue benchmark?

The TRA erred on Issue 8 in finding that the existence of a subsidy to universal service can be determined by comparing total revenues and costs of all residential services sold for universal service subsidy purposes and on Issue 9 by including all revenues from residential services in the revenue benchmark for universal service fund purposes. For the reasons stated herein, BellSouth respectfully requests its motion for rehearing and reconsideration on these issues be granted.

I. The TRA Erred in Its Determination on Issue 8 that “Total Revenues Equal or Exceed the Total Costs of All the Goods and Services Sold” for Universal Service Subsidy Purposes.

In this docket, the TRA was to decide whether a subsidy existed, (pursuant to the Act and Tennessee law), for universal service. There was no issue as to whether a subsidy exists for the provision of all residential services. Yet the TRA's Interim Order incorrectly focused on this latter issue of whether residential revenues, in the aggregate, cover their costs. The TRA erred in its finding for purposes of this docket that all costs and all revenues of residential services should be considered in determining whether a subsidy exists for universal service.¹ Although the TRA correctly

¹ The TRA found the revenue benchmark should include the revenues for basic local service, toll, directory assistance, all vertical features, touch-tone, zone charges, long distance access (both interstate and intrastate), the interstate Subscriber Line Charge, and white page services as well as the subsidy from Yellow Pages advertising. Interim Order at 36-37. Yet, there is no legal basis to support the view that all such residential services constitute universal service, specifically defined in Tenn. Code Ann. § 65-5-207 and 208 as being “basic local exchange telephone service,” which definition was adopted by the TRA in its findings on Issue 1. Interim Order at 10-11.

defined “universal service” in its order and correctly defined “implicit subsidy,” the Interim Order fails to apply the subsidy test to universal service.

Pursuant to Tennessee law, “Universal Service” consists of “residential basic local exchange telephone service,” which is defined as “telecommunications services which are comprised of an access line, dial tone, touch-tone, and usage provided to the premises of a residential customer for the provision of two-way switched voice or data transmission over voice grade facilities, Lifeline, Link-Up Tennessee, 911 Emergency Services, and educational discounts existing on June 6, 1995.” Tenn. Code Ann. §§ 65-5-207(a), 65-5-208(a)(1) (emphases added). This definition and designation of the services which make up universal service was adopted by the TRA in its findings on Issue 1. Interim Order at 11, citing Tenn. Code Ann. § 65-5-207(a) (“State statutes are clear regarding what services should be supported by the intrastate USF.”) and 12.

The question before the TRA in this docket under both federal and state law was whether a “subsidy” exists for universal service. Under the widely accepted definition, a “subsidy” exists if the cost of a service being provided (in this case, basic local exchange service, i.e., universal service), exceeds the revenues obtained from that service. The evidence in the hearing clearly identified the current level of implicit support or subsidy as the “difference between the cost of the basic service that constitutes universal service, calculated for small areas such as census block groups or wire centers, minus the maximum revenue that can be collected for universal service.” Tr. Vol. I.D. at 293, lines 16-17 (emphases added).

The TRA itself acknowledged that the “existing implicit subsidy is . . . the amount by which the universal service costs exceed the universal service revenues,” and adopted this methodology of determining subsidies existing in current rates in its Directors’ Conference on February 3, 1998. Tr. Vol. III at 30-31 (emphases added). This acknowledgment by the TRA is clearly consistent with the widely accepted definition and understanding of what constitutes a subsidy.

In spite of correctly defining universal service and correctly identifying the subsidy test for universal service, as outlined above, the TRA did not apply this test properly. Instead, the TRA shifted its emphasis to residential services in their aggregate and found that, “[t]he existing implicit subsidy for a particular wire center is the amount by which the costs of providing the services included in the revenue benchmark exceeds the revenues generated by the services in the benchmark.” Interim Order at 34.

Under state law, the TRA has a statutory requirement to “administer the universal service support mechanism in accordance with established Authority rules and federal statutes.” Tenn. Code Ann. § 65-5-207(c)(4). The TRA’s finding that “total revenues equal or exceed the total costs of all the goods and services sold” for universal service implicit subsidy purposes is not only inconsistent with the federal Act and Tennessee law, but is also inconsistent with its own order and previous findings. In its Interim Order, the TRA did not follow the methodology unanimously adopted by it in its Directors’ Conference and did not compare universal service costs with revenues for universal service as universal service is defined in Issue 1 of the TRA’s order, the

federal Act and Tennessee law. Instead, the TRA erroneously established a support mechanism for determining whether residential services in the aggregate should receive a subsidy. The service at issue in this docket, however, was clearly and indisputably universal service, not all residential services.

The TRA also erred in its determination of what implicit and explicit subsidies are. The TRA correctly found that “[i]mplicit subsidies are ‘hidden’ in the prices of certain goods or services,” and that an explicit subsidy is a “set payment intended to cover the cost in excess of revenues for certain goods delivered or services provided.” Interim Order at 33. The TRA’s additional finding that the “sources, amounts, and uses of the explicit subsidies are identified and known with precision,” id., when considered with the Act, clearly requires the creation of an explicit fund to which all companies contribute based on a clear formula. Tr. Vol. I.D. at 293-15.

Nevertheless, in giving an example of an explicit subsidy, the TRA listed a service that “is intentionally priced to recover more than the costs for providing the service, thereby generating a revenue stream of a known amount to cover costs associated with ... [another] ... service.” Interim Order at 34. The TRA’s apparent rationale in this example is that merely identifying the existence of an implicit subsidy, without more, necessarily makes the subsidy explicit. The Act, however, requires more. The Act’s intent in requiring explicit funding is to require the creation of a universal funding mechanism that will survive in a competitive environment. Thus, while implicit subsidies must be identified, they must also be made explicit by the creation of an explicit competitively neutral, portable fund to which all carriers will contribute.

In conclusion, although the TRA correctly defined “universal service” in its order and correctly defined “implicit subsidy,” the Interim Order fails to apply the subsidy test to universal service. The interim decision that the costs and revenues of other residential services, which do not constitute universal service, should be considered in determining the existing implicit subsidy for purposes of the universal service fund is inconsistent with the TRA’s own adoption of the statutory definition of universal service in Tenn. Code Ann. §§ 65-5-207 and 65-5-208, the federal Act, and other findings in its Interim Order. Interim Order at 11-12. Such inconsistencies constitute both material errors of law and of fact. Therefore, reconsideration is appropriate.

II. The TRA’s Finding that the Revenue Benchmark to Be Used in Each Wire Center Should Include Revenue from Residential Services Other than Universal Service Is a Material Error of Both Law and Fact.

The benchmark at issue is the amount of revenue that supports the provision of universal service. The difference between the benchmark and the cost to provide universal service in any given instance represents the amount of explicit subsidy that must be provided by the universal service fund. The TRA by finding in its Interim Order that costs and revenues for all residential services are to be considered in determining the revenue benchmark has attempted to convert what it has found to be implicit subsidies into what it now refers to as explicit subsidies. Such a “conversion” is violative of the Act and, as a practical matter, cannot be sustained in a competitive environment.

The revenue benchmark should not include services that currently provide the implicit support that the explicit universal service fund is meant to replace. Tr. Vol. I.D.

at 293-22. To adopt a revenue benchmark which incorporates the revenues which today provide the implicit subsidies for universal service would be to ignore § 254 of the Act which states that universal service support should be explicit. Tr. Vol. I.D. at 246.

To determine the current subsidy, one must compare the cost of providing universal service to the revenue received from universal service. Inclusion within the benchmark of revenues from other services that have historically provided an implicit subsidy fails to do this.

The inclusion in the revenue benchmark of revenues from the services that provide a current implicit subsidy constitutes a material error of law because it is contrary to § 254(e) of the Telecommunications Act, (entitled "UNIVERSAL SERVICE SUPPORT"), which requires that universal service "support should be explicit and sufficient to achieve the purposes of this section." BellSouth's proposed process whereby the amount of the necessary subsidy would be identified and provided from a newly created explicit fund, while the current LEC rates would be reduced in Phase III of this proceeding to remove the implicit subsidies from other services, complies with the intent and meaning of the Act.

The Interim Order, in effect, requires the explicit fund to be reduced by the amount of implicit subsidies attributable to certain services (in this case, residential), which is contrary to the Act. If a provider must rely upon subsidies from certain services to be able to provide universal service, then the rates for these services cannot be reduced. Placing any carrier in the position of having to attempt to preserve implicit subsidies in order to cover the cost to provide universal service is, thus, directly

contrary to the requirement of the Act that the support for universal support be made explicit.

The Interim Order also contravenes the intention of the Act by assuming a continuation of the current level of implicit support; this assumption is irreconcilable with the reality of a competitive environment. The notion that anyone who provides basic service to a customer will necessarily (and automatically) receive revenues from each customer for an entire bundle of other services is incorrect.

First, average revenues from intralata toll currently received by the incumbent LEC are subject to competitive erosion. Tr. Vol. II.B. at 135. Once intralata presubscription begins in Tennessee, competing interexchange carriers will be able to make greater “substantial competitive inroads” into the incumbent’s current share of the market. Id. at 137. Thus, the notion that revenues from intralata toll should be included in the benchmark because the provider of universal service will necessarily receive these revenues is incorrect.

Second, the notion that a subsidy from any discretionary service is likely to continue at its current level is equally wrong and contrary to the spirit of the Act. Generally, in a competitive environment revenues are driven toward cost. Tr. Vol. II.B. at 146. Assuming discretionary services provide high margins, new entrants will undoubtedly cut these margins and lower other prices to attract new customers. Where there are two or more relatively comparable providers, customers will migrate to the carrier with the lower priced package. Id. Competition will then result, at least to some extent, in an across-the-board erosion in the margins on services that are currently the

source of implicit subsidies. Consequently, the availability of current implicit subsidy levels will be reduced.

Third, the revenues attributable to discretionary services are skewed. Some customers purchase a number of discretionary services, while others purchase none at all. Tr. Vol. II.A. at 47. New entrants in the local market will certainly attempt to serve the customers who will generate the most profit. To the extent that new entrants are able to pick and choose only the profitable customers and low cost areas it wishes to serve, it will obviously erode, on a per line basis, the incumbent's average revenue from discretionary services. Nevertheless, the LEC would be forced to rely upon these sources of ever-diminishing implicit subsidy to sustain universal service for the less profitable, high cost customers who remain with the incumbent.

Therefore, the Interim Order creates a situation in which the fund will be smaller than it would otherwise be because of the unsupportable assumption that the provider of service to any given customer will necessarily receive continued support in the form of an average amount of revenue per line from discretionary and other services. For the reasons set forth above, and supported by the record, this is simply not possible in a competitive environment.

The purpose of the Act is to create an explicit support mechanism for universal service which can survive in a competitive environment - one that will be competitively neutral and portable. The TRA's finding that all costs and revenues from residential services should be included in the revenue benchmark is contrary to this goal and to

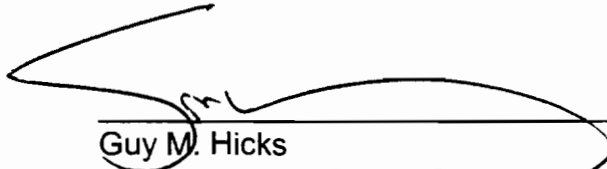
§ 254 of the Act that universal service support “should be explicit.” This finding will result in minimizing the fund by raising the revenue benchmark as if the current sources of implicit subsidy will continue. If the fund is too small, however, it will make service by new entrants to high cost areas difficult or impossible. See, e.g., Tr. Vol. II.B. at 148. If the fund is too small, there will not be explicit support sufficient to make up any shortfall between the cost of service in a high cost area and the rate that can be charged in that area for new entrants. Such a result is contrary to the goal of providing universal service, as manifested in the 1996 Act and Tennessee law.

The only way to assure quality basic local service to all customers at affordable rates is by having an adequately sized explicit fund that is not dependent upon the fiction that implicit subsidies can, or should, continue to support universal service in the future. The Interim Order violates the Act by dealing with the revenue benchmark in a way that is contrary to the development of an explicit fund adequate to further the universal services goals of the Act. For this reason, Issues 8 and 9 of the Interim Order should be reconsidered.

WHEREFORE, BellSouth respectfully requests the entry of an Order reconsidering the TRA's decisions on Issues 8 and 9 and amending those decisions as set forth above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 1, 1998, a copy of the foregoing document was served on the parties of record, via hand delivery, fax, or U. S. Mail, postage pre-paid, addressed as follows:

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A handwritten signature in black ink, appearing to be 'S. Taylor', written over a horizontal line.