

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	CC Docket No. 96-45
Federal-State Joint Board on)	
Universal Service)	

**ORDER ON REMAND, FURTHER NOTICE OF PROPOSED RULEMAKING, AND
MEMORANDUM OPINION AND ORDER**

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By the Commission: Chairman Powell, Commissioners Abernathy, Copps and Adelstein issuing separate statements; Commissioner Martin approving in part, dissenting in part, and issuing a separate statement.

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I. INTRODUCTION

1. In this Order, in response to the decision of the United States Court of Appeals for the Tenth Circuit and the recommendations of the Federal-State Joint Board on Universal Service (Joint Board), we modify the high-cost universal service support mechanism for non-rural carriers and adopt measures to induce states to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers.¹ We will continue to determine non-rural support by comparing statewide average costs to a national cost benchmark, but we establish a

¹ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*), remanded, *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001) (*Qwest*); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 17 FCC Rcd 20716 (2002) (*Recommended Decision*). The term “non-rural carriers” refers to incumbent local exchange carriers that do not meet the statutory definition of a rural telephone company. See 47 U.S.C. § 153(37). Under this definition, rural telephone companies are incumbent carriers that either serve study areas with fewer than 100,000 access lines or meet one of three alternative criteria. *Id.* Thus, “non-rural carriers” are principally defined by study area size. Non-rural carriers serve the majority of access lines nationwide, including lines in rural, insular, and high-cost areas. Rural carriers serve fewer than twelve percent of lines nationwide, and their operations tend to be focused in high-cost areas. “Non-rural support” refers to high-cost universal service support for non-rural carriers.

new cost benchmark at two standard deviations above the national average cost. Our action today ties the cost benchmark more closely to the data in the record, consistent with the court's directive, but does not substantially alter the level of non-rural support. Based on analysis of the relevant data, we explain why the modified non-rural mechanism will be sufficient to achieve the statutory principle of making rural and urban rates for non-rural carrier customers reasonably comparable.

2. In addition, we will implement a rate review, through an expanded annual certification process, to induce states to achieve reasonably comparable rates and to assess how successfully the non-rural high-cost support mechanism ensures reasonably comparable rural and urban rates. Consistent with the Joint Board recommendation, states will be required to certify that the basic service rates in their rural, high-cost areas served by non-rural carriers are reasonably comparable to a national urban rate benchmark or explain why they are not.² This process will add a dynamic element to the non-rural high-cost support mechanism.³ By requiring states to review their rates in rural, high-cost areas served by non-rural carriers annually in comparison to a national urban rate benchmark, the Commission will be able to determine whether federal and state universal service mechanisms are resulting in reasonably comparable rural and urban rates as competition develops and erodes implicit support mechanisms.

3. In the attached Further Notice of Proposed Rulemaking, we seek comment to further develop the record on specific issues that relate to the rate review and expanded state certification process recommended by the Joint Board. We also seek comment on a proposal to further encourage states to preserve and advance universal service by making available additional targeted federal support for high-cost wire centers in states that implement explicit universal service mechanisms.

II. EXECUTIVE SUMMARY

4. In this Order, we take the following actions to modify the non-rural high-cost support mechanism and to induce states to ensure reasonably comparable rural and urban rates in areas served by non-rural carriers:

- Consistent with the Joint Board's recommendations, we reaffirm that comparing statewide average costs to a nationwide cost benchmark reflects the appropriate federal and state roles in determining federal non-rural high-cost support. We find no evidence

² As discussed below, the purposes of the rate and cost benchmarks are different. The cost benchmark is used to determine the amount of high-cost support non-rural carriers in each state will receive, whereas the rate benchmark will be used in determining whether a state's rural rates are reasonably comparable to urban rates nationwide.

³ See *Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11249, para. 11 (2001) (*Rural Task Force Order*) (recognizing that "[o]ur universal service rules cannot remain static in a dynamic marketplace.").

in the record either for radically altering the current non-rural mechanism or for establishing a substantially larger federal subsidy to lower local telephone service rates, as some commenters advocate.

- In response to the Tenth Circuit’s remand, we define the relevant statutory terms “sufficient” and “reasonably comparable” more precisely for purposes of the non-rural mechanism. As recommended by the Joint Board, we define “sufficient” in terms of the statutory principle in section 254(b)(3), as enough federal support to enable states to achieve reasonable comparability of rural and urban rates in high-cost areas served by non-rural carriers. We also agree with the Joint Board that the principle of sufficiency means that non-rural support should be only as large as necessary to achieve the statutory goal. We define “reasonably comparable” in terms of a national urban rate benchmark recommended by the Joint Board. As part of the rate review process discussed below, the rate benchmark will be used in determining whether a state’s local rates in rural, high-cost areas served by non-rural carriers are reasonably comparable to urban rates nationwide.
- We modify the non-rural mechanism by basing the cost benchmark, which is used to determine the amount of non-rural high-cost support, on two standard deviations above the national average cost per line. Modifying the cost benchmark ties it more directly to the relevant data, consistent with the court’s directive, but does not alter the level of non-rural support in a major way. We agree with the Joint Board that the current level of non-rural support is supported by data from a General Accounting Office (GAO) Report indicating that rural and urban rates generally are reasonably comparable today.
- To induce states to achieve reasonably comparable rates, we adopt with minor changes the rate review and expanded certification process recommended by the Joint Board. Each state will be required to review its rates in rural, high-cost areas served by non-rural carriers annually to assess their comparability to urban rates nationwide, and then to file a certification with the Commission stating whether its rural rates are reasonably comparable to urban rates nationwide or explaining why they are not.
- For purposes of the rate review process, we adopt the Joint Board’s recommendation that we establish an annually-adjusted nationwide rate benchmark based on the most recent urban residential rates in the *Reference Book*, the Wireline Competition Bureau’s annual rate survey. Specifically, we adopt a rate benchmark of two standard deviations above the average urban rate, which, based on the most recent *Reference Book* survey, is \$32.28 or 138 percent of the average urban rate. The rate benchmark will establish a “safe harbor,” that is, a presumption that rates in rural, high-cost areas that are below the rate benchmark are reasonably comparable to urban rates nationwide. States with rural rates below the rate benchmark may certify that their rates are reasonably comparable without providing additional information, or rebut the presumption by demonstrating that factors other than basic service rates affect the comparability of their rates.
- For purposes of the rate review process, we also establish a basic service rate template for states to use in comparing rates in rural, high-cost areas served by non-rural carriers to

the nationwide urban rate benchmark. In addition, we adopt, with slight modifications, the definition of “rural area” already contained in section 54.5 of the Commission’s rules for purposes of the rate review process.

- We adopt the Joint Board’s recommendation to permit states to request further federal action, if necessary, based on a demonstration that the state’s rates in rural, high-cost areas served by non-rural carriers are not reasonably comparable to urban rates nationwide and that the state has taken all reasonable steps to achieve reasonable comparability through state action and existing federal support.
- In response to the Tenth Circuit’s remand, we review and explain our comprehensive plan for supporting universal service in high-cost areas.
- In the attached Further Notice, we seek comment on issues related to the rate review and expanded certification process. In particular, we propose a method for calculating any additional targeted federal support that may be provided in response to a state request for further federal action, based on forward-looking cost estimates. Under this proposal, any such support would be targeted on a wire-center basis, based on a set percentage of per-line costs exceeding a threshold above the national average cost for wire centers.
- We also seek comment in the attached Further Notice on whether we should make additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms, without regard to their achievement of rate comparability, in order to encourage states to adopt universal service mechanisms that will be sustainable in a competitive environment.

III. BACKGROUND

A. The Act

5. The Telecommunications Act of 1996 Act codified the historical commitment of the Commission and state regulators to promote universal service by ensuring that consumers in all regions of the nation have access to affordable, quality telecommunications services.⁴ In section 254 of the Act, Congress directed the Commission, after consultation with the Joint Board, to establish specific, predictable, and sufficient support mechanisms to preserve and advance universal service, based on several enumerated principles.⁵ Among other things, section 254(b) provides that consumers in rural, insular, and high-cost areas should have access to telecommunications services at rates that are “reasonably comparable to rates charged for similar

⁴ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151, *et seq.* (Communications Act or Act). References to section 254 in this Order and Further Notice of Proposed Rulemaking refer to the universal service provisions of the 1996 Act, which are codified at 47 U.S.C. § 254 of the Act. 47 U.S.C. § 254; *see also* 47 U.S.C. § 214(e).

⁵ 47 U.S.C. § 254. *See also Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996).

services in urban areas.”⁶ In addition, section 254(e) provides that federal universal service support “should be explicit and sufficient to achieve the purposes of this section.”⁷

B. Ninth Report and Order

6. Consistent with the Act, the Commission has taken major steps over the last seven years to put in place explicit federal universal service support mechanisms that will be resilient as competition develops over time.⁸ In one of these major steps, in the *Ninth and Tenth Report and Orders*, the Commission established a new federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic costs.⁹ The non-rural mechanism determines the amount of federal support to be provided to non-rural carriers in each state by comparing the statewide average cost per line, as estimated by the Commission’s cost model, to a nationwide cost benchmark of 135 percent of the national average cost.¹⁰ Federal support is provided to non-rural carriers in states with costs that exceed the benchmark.

C. Tenth Circuit Remand

7. In *Qwest*, the Tenth Circuit upheld the Commission’s cost model, but remanded the methodology for determining non-rural support adopted in the *Ninth Report and Order*. On remand, the court required the Commission to define more precisely the statutory terms “reasonably comparable” and “sufficient” and then to assess whether the non-rural mechanism will be sufficient to achieve the statutory principle of making rural and urban rates reasonably comparable.¹¹ In addition, the court found that the Commission failed to explain how its 135 percent nationwide cost benchmark will help achieve the goal of reasonable comparability or sufficiency.¹² The court required the Commission on remand “to develop mechanisms to induce adequate state action.”¹³ Finally, because the non-rural mechanism concerns only one piece of universal service reform, the court stated that it could not properly assess whether the total level

⁶ 47 U.S.C. § 254(b)(3).

⁷ 47 U.S.C. § 254(e).

⁸ See *infra* part IV.E.

⁹ *Ninth Report and Order*, 14 FCC Rcd 20432; *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, *Tenth Report and Order*, 14 FCC Rcd 20156 (1999) (*Tenth Report and Order*), *affirmed*, *Qwest*, 258 F.3d 1191.

¹⁰ *Ninth Report and Order*, 14 FCC Rcd 20432; *Tenth Report and Order*, 14 FCC Rcd 20156. The cost model estimates the forward-looking costs of providing supported services for non-rural carriers. The Commission selected input values for the model in the *Tenth Report and Order*, and found the model provides reasonably accurate cost estimates.

¹¹ *Qwest*, 258 F.3d at 1202. See *infra* part IV.B.1.

¹² *Qwest*, 258 F.3d at 1202-03. See *infra* part IV.C.1.

¹³ *Qwest*, 258 F.3d at 1204. See *infra* part IV.D.1.

of federal support for universal service was sufficient and indicated the Commission would have the opportunity on remand to explain further its complete plan for supporting universal service.¹⁴

D. Joint Board Recommendation

8. On February 15, 2002, the Commission released a Notice of Proposed Rulemaking seeking comment on: (1) how the Commission should define the key statutory terms “reasonably comparable” and “sufficient”; (2) whether, in light of the interpretation of those key statutory terms, the Commission can and should maintain the previously established benchmark or, in the alternative, should adopt a new benchmark or benchmarks; and (3) how the Commission should induce states to implement state universal service policies.¹⁵ Because the *Ninth Report and Order* was based on previous Joint Board recommendations, the Commission determined that further Joint Board input would be beneficial for its consideration of the issues on remand. Accordingly, the Commission referred the issues described in the *Remand Notice*, and the record developed therein, to the Joint Board for a recommended decision.¹⁶

9. In its *Recommended Decision*, the Joint Board recommended that, for purposes of non-rural high-cost support, sufficiency should be principally defined as enough support to enable states to achieve reasonably comparable rates.¹⁷ The Joint Board also reaffirmed that the statutory principle of sufficiency means non-rural support should be only as large as necessary to achieve its statutory goal.¹⁸ The Joint Board recommended that support should continue to be based on cost differences among states.¹⁹ In addition, the Joint Board supported the continued use of statewide average costs compared to a national cost benchmark for purposes of determining non-rural support amounts, because this methodology reflects an appropriate division of federal and state responsibility for achieving rate comparability for non-rural carrier customers.²⁰ The Joint Board also supported continued use of a national cost benchmark of 135 percent.²¹

¹⁴ *Qwest*, 258 F.3d at 1205. See *infra* part IV.E.

¹⁵ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order, 17 FCC Rcd 2999, 3004-10, paras. 12-24 (2002) (*Remand Notice*).

¹⁶ See *id.* at 3011, para. 26. The Commission did not refer to the Joint Board the issue of how the non-rural mechanism relates to other funding mechanisms. See also *id.* at 3010-11, para. 25.

¹⁷ *Recommended Decision*, 17 FCC Rcd at 20723-24, para. 15. See *infra* part IV.B.1

¹⁸ *Recommended Decision*, 17 FCC Rcd at 20724, para. 16. See *infra* part IV.B.1.

¹⁹ *Recommended Decision*, 17 FCC Rcd at 20724-26, paras. 18-21. See *infra* part IV.A.1.

²⁰ *Recommended Decision*, 17 FCC Rcd at 20727-28, paras. 24-27. See *infra* part IV.A.1.

²¹ *Recommended Decision*, 17 FCC Rcd at 20729, para. 34. The *Recommended Decision* printed in the FCC Record is missing two pages, from near the end of paragraph 29 to the middle of paragraph 34. To read these paragraphs, see the *Recommended Decision* located at www.fcc.gov/wcb/universal_service/highcost.html under “October 2002 Releases.” On Westlaw, the missing pages are identified as being on page 28. See *infra* part IV.C.1.

10. To induce states to achieve reasonably comparable rural and urban rates, the Joint Board recommended that the Commission implement a rate review. States would be required to certify that the basic service rates in their high-cost areas are reasonably comparable to a national urban rate benchmark or explain why they are not.²² In addition to inducing states to achieve rate comparability, the Joint Board concluded the rate review would allow the Commission to assess whether non-rural high-cost support continues to provide sufficient support to enable states to maintain reasonably comparable rates.²³ States would have the opportunity to demonstrate that further federal action is needed based on a showing that federal support and state actions together are not sufficient to yield reasonably comparable rates.²⁴ The Joint Board also suggested that the Commission further develop the record on certain issues related to the rate review.²⁵

11. On November 5, 2002, a Public Notice invited comment on the Joint Board's recommendations.²⁶ Comments were filed by December 20, 2002, and reply comments were filed by January 17, 2003.

IV. DISCUSSION

12. Below, we first reaffirm our view that the basic framework of the non-rural high-cost support methodology is consistent with the Act's dual regulatory structure. Next, in response to the specific issues remanded by the court, we define the relevant statutory terms "sufficient" and "reasonably comparable" more precisely for purposes of the non-rural mechanism. Then, we establish a new cost benchmark at two standard deviations above the national average cost, and explain why the level of support provided using this benchmark will be sufficient to ensure that urban and rural rates are reasonably comparable. We then adopt the rate review process recommended by the Joint Board to induce states to achieve reasonably comparable rural and urban rates and to permit assessment of the non-rural mechanism's success in ensuring rate comparability.²⁷ Finally, we explain further how the federal high-cost support mechanisms work together to provide sufficient support for universal service.

²² *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50. *See infra* parts IV.B.1, IV.D.1.

²³ *Recommended Decision*, 17 FCC Rcd at 20736-40, paras. 50-56. *See infra* part IV.D.1.

²⁴ *Recommended Decision*, 17 FCC Rcd at 20722, 36-37, paras. 10, 50. *See infra* part IV.D.1.

²⁵ *Recommended Decision*, 17 FCC Rcd at 20736-38, paras. 50 & n.125, 52-53. *See infra* IV.D.1, V.

²⁶ *Comment Sought on the Recommended Decision of the Federal-State Joint Board on Universal Service Regarding the Non-Rural High-Cost-Support Mechanism*, Public Notice, CC Docket 96-45, DA 02-2976 (rel. Nov. 5, 2002), 67 Fed. Reg. 71,121 (2002).

²⁷ As stated above, we also seek comment on several specific aspects of the rate review process in the attached Further Notice. *See infra* part V.

A. Federal and State Roles in Supporting Universal Service

13. Before turning to the specific issues remanded to us for further consideration and explanation, we begin by discussing in more detail the appropriate federal and state roles in supporting universal service. As held in *Texas Office of Public Utility Counsel v. FCC*, section 254 did not affect the proscription in section 2(b) of the Communications Act against Commission regulation of intrastate rates.²⁸ Thus, our choices in implementing the universal service goals of the Act and in determining the basic framework of the non-rural high-cost support methodology are shaped and limited by the continued dual federal/state jurisdictional structure. A discussion of this framework provides the context needed to fully explain our actions with respect to the specific issues remanded by the court. In addition, a discussion of the dual federal/state jurisdictional roles is a critical backdrop to addressing several commenters' arguments that the Commission must fundamentally alter this basic framework in response to the court's remand decision.

14. As discussed below, we find support in the court's opinion for the basic framework of the non-rural support methodology, which is designed to reflect the division of federal and state roles under the Act. We do not believe that the court's decision requires us to fundamentally alter this framework. We agree with the Joint Board, therefore, that we should continue to determine non-rural high-cost support by comparing statewide average costs to a national cost benchmark. We find no evidence in the record either for radically altering the current non-rural mechanism or for establishing a substantially larger federal subsidy to lower local telephone service rates, as some commenters advocate.

1. Background

15. Historically, the purpose of universal service support always has been to promote universally available telephone service at reasonable and affordable rates.²⁹ When the 1996 Act was adopted, universal service was achieved largely through implicit support mechanisms.³⁰ Although the Commission and a few states had in place some explicit support mechanisms to enable access to telephone service in areas where the cost of such service otherwise would be prohibitively high,³¹ most universal service support came from state rate designs aimed at

²⁸ *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 421, 424, 446-48 (5th Cir. 1999).

²⁹ See *First Report and Order*, 12 FCC Rcd at 8784, para. 10. This proceeding concerns high-cost support mechanisms generally designed to keep rates in high-cost areas affordable by ensuring that rates in these areas are reasonably comparable to rates in low-cost areas. The Commission and most states also have programs designed to make service affordable for low-income consumers.

³⁰ See *id.* at 8784-85, paras. 10-12.

³¹ The cost of providing telephone service is largely a function of population density and distance. Sparsely populated, rural areas generally are more expensive to serve than urban areas because rural areas have longer telephone loops, the most expensive portion of the telephone network, and costs are spread among fewer customers. Prior to the implementation of the non-rural high-cost support mechanism adopted in the *Ninth and Tenth Report and Orders*, the Commission's high-cost loop support mechanism provided support to non-rural carriers, as well as to rural carriers.

ensuring affordable residential rates.³² States typically maintained low residential basic service rates through, among other things, geographic rate averaging, higher rates for business customers, higher intrastate access rates, higher rates for intrastate toll service, and/or higher rates for vertical features, such as call waiting. In addition, the federal access charge rate structure provided some implicit support for the interstate portion of joint and common costs.³³

16. Congress recognized that the universal service support mechanisms developed in a monopoly environment would not be appropriate in the competitive environment envisioned by the 1996 Act. In particular, it would be difficult to sustain implicit subsidies in a competitive market: competition would erode the implicit subsidies that state and, to a lesser extent, federal policies had relied on to keep rates comparable because competitive pressures would drive down above-cost rates.³⁴ Congress adopted section 254 to help ensure that, as competition develops, explicit support mechanisms would replace, as far as possible, implicit support mechanisms in order to preserve the fundamental communications policy goal of providing universal telephone service in all regions of the nation at reasonably comparable rates.³⁵

17. The Act makes clear that preserving and advancing universal service is a shared federal and state responsibility.³⁶ Among the principles in section 254(b) is that “[t]here should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service.”³⁷ Pursuant to section 2(b) of the Communications Act, states retain primary responsibility for ensuring reasonable comparability of rates within their borders.³⁸ In *Texas Office of Public Utility Counsel v. FCC*, the United States Court of Appeals for the Fifth Circuit

³² See *First Report and Order*, 12 FCC Rcd at 8784-86, paras. 11, 14.

³³ See *id.* at 8784-85, paras. 10-12.

³⁴ See *Ninth Report and Order*, 14 FCC Rcd at 20441-42 para. 16; see also *Federal-State Joint Board on Universal Service, Access Charge Reform*, 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, 14 FCC Rcd 8078, 8081-82 paras. 7-8 (1999) (*Seventh Report and Order*).

³⁵ See 47 U.S.C. § 254(e); S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 131 (“To the extent possible, the conferees intend that any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today.”).

³⁶ See 47 U.S.C. § 254(b)(5); *Qwest*, 258 F.3d at 1203 (“The Telecommunications Act plainly contemplates a partnership between federal and state governments to support universal service.”) (citing 47 U.S.C. §§ 254(b)(5), 254(f), 254(k)).

³⁷ 47 U.S.C. § 254(b)(5).

³⁸ See 47 U.S.C. § 152(b). Section 2(b) states that, except as provided in certain designated sections, “nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service by wire or radio of any carrier.” Section 2(b) predated the 1996 Act and was not amended by that legislation.

held that section 254 of the Act did not affect the proscription in section 2(b) against Commission regulation of intrastate rates.³⁹

18. In recognition of the Act's dual federal/state jurisdictional structure, in the *Ninth Report and Order*, the Commission determined, based on the recommendations of the Joint Board, that the primary federal role in ensuring the statutory goal of reasonably comparable rural and urban rates for non-rural carrier customers is to enable reasonable comparability *among* states.⁴⁰ By averaging costs at the statewide level, the non-rural high-cost support mechanism adopted in the *Ninth Report and Order* compares the relative costs of providing supported services in different states.⁴¹ The mechanism then provides support to non-rural carriers in those states with costs that exceed the national average by a certain amount, i.e., the national benchmark. This approach ensures that no state with average costs greater than the national benchmark will be expected to keep rates reasonably comparable without the benefit of federal support.

19. The Tenth Circuit recognized that the 1996 Act "plainly contemplates a partnership between the federal and state governments to support universal service."⁴² The court further recognized that the Commission "may not be able to implement universal service by itself, since it lacks jurisdiction over intrastate service," citing section 2(b) of the Communications Act.⁴³ The court rejected the petitioner's argument "that the FCC alone must support the full costs of universal service."⁴⁴ The court also rejected the petitioner's argument "that the use of statewide and national averages is necessarily inconsistent with [section] 254."⁴⁵ Thus, the court's decision recognizes the Act's dual federal/state jurisdictional structure.

20. In response to the court's decision, the Joint Board affirmed its belief that the non-rural mechanism reflects the appropriate division of federal and state responsibility for achieving reasonably comparable rural and urban rates for non-rural carrier customers. The Joint Board explained that "[b]ecause the states, not the Commission, set intrastate rates, the states have primary responsibility for ensuring reasonably comparable rural and urban rates."⁴⁶

³⁹ *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 421, 424, 446-48.

⁴⁰ *See Ninth Report and Order*, 14 FCC Rcd at 20454, para. 38.

⁴¹ *See id.* at 20457-58, paras. 45-46.

⁴² *Qwest*, 258 F.3d at 1203.

⁴³ *Id.* at 1203.

⁴⁴ *Id.* at 1203.

⁴⁵ *Id.* at 1202 n.9. The petitioner argued that support should be based on a comparison of wire center costs, rather than a comparison of statewide average costs. Although the court rejected the Commission's justification for the 135% national average cost benchmark, the court noted that "[i]f, however, the FCC's 135% benchmark actually produced urban and rural rates that were reasonably comparable . . . we likely would uphold the mechanism." *Id.* at 1202.

⁴⁶ *Recommended Decision*, 17 FCC Rcd at 20727, para. 24.

Because some states cannot support their high-cost areas by using resources from their low-cost areas, “[t]he Commission’s primary role is to identify those states that do not have the resources within their borders to support all of their high-cost lines.”⁴⁷

2. Discussion

21. Consistent with the Act’s dual jurisdictional structure, we agree with the Joint Board that the states should continue to have primary responsibility for ensuring reasonably comparable rural and urban rates, and that the Commission’s primary role under the non-rural mechanism is to identify those states that do not have the resources within their borders to support all of their high-cost lines. The 1996 Act makes clear that Congress intended preserving and advancing universal service to be a shared federal and state responsibility.⁴⁸ The legislative history of the 1996 Act also indicates that Congress intended the states to continue to have the primary role in implementing universal service for intrastate services.⁴⁹ In designing the non-rural mechanism, the Commission left intact the states’ primary jurisdiction over intrastate support.⁵⁰ The Commission stated that “it would be unfair to expect the federal support mechanism, which by its very nature operates by transferring funds among jurisdictions, to bear the support burden that has historically been borne within a state by intrastate, implicit support mechanisms.”⁵¹ The Tenth Circuit’s decision supports the view that Congress did not intend the Commission to federalize the dual federal/state universal service support system by converting implicit state subsidies to explicit federal subsidies and taking on the entire burden of providing support for intrastate costs in high-cost and rural areas. The court said that it saw “nothing in [section] 254 requiring the FCC to replace implicit support previously provided by the states

⁴⁷ *Id.* at 20727, para. 25.

⁴⁸ See 47 U.S.C. § 254(b)(5) (“There should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service.”).

⁴⁹ See S. Rep. No. 23, 104th Cong., 1st Sess. 25. (“ . . . the Committee intends that States shall continue to have the primary role in implementing universal service for intrastate services . . .”).

⁵⁰ See *Ninth Report and Order*, 14 FCC Rcd at 20458, para. 46.

⁵¹ *Id.* at 20458, para. 46 (quoting the *Seventh Report and Order*, 14 FCC Rcd at 8101, para. 46). The Commission explained in the *Ninth Report and Order* that the non-rural high-cost support mechanism “has the effect of shifting money from relatively low-cost states to relatively high-cost states,” by identifying states whose average costs are significantly above the national average and providing federal support to those high-cost states. *Id.* at 20457, para. 45. The non-rural high-cost support mechanism does not directly shift funds from low-cost to high-cost states. Rather, contributions to universal service are based on interstate telecommunications revenues, and interstate carriers typically pass these charges onto their customers. More populous states, which tend to be low-cost, have more interstate customers than sparsely populated states, which tend to be high-cost, so that customers in more populous states effectively bear the cost of funding universal service. As the Joint Board and the Commission have previously noted, only the federal jurisdiction can shift funds among states. See *id.* at 20458, para. 47; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 13 FCC Rcd 24754, 24760, para. 37 (1998) (*Second Recommended Decision*).

with explicit federal support.”⁵² Indeed, the court rejected the petitioner’s argument that the Commission alone must support the full costs of universal service.⁵³

22. Moreover, primary state responsibility for ensuring intrastate rate comparability is consistent with state ratemaking authority under the Act. The states, not the Commission, set intrastate rates.⁵⁴ Since passage of the 1996 Act, many states have adopted explicit universal service support mechanisms, but most states continue to provide at least some implicit support to residential customers through their rate designs.⁵⁵ Given the substantial amounts of universal service support built into most state rate designs, the Commission previously observed that “states are best positioned to determine how and whether these [implicit] mechanisms need to be altered to ensure that carriers do not double-recover universal service support.”⁵⁶ We continue to believe that the states are in the best position to assess the impact of competition on the erosion of implicit support in their jurisdictions and adjust their universal service mechanisms accordingly.⁵⁷ We believe that the states generally are fulfilling their responsibilities under the

⁵² *Qwest*, 258 F.3d at 1204. See also AT&T Comments at 9 (“If Congress had felt there was a need for significant new subsidies to achieve “reasonably comparable” rates, it would have explicitly authorized such a program through express statutory command.”).

⁵³ *Qwest*, 258 F.3d at 1203. Contrary to SBC’s assertion, the court did not “direct[] the Commission on remand to take responsibility for the sufficiency of funding in all ‘areas,’ including those that fall within states that have unexceptional statewide averages.” See SBC Reply Comments at 2.

⁵⁴ See *Recommended Decision*, 17 FCC Rcd at 20727, para. 24.

⁵⁵ For example, in response to a survey of state commissions conducted by the United States General Accounting Office (GAO), 21 states report having programs that provide assistance to high-cost local exchange carriers. See United States General Accounting Office, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding* at 39 (GAO-02-187, Feb. 4, 2002) (GAO Report). Fourteen states report having programs that provide assistance to small local exchange carriers. *Id.* at 40. In most states, rates for residential customers of the largest local exchange carriers are geographically averaged, either throughout the company’s service territory, in broad geographic areas, or in areas with similar geographic size and number of access lines. *Id.* at 36. In states where non-rural carriers have multiple geographic areas over which rates are averaged, more than half report using value-of-service pricing to establish relative rates for different geographic areas, which results in lower rates in rural, less populous areas relative to rates in urban areas. *Id.* at 15, 36. See also Wisconsin Comments at 6. In all but one state, residential rates are lower than single-line business rates in the same geographic area. GAO Report at 37. About half the states report setting intrastate long distance access charges above cost to subsidize basic local service. *Id.* at 37.

⁵⁶ See *Seventh Report and Order*, 14 FCC Rcd at 8110 para. 65 (1999). See also *First Report and Order*, 12 FCC Rcd at 8888-89, para. 202 (“We believe that existing levels of implicit intrastate support are substantial. We find, however, that states, acting pursuant to section 254(f) and 253 of the Act, must in the first instance be responsible for identifying implicit intrastate universal service support.”).

⁵⁷ Although this belief does not constitute a directive to do so, the Commission has stated its belief that, “as competition develops, states may be compelled by marketplace forces to convert implicit support to explicit, sustainable mechanisms consistent with section 254(f).” *First Report and Order*, 12 FCC Rcd at 8888-89, para. 202.

Act, with the help of federal support in high-cost states, to ensure reasonably comparable rates in rural and urban areas within their borders.⁵⁸

23. We also agree with the Joint Board that we must consider cost differences in determining which states need federal support to achieve rural rates that are comparable to urban rates.⁵⁹ Because the states retain jurisdiction over intrastate rates, the Joint Board and the Commission always have looked at cost differences, not rate differences, in determining high-cost support.⁶⁰ States may base rates on a variety of factors, so that comparing only rates, which may or may not include implicit support, would not be a fair and equitable way to apportion federal support.⁶¹ Because the underlying purpose of rates is to recover the cost of providing service, comparing costs provides a more accurate and consistent measure of what rate differences would be in any given state, given identical state rate policies. States with high costs would have higher rates in the aggregate than those in other states, were it not for federal support. We disagree with the argument that the statutory principle of reasonable comparability requires the determination of non-rural support to be based on rate differences.⁶² We find nothing in the court's remand decision that requires such an approach.⁶³ The advocates of such

⁵⁸ The Joint Board found that the GAO Report supported a finding that current rates are affordable and reasonably comparable. *See Recommended Decision*, 17 FCC Rcd at 207329, para. 34, *supra* note 21. As discussed below, based on further analysis of the GAO Report data, rural rates in most states would be presumed to be reasonably comparable to the national urban rate benchmark adopted in this Order. *See infra* part IV.C. As also discussed below, we adopt in this Order the Joint Board's recommendation to implement a procedure that will induce states to achieve reasonably comparable rates and enable the Commission to take additional action, if necessary, to achieve comparable rates. *See Recommended Decision*, 17 FCC Rcd at 20736, para. 50; *infra* part IV.D.

⁵⁹ *See Recommended Decision*, 17 FCC Rcd at 20725-26, paras. 19-20. Most commenters agree that support should be based on a comparison of costs, not rates. *See, e.g.*, AT&T Comments at 13-14; California Comments at 6; Maine Comments at 6-9, 19; Montana/Vermont Comments at 40-44; New York Comments at 3; Verizon Comments 5-6; Verizon Reply Comments at 3 ("There is general agreement among the commenters, even those opposing the Joint Board's recommended decision, that universal service support should be based on comparisons of costs, not rates.").

⁶⁰ *See Second Recommended Decision*, 13 FCC Rcd at 24754, para. 19; *Ninth Report and Order*, 14 FCC Rcd at 20453-54, paras. 36-38; *Recommended Decision*, 17 FCC Rcd at 20724-26, paras. 17-21.

⁶¹ For example, a state could decide as a policy matter that universal service should include intrastate toll services and fund such services by increasing local telephone rates to levels that are not comparable to rates in other states. If this state were thereby eligible for more federal support, it would burden the federal universal service support mechanism. Pursuant to section 254(f) of the Act, the state could expand its definition of universal service to include intrastate toll services, but it would be required to fund these additional services through its own universal service mechanisms without relying on federal support. *See* 47 U.S.C. § 254(f). *See also* California Comments at 13; Verizon Reply Comments at 3 (arguing that a direct comparison of rates is an unreliable indicator of a state's need for federal support).

⁶² *See* Surewest Comments at 6-7.

⁶³ *Cf. Qwest*, 258 F.3d at 1202 ("As noted above, the FCC has substituted a comparison of national and statewide [cost] averages for the statutory comparison of urban and rural rates. If, however, the FCC's 135% [cost] benchmark actually produced urban and rural rates that were reasonably comparable, . . . we likely would uphold the mechanism.").

an approach have not suggested methods of apportioning non-rural support based on rate differences that would be fair, equitable, or administratively manageable. Moreover, nothing in the record suggests that basing non-rural support on cost differences will not result in reasonably comparable rural and urban rates. Indeed, as discussed below, we find that our cost-based non-rural support mechanism has achieved rates that generally are reasonably comparable.⁶⁴

24. We also agree with the Joint Board that the general framework of the non-rural mechanism, through the use of statewide average costs, reflects the appropriate division of federal and state responsibility for determining high-cost support for non-rural carriers.⁶⁵ The non-rural mechanism estimates costs by determining the average cost in each wire center, weighted by lines, and then averaging the wire center costs at the state level, weighted by lines. In effect, this “nets out” the high-cost and low-cost lines in a state. States with high average costs do not have enough low-cost lines to support their high-cost areas. High-cost states receive federal non-rural support, which is targeted to their high-cost wire centers.⁶⁶ This is the most reasonable way to identify the states that do not have enough non-rural carrier low-cost lines to keep their rural rates reasonably comparable to urban rates in most other states. Statewide averaging effectively enables the state to support its high-cost wire centers with funds from its low-cost wire centers through implicit or explicit support mechanisms, rather than unnecessarily shifting funds from other states.⁶⁷

25. We recognize, as the Joint Board observed, that statewide averaging may not be appropriate for the high-cost mechanism providing support to rural carriers.⁶⁸ Compared to non-rural carriers, rural carriers generally serve fewer subscribers, serve more sparsely populated areas, and generally do not benefit from economies of scale and scope as much as non-rural carriers.⁶⁹ In addition, compared to customers of non-rural carriers, customers of rural carriers tend to have a relatively small local calling scope and make proportionately more toll calls.⁷⁰ Most non-rural carriers historically have received lower levels of high-cost support than rural carriers. Specifically, the high-cost loop support mechanism provides a greater percentage of federal support to carriers with 200,000 or fewer lines.⁷¹ In the future, we intend to ask the Joint

⁶⁴ See *infra* part IV.C.2

⁶⁵ See *Recommended Decision*, 17 FCC Rcd at 20727, para. 24.

⁶⁶ Although average costs are used to determine total statewide non-rural support amounts, support is targeted to wire centers based on relative cost. *Ninth Report and Order*, 14 FCC Rcd at 20470-73, paras. 68-76.

⁶⁷ See *Ninth Report and Order*, 14 FCC Rcd at 20460, para. 49; see also *supra* note 51.

⁶⁸ See *Recommended Decision*, 17 FCC Rcd at 20728, para. 28.

⁶⁹ See *First Report and Order*, 12 FCC Rcd at 8936, para. 294.

⁷⁰ See Rural Task Force, White Paper 2: The Rural Difference 11 (January 2000).

⁷¹ See 47 C.F.R. § 36.631(c)-(d). Prior to the 1996 Act, both rural and non-rural carriers were eligible for federal support under the Commission’s high-cost loop support mechanism. That mechanism provides gradually more support for costs that exceed the national average cost by certain percentages. For example, carriers with 200,000 or fewer lines receive support for 65% of the costs above 115% percent of the national average cost, and for 75% of the costs above 150%. Carriers with more than 200,000 lines receive support for 10% of the costs (continued....)

Board to conduct a comprehensive review of the high-cost support mechanisms for rural and non-rural carriers as a whole to ensure that both mechanisms function efficiently in a coordinated fashion.⁷²

26. Several commenters criticize the *Recommended Decision* for appearing to endorse continued reliance on implicit subsidies.⁷³ While we generally agree that states should be encouraged to replace implicit support with explicit support mechanisms, we are not persuaded that, to comply with the court's remand, we must require or induce all states to immediately remove implicit subsidies from intrastate rates through substantial increases in federal support.⁷⁴ We do not find in the language of the statute, as SBC does,⁷⁵ a clear mandate requiring states to establish explicit universal service support mechanisms.⁷⁶ Although section 254 states a clear preference for explicit, rather than implicit, support, the Joint Board and the Commission previously agreed that the 1996 Act does not require states to adopt explicit universal service support mechanisms.⁷⁷ Section 254(e), which provides that support should be explicit, refers

(Continued from previous page) _____

above 115% percent of the national average cost, 30% for costs above 160%, 60% for costs above 200%, and 75% for costs above 250%. These percentages are based on Joint Board recommendations from the 1980's that the Commission increase high-cost assistance for study areas with 200,000 lines or fewer and decrease assistance for larger study areas from previous levels. The Joint Board premised its recommendation on the assumption that larger companies have greater flexibility in how they recover above-average costs than smaller companies. See *MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Recommended Decision and Order, CC Docket Nos. 78-72, 80-286, 2 FCC Rcd 2324, 2334 (1987).

⁷² See *Rural Task Force Order*, 16 FCC Rcd at 11310, para. 169; *Remand Notice*, 17 FCC Rcd at 3011-12, paras. 27-28.

⁷³ See, e.g., CUSC Comments at 12 ("Rather than approving and continuing to rely on such a monopoly-based policy as statewide averaging, the Commission should work with the states to phase out and ultimately eliminate such implicit subsidies."); SBC Comments at 6 ("[T]he *Recommended Decision* tacitly endorses the use of implicit subsidies as a legitimate way for states to support universal service, even though implicit subsidy mechanisms are unsustainable and contrary to the requirements of section 254."); Qwest Comments at 9 ("It appears that a state could certify that rates within its borders are reasonably comparable, even if such comparability depends on continued existence of implicit subsidies.").

⁷⁴ See e.g., SBC Comments at 17 (arguing that the Commission "should immediately initiate a proceeding to establish inducements or agreements for states to establish residential pricing structures that would allow prices for residential local service to rise to levels that are self-supporting"); Qwest Comments at 8 (arguing that many "states are unlikely to replace implicit subsidies until they have reached a crisis point where these subsidies have been virtually eliminated"). Although we do not agree with SBC and Qwest that substantial increases in federal support are warranted, we seek comment in the attached Further Notice of Proposed Rulemaking whether we should make some additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms. See generally SBC Comments; Qwest Comments; *infra* part V.D.

⁷⁵ See, e.g., SBC Comments at 11 ("the Joint Board appears to accept that implicit subsidies can continue unabated, notwithstanding the plain language of section 254"); SBC Comments at 24 ("the elimination of implicit subsidies is a statutory imperative").

⁷⁶ Several commenters agree with our analysis. See, e.g., NASUCA Comments at 3-5, Verizon Reply Comments at 16.

⁷⁷ See *Seventh Report and Order*, 14 FCC Rcd at 8102, para. 45 (1999).

only to federal, not state, universal service support.⁷⁸ Section 254(f), which provides that states *may* adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service, does not include the word "explicit."⁷⁹ In addition, requiring the states to establish explicit universal service support mechanisms raises serious legal concerns in light of section 2(b) of the Communications Act.⁸⁰ Requiring the states to remove implicit support from their rate structures arguably would involve the Commission in the regulation of intrastate rates.⁸¹

27. We disagree with some commenting states that the Commission must significantly increase federal support by adopting an urban cost benchmark.⁸² They claim that the Joint Board's premise, that Congress sought to prevent prospective harm due to competition, narrows and distorts the purpose of section 254.⁸³ We are not persuaded by their arguments. In particular, we find no evidence for one state's claim that section 254(b) was intended to address a pending waiver petition of a specific Commission rule related to high-cost support for larger carriers.⁸⁴ Nothing in the 1996 Act's language or legislative history suggests such an intention. If Congress intended to address a particular Commission proceeding in section 254, it knew how

⁷⁸ See 47 U.S.C. § 254(e).

⁷⁹ See 47 U.S.C. § 254(f) (emphasis added).

⁸⁰ See 47 U.S.C. § 152(b); see also *supra* para. 17. SBC claims that the Commission has the authority to end state reliance on implicit subsidies by establishing general universal service pricing standards and setting a deadline for state compliance. SBC Comments at 17, 19. A similar process is used to implement the local competition provisions of the 1996 Act, in which the Commission sets pricing guidelines and the states set specific rates. This process was upheld by the Supreme Court. See *AT&T v. Iowa Utilities Board*, 525 U.S. 366, 377-386 (1999). We need not decide at this time whether or not the Commission would have the authority to set pricing standards because, as discussed below, we do not agree that rates must be rebalanced without delay. See *infra* para. 77; see also Wisconsin Comments at 7 (noting that a significant competitive presence in residential markets has been seen only in recent years and competitive impact has not been geographically ubiquitous).

⁸¹ The Commission also has not attempted to identify existing state-determined intrastate implicit universal service support effectuated through intrastate rates or other state decisions. Attempting to identify, compare, and evaluate implicit support mechanisms in each state arguably could result in the Commission second-guessing state ratemaking decisions.

⁸² See generally, Maine Comments; Montana and Vermont Comments; Maine Reply Comments.

⁸³ See Montana and Vermont Comments at 16-18.

⁸⁴ See Maine Reply Comments at 2. As previously noted, prior to the 1996 Act, both rural and non-rural carriers were eligible for federal support under the Commission's high-cost loop support mechanism, which provides support based on embedded costs. That mechanism provides gradually more support for costs that exceed the national average cost by certain percentages and provides greater levels of support for carriers serving 200,000 or fewer lines than for carriers serving more than 200,000 lines. See 47 C.F.R. § 36.631, *supra* note 71. Vermont had a request for waiver of this rule pending before passage of the Act requesting that Verizon-Vermont (formerly New England Telephone and Telegraph), serving 270,000 lines, receive the amount of high-cost loop it would have received if it had served 200,000 or fewer lines. See Petition for Waiver of Section 36.631 of the Commission's Rules Governing the Universal Service Fund, filed by the Vermont Department of Public Service and the Vermont Public Service Board, September 21, 1993, AAD 93-103. Maine claims that the 1996 Act established funding standards that made Vermont's petition moot. See *infra* note 89 and accompanying text.

to make its intention clear.⁸⁵ For example, the conference report explains that section 254(g) is intended to incorporate the Commission's rate integration policies contained in a specific Commission order.⁸⁶ Rather than directing the Commission to establish any particular universal service support mechanism, we find that a better reading of the statute is that Congress provided general principles and goals in section 254 to preserve and advance universal service as competition develops.⁸⁷ The Commission already had in place federal support mechanisms that had the effect of shifting support among states. Pursuant to section 254, the Commission adapted those mechanisms to be sustainable and appropriate for a competitive environment.⁸⁸ We find nothing in the statute to support the commenting states' contention that we should dramatically increase federal support flows among states. We note that actions taken by the Commission in implementing the 1996 Act rendered the waiver petition moot.⁸⁹

28. We also agree with the Joint Board that, for purposes of determining non-rural high-cost support, comparing statewide average costs to the nationwide average cost, rather than to an urban average cost, more appropriately reflects the division of federal and state responsibility under the Act as outlined above.⁹⁰ Because the national urban average cost is

⁸⁵ See AT&T Comments at 2, 9.

⁸⁶ See 47 U.S.C. § 254(g); S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 132 (citing *Integration of Rates and Services for the Provision of Communications by Authorized Common Carriers between the United States Mainland and the Offshore Points of Hawaii, Alaska, and Puerto Rico/Virgin Islands* (61 FCC2d 380 (1976))). The conference report references another Commission proceeding with regard to section 254(a): "the conferees do not view the existing proceeding under Common Carrier Docket 80-286 (regarding amendment of Part 36 of the Commission's Rules and appointment of a Joint Board) as an appropriate foundation on which to base the proceeding required by new section 254(a)." See 47 U.S.C. § 254(a); S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 131.

⁸⁷ The 1996 Act explicitly preserves the traditional authority of the Commission and the states to impose carrier-of-last-resort obligations on carriers and to generally promote universal service. See 47 U.S.C. §§ 214(e), 254.

⁸⁸ See *First Report and Order*, 12 FCC Rcd at 8926-34, paras. 273-90. For example, high-cost loop support previously was funded only by interexchange carriers. Section 254(e) requires that all telecommunications carriers providing interstate service contribute to the universal service support mechanisms and the Commission changed its funding mechanisms accordingly. See 47 U.S.C. § 254(e). In addition, whereas high-cost support previously was available only to incumbents and was averaged over an entire study area, the Commission made high-cost support competitively neutral, portable, and targeted to high-cost areas. See *First Report and Order*, 12 FCC Rcd at 8932-34, paras. 286-90; *Ninth Report and Order*, 14 FCC Rcd at 20470-73, paras. 68-76. See also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 17 FCC Rcd 22642 (2002) (*Referral Order*); *infra* part IV.E.

⁸⁹ For the reasons discussed in paragraph 27, we do not agree that mere passage of the 1996 Act rendered Vermont's petition moot. Subsequent actions by the Commission in implementing the 1996 Act, however, did make Vermont's petition moot. Specifically, in the *First Report and Order*, the Commission determined support should be based on forward-looking economic costs, rather than embedded costs, and that larger, non-rural carriers would transition to forward-looking support before smaller, rural carriers. Pursuant to the rules adopted in the *Ninth Report and Order*, beginning January 1, 2000, Verizon-Vermont and other non-rural carriers began receiving support based on forward-looking costs. The rule challenged by Vermont currently applies only to rural carriers and non-rural carriers receiving hold-harmless support.

⁹⁰ See *Recommended Decision*, 17 FCC Rcd at 20,733-34, para. 39-41. See *supra* paras. 21-22. See also AT&T Reply Comments at 2 ("[B]asing the benchmark on urban cost is inappropriate when designing the *federal* high- (continued....)

lower than the national average cost, the effect of using the national urban average cost, assuming use of the same cost benchmark, would be to increase federal support. For example, using the benchmark proposed by the proponents of an urban average cost benchmark would increase federal non-rural support from approximately \$214 million to an estimated \$1.7 billion.⁹¹ We do not need to use an urban cost benchmark in order to achieve rural rates that are reasonably comparable to urban rates because, as explained below, we conclude that the current level of federal support has resulted in rural and urban rates that generally are reasonably comparable.⁹² Using an urban cost benchmark (or obtaining the same result with a lower national average cost benchmark) would simply increase the amount of federal support, thereby driving the costs to be supported with federal funds down to the lower-than-average urban level.⁹³ That is, federal support would be used to reduce overall intrastate rate levels by replacing the support in state rates with federal support. As discussed above, we do not believe that the 1996 Act or the court's remand requires the Commission to replace the implicit support historically provided by states with explicit federal support, thereby significantly increasing the federal burden for supporting intrastate costs.⁹⁴ Moreover, as discussed below, significantly increasing the amount of federal support without evidence that such a measure is necessary to achieve rural and urban rate comparability would be inconsistent with the statutory principle of sufficiency.⁹⁵

29. We reaffirm that comparing statewide average costs to a nationwide cost benchmark reflects the appropriate federal and state roles in determining federal non-rural high-cost support amounts. We find that the basic framework of the non-rural support methodology is consistent with the court's view that the Commission is not required by the Act to replace (Continued from previous page) _____ cost support mechanism, because it ignores the fact that states must use intrastate resources in the first instance to make rates comparable.”)(emphasis in original).

⁹¹ See Verizon Reply Comments at 4. Proponents of the urban cost benchmark concede that the same result could be achieved by lowering the nationwide benchmark. See Montana and Vermont Comments at 48. Thus, we see no merit to the argument that comparing statewide average costs to a nationwide cost benchmark is a fundamentally different exercise than comparing statewide average costs to an urban cost benchmark. Both methodologies identify states with high average costs. See Maine Comments at 9 (arguing that any support system “must support those states with high average costs”).

⁹² See *infra* part IV.C.2.

⁹³ As explained in more detail below, using an urban cost benchmark would exaggerate the need for federal support to ensure rate comparability. See *infra* paras. 68-69. See also Verizon Reply Comments at 6 (“[A]n urban cost benchmark would produce more support than is necessary to enable states to maintain reasonably comparable rates, and the excessive size of a fund based on an urban benchmark would be adverse to other universal service principles of sufficiency and affordability.”). AT&T points out that Maine and Vermont, proponents of the urban cost benchmark, have two of the highest penetration rates in the country, and that the non-rural carrier in those states, Verizon, opposes any increase in federal non-rural support. See AT&T Reply Comments at 6.

⁹⁴ See *supra* para. 21. See also *Ninth Report and Order*, 14 FCC Rcd at 20455, para. 57 (“[W]e do not believe it would be equitable to expect the federal mechanism – and thus ratepayers nationwide – to provide support to replace implicit state support that has been eroded by competition if the state possesses the resources to replace that support through other means at the state level.”); Verizon Comments at 10; Wisconsin Comments at 2.

⁹⁵ See *infra* parts IV.B., IV.C.

implicit state support with explicit federal support or to support the full costs of universal service.

B. Definitions of Relevant Statutory Terms

30. We now turn to the specific issues remanded by the court. Consistent with the Joint Board's recommendations, we define "sufficient" for purposes of the non-rural mechanism in terms of the statutory principle in section 254(b)(3), as enough federal support to enable states to achieve reasonable comparability of rural and urban rates in high-cost areas served by non-rural carriers. We also agree with the Joint Board that the principle of sufficiency means that non-rural high-cost support should be only as large as necessary to meet the statutory goal. In addition, we establish a more precise definition of "reasonably comparable" rural and urban rates, based on the Joint Board's recommended national urban rate benchmark, for purposes of assessing whether the non-rural mechanism is sufficient to achieve reasonably comparable rates.⁹⁶ Specifically, we define "reasonably comparable" rates in terms of a rate benchmark based on the most recent urban residential rates in the *Reference Book*, the Wireline Competition Bureau's annual rate survey.⁹⁷ By adopting a rate benchmark based on actual data, we will help ensure that rural rates remain reasonably comparable to urban rates as market conditions and rates change over time.

1. Background

31. Section 254(b) provides that "[t]he Joint Board and the Commission shall base policies for the preservation and advancement of universal service" on certain principles, two of which the court found were relevant to this proceeding.⁹⁸ Section 254(b)(3) provides that consumers in rural, insular, and high-cost areas should have access to telecommunications services at rates that are "reasonably comparable to rates charged for similar services in urban areas."⁹⁹ Section 254(b)(5) provides that "[t]here should be specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service."¹⁰⁰ In addition, section 254(e) provides that any federal universal service support "should be explicit and sufficient to achieve the purposes of this section."¹⁰¹

⁹⁶ As discussed below in part IV.D.2.a, we adopt the Joint Board's recommendation to establish a national urban rate benchmark based on the most recent average urban residential rate in the Bureau's annual rate survey.

⁹⁷ See Industry Analysis and Technology Division, Wireline Competition Bureau, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (July 2003) (*2003 Reference Book*).

⁹⁸ 47 U.S.C. § 254(b); *Qwest*, 258 F.3d at 1199.

⁹⁹ 47 U.S.C. § 254(b)(3).

¹⁰⁰ 47 U.S.C. § 254(b)(5).

¹⁰¹ 47 U.S.C. § 254(e).

32. In the *Ninth Report and Order*, the Commission stated that the non-rural high-cost support mechanism would “provide sufficient support to enable reasonably comparable rates.”¹⁰² While the Act does not define “reasonably comparable,” the Joint Board and the Commission interpreted the reasonable comparability standard to refer to “a fair range of urban/rural rates both within a state’s borders, and among states nationwide.”¹⁰³ The Commission interpreted the goal of maintaining a “fair range” of rates to mean that “support levels must be sufficient to prevent pressure from high costs and the development of competition from causing unreasonable increases in rates above current, affordable levels.”¹⁰⁴ The Commission explained that “reasonably comparable does not mean that rate levels in all states, or in every area of every state, must be the same,” but rather means “some reasonable level above the national average forward-looking cost per line, i.e., greater than 100 percent of the national average.”¹⁰⁵

33. The court found that the Commission did not define adequately the key statutory terms “reasonably comparable” and “sufficient.”¹⁰⁶ The court observed that the Commission’s definition of reasonably comparable as a fair range of urban/rural rates failed to address petitioners’ claim that some rural rates will be 70 to 80 percent higher than urban rates under the non-rural mechanism.¹⁰⁷ The court also found that the Commission’s further explanations of the meaning of reasonably comparable could not be considered reasonable interpretations of the statutory language, because “[t]he Act calls for reasonable comparability between rural and urban rates.”¹⁰⁸ The court stated that the Commission’s further definitions “simply substitute different standards.”¹⁰⁹ The court also concluded that the Commission asserted without explanation in the *Ninth Report and Order* that the non-rural mechanism would be sufficient.¹¹⁰ The court declared the Commission’s holding conclusory and, thus, “inadequate to enable appellate review of the sufficiency of the federal mechanism.”¹¹¹ The court required the Commission on remand to define “reasonably comparable” and “sufficient” “more precisely in a

¹⁰² *Ninth Report and Order*, 14 FCC Rcd at 20464, para. 56.

¹⁰³ *Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30 (adopting the Joint Board’s interpretation in the *Second Recommended Decision*, 13 FCC Rcd at 24753, para. 18); *see also Ninth Report and Order*, 14 FCC Rcd at 20461, para. 54.

¹⁰⁴ *Seventh Report and Order*, 14 FCC Rcd at 8092 para. 30; *see also Ninth Report and Order*, 14 FCC Rcd at 20446, para. 24.

¹⁰⁵ *Ninth Report and Order*, 14 FCC Rcd at 20463 para. 54; *see also Seventh Report and Order*, 14 FCC Rcd at 8092, para. 30.

¹⁰⁶ *Qwest*, 258 F. 3d at 1201.

¹⁰⁷ *Id.* Petitioners clarify in their comments filed in this proceeding that the 70-80% discrepancy relates to cost differences, not rate differences. *See Maine Comments* at 6 n.4; *Montana and Vermont Comments* at 3 n.6.

¹⁰⁸ *Qwest*, 258 F. 3d at 1201.

¹⁰⁹ *Id.*

¹¹⁰ *Id.* *See Ninth Report and Order*, 14 FCC Rcd at 20464, para. 56.

¹¹¹ *Qwest*, 258 F.3d at 1201.

way that can be reasonably related to the statutory principles, and then assess whether its funding mechanism will be sufficient for the principle of making rural and urban rates reasonably comparable.”¹¹²

34. In response to the court remand, the Joint Board recommended that, for purposes of non-rural high-cost support, sufficiency should be principally defined as enough support to enable states to achieve reasonably comparable rates.¹¹³ The Joint Board reasoned that sufficiency should be defined in terms of the relevant statutory goals found in section 254(b) and, therefore, the definition of sufficiency may vary depending on the underlying purpose of the universal service program in question.¹¹⁴ The Joint Board found that the principal purpose of the non-rural high-cost support mechanism is to provide enough federal support to enable states to achieve reasonable comparability of rural and urban rates, the principle found in section 254(b)(3).¹¹⁵ The Joint Board also found that correct fund size is essential to ensure that all consumers benefit from universal service, and reaffirmed its view that the statutory principle of sufficiency means that non-rural high-cost support should be only as large as necessary to achieve its statutory goal.¹¹⁶

35. Although the Joint Board did not explicitly propose a definition of “reasonably comparable,” in its *Recommended Decision*, it recommended that the Commission require states to certify annually that their rates are reasonably comparable or explain why they are not. Specifically, the Joint Board recommended that the Commission establish a “safe harbor” whereby a state whose rates in high-cost areas served by non-rural carriers are at or below a certain rate benchmark may certify that its basic service rates are reasonably comparable without the necessity of submitting additional information.¹¹⁷ The Joint Board recommended that the Commission base the rate benchmark on the most recent average urban residential rate in the Wireline Competition Bureau’s *Reference Book*, an annual survey of local telephone rates in ninety-five urban areas that the Bureau has conducted for the past seventeen years.¹¹⁸ The Joint Board suggested that 135 percent of this average rate may be an appropriate rate benchmark for the safe harbor, but recommended that the Commission further develop the record on the appropriate rate benchmark.¹¹⁹ The rate benchmark would establish a presumption that rates are

¹¹² *Id.* at 1202.

¹¹³ *Recommended Decision*, 17 FCC Rcd at 20723-24, para. 15.

¹¹⁴ *Id.* at 20723-24, para. 15.

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 20724, para.16.

¹¹⁷ *Id.* at 20736-37, para. 50. *See infra* part IV.D.1.

¹¹⁸ *See 2003 Reference Book* at 1-10. The average rate in the most recent *Reference Book* survey includes a monthly charge for flat-rate service, federal and state subscriber line charges, additional monthly charges for touch-tone service, and taxes, 911 and other charges. *See id.* at 3. *See also Recommended Decision*, 17 FCC Rcd at 20736-38, para. 49 & n.124, para. 52.

¹¹⁹ *See Recommended Decision*, 17 FCC Rcd at 20738, para. 52.

reasonably comparable, but states could submit additional information to demonstrate that other factors affect the comparability of their rates.¹²⁰

2. Discussion

36. We agree with the Joint Board that “sufficient” should be defined, for purposes of the non-rural mechanism, as enough federal support to enable states to achieve reasonably comparable rural and urban rates. We also agree that “sufficient” should be defined in terms of the statutory principle in section 254(b) that the particular universal service program is designed to achieve.¹²¹ The non-rural high-cost support mechanism is designed to help ensure that consumers in high-cost areas, served by non-rural carriers, have access to telecommunications services at rates that are reasonably comparable to rates charged for similar services in urban areas.¹²² As explained in part IV.A.2. above, the non-rural mechanism achieves this goal by identifying and providing support to those states that do not have the resources within their borders to achieve reasonably comparable rural and urban rates for their non-rural carrier customers. Accordingly, for purposes of the non-rural mechanism, we define “sufficient” in terms of the section 254(b)(3) principle of reasonable comparability of rural and urban rates.

37. We also agree with the Joint Board that the principle of sufficiency encompasses the idea that the amount of support should be only as large as necessary to achieve the relevant statutory goal.¹²³ Because support ultimately is recovered from customers, collecting more support than is necessary to benefit certain customers would needlessly burden all customers.¹²⁴ We agree with the Joint Board that correct fund size is essential to ensure all consumers benefit from universal service.¹²⁵ In discussing whether support is sufficient, the Commission previously cited the Fifth Circuit’s suggestion that “excessive funding may itself violate the sufficiency requirements of the Act.”¹²⁶ We find that the idea of minimizing the burden on

¹²⁰ *See id.* at 20737, para. 50.

¹²¹ *See id.* at 20723-24, para. 15.

¹²² *Ninth Report and Order*, 14 FCC Rcd at 20434-35, para. 2.

¹²³ *See Recommended Decision*, 17 FCC Rcd at 20724, para. 16. *See also Ninth Report and Order*, 14 FCC Rcd 20465 para. 58.

¹²⁴ *See, e.g.*, AT&T Comments at 12; California Comments at 5 (“California agrees with the Commission that a mechanism that produces a federal universal service fund at or near the existing level produces affordable rates, balances the interests of contributor and recipient states, and therefore satisfies the goal of universal service.”); NASUCA Comments at 8 (“NASUCA supports the Joint Board’s recognition that “sufficient” implies “no more than sufficient.”); Verizon Comments at 5 (“A fund that is too large would increase costs for all consumers and impair the ability of some customers to continue subscribing to telephone service.”).

¹²⁵ *Recommended Decision*, 17 FCC Rcd at 20724, para. 16. *See also Second Recommended Decision*, 13 FCC Rcd at 24756 para. 3 (“The transition to a competitive environment requires us to be mindful of two competing goals: (1) supporting high cost areas so that consumers there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, over-burden consumers across the nation.”).

¹²⁶ *See Rural Task Force Order*, 16 FCC Rcd at 11257, para. 27. As the Fifth Circuit explained, “[b]ecause universal service is funded by a general pool subsidized by all telecommunications providers – and thus indirectly (continued....)

contributors is inherent in the principle of sufficiency.¹²⁷ For these reasons, we disagree with commenters who claim that we should not consider the size of the fund in determining how much support should be provided.¹²⁸ We also disagree with commenters who urge us to adopt a separate principle under section 254(b)(7) to consider the burdens on contributors in determining sufficiency.¹²⁹

38. In response to the Tenth Circuit's remand, we also adopt a more precise definition of "reasonably comparable" rural and urban rates for purposes of assessing the sufficiency of the non-rural high-cost support mechanism. Specifically, for purposes of the non-rural mechanism, rates in rural areas will be presumed to be "reasonably comparable" to urban rates if they deviate no further than two standard deviations above the national average urban rate in the Bureau's *Reference Book*.¹³⁰ This definition of "reasonably comparable" rural and urban rates is derived from the recommendation of the Joint Board that we establish a national urban rate benchmark based on the available rate data in the Bureau's *Reference Book*. Although the Joint Board did not explicitly define "reasonably comparable," it recommended that the Commission establish a "safe harbor" whereby a state whose rates in rural, high-cost areas served by non-rural carriers are at or below the national urban rate benchmark may certify that its rural rates in areas served by non-rural carriers are reasonably comparable to urban rates nationwide.¹³¹ We emphasize that the definition of "reasonably comparable" we adopt establishes a presumption only.¹³² As discussed below in part IV.D.2, factors other than basic rates may affect rate comparability, and states will have the opportunity to provide additional information rebutting the presumption established by the definition.¹³³

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by customers – excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market." *Alenco Communications, In. v. FCC*, 201 F.3d 608, 619 (5th Cir. 2000).

¹²⁷ The Tenth Circuit suggested that excessive subsidization arguably may violate the affordability principle in section 254(b)(1). *Qwest*, 258 F.3d at 1200.

¹²⁸ See, e.g., Montana and Vermont Comments at 5; SBC Reply Comments at 13-15.

¹²⁹ AT&T argues that we should adopt an explicit principle, pursuant to section 254(b)(7), stating that the burden on contributors to universal service should be minimized. See AT&T Comments at 11-12.

¹³⁰ See 2003 *Reference Book*. The Bureau's *Reference Book* includes an annual survey of local telephone rates in 95 cities that the Bureau has conducted for the past 17 years. As discussed below, based on the most recent Bureau data, the rate benchmark level presently is \$32.28, or 138% of the national average urban rate. See *infra* para. 41; part IV.D.2.

¹³¹ Several commenters interpret the Joint Board's recommendation as a definition of reasonably comparable rates. See e.g., NASUCA Comments at 6-8; but see Sprint Comments at 5 ("[T]he Joint Board's recommendation does not define reasonably comparable rates, but merely provides a conclusion of same . . .").

¹³² The Joint Board emphasized that the rate benchmark is meant simply as a "safe harbor." See *Recommended Decision*, 17 FCC Rcd at 20738, para. 53.

¹³³ For example, a state could show that due to other factors, such as additional services included in the basic service rate, its rates should be considered to be reasonably comparable even though they are above the benchmark. Alternatively, a state could show that its rates should not be considered to be reasonably comparable (continued...)

39. We conclude that the range of variability of urban rates is an appropriate measure of what should be considered reasonably comparable rural and urban rates for purposes of assessing the sufficiency of non-rural high-cost support. We agree with the Joint Board that Congress, in seeking to preserve universal service, considered rural and urban rates to be reasonably comparable in 1996.¹³⁴ If Congress had determined that rates were not reasonably comparable at the time of the Act, it would have explicitly directed the Commission and the states to alter the existing intrastate rate structure.¹³⁵ Instead, Congress specifically preserved state authority and flexibility in setting intrastate rates.¹³⁶ We also note that Congress used the words “preservation” and “preserve” in the 1996 Act, indicating its view that the universal service mechanisms that pre-dated the 1996 Act adequately promoted universal service.¹³⁷ We do not believe that our reading of the statute is undermined by the fact that section 254 is designed to advance, as well as preserve, universal service. We find that the goal of advancing universal service is consistent with our understanding that our universal service rules should evolve as markets and technology change.¹³⁸

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even though they are below the benchmark, because, for example, the services included in its basic rate are not comparable to services in other states or the calling scopes are significantly different.

¹³⁴ See *Recommended Decision*, 17 FCC Rcd at 20729, para. 35 & n.88; AT&T Comments at 8; Verizon Comments at 8. As discussed herein, we are not persuaded by commenters who argue that the 1996 Act required the Commission to require or induce all states to immediately remove implicit subsidies and rebalance rates. See *supra* para. 26; *infra* para. 77; see also, e.g., Qwest Comments at 7; SBC Comments at 1-2, 24. Nor do we agree that we should establish a rate floor. See Sprint Comments at 4.

¹³⁵ See AT&T Comments at 9.

¹³⁶ See S. Conf. Rep. No. 230, 104th Cong., 2nd Sess. 232. (“State authority with respect to universal service is specifically preserved under new section 254(f).”); see also 47 U.S.C. §152(b).

¹³⁷ See 47 U.S.C. § 254(b) (“The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles.”); 47 U.S.C. § 254(b)(5) (“There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.”). During the Senate debate, Senator Pressler, the Chairman of the Committee on Commerce, Science, and Transportation (Commerce Committee), stated that “the need to preserve widely available and reasonably priced services is a fundamental concern addressed” in the legislation. 141 Cong. Rec. S7893 (June 7, 1995). “To smaller cities and rural communities and others who depend upon universal service,” Senator Pressler said, “nothing is changed. They continue to enjoy affordable access to phone service as before.” 141 Cong. Rec. S7893-94 (June 7, 1995). After calling universal service the most important objective and criticizing airline deregulation, Senator Hollings, Ranking Member of the Commerce Committee, said he wanted to make sure that deregulation did not “mess up . . . the wonderful telecommunications service that we have had.” 141 Cong. Rec. S7894 (June 7, 1995). Senator Hollings said that “[s]pecial provisions in the legislation address universal service in rural areas to guarantee that harm to universal service is avoided there.” 141 Cong. Rec. S7895 (June 7, 1995). Senator Stevens, a key sponsor of the universal service provisions, said that the “concept [of universal service] is preserved in [the legislation] in a new manner. It opens up the local market to competition while still preserving the concept of universal service.” 141 Cong. Rec. S7900 (June 7, 1995).

¹³⁸ Section 254 explicitly defines universal service as an “evolving level of telecommunications services” to take into account advances in telecommunications and information technology. 47 U.S.C. § 254(c); see also S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 131.

40. In considering what Congress meant by reasonably comparable rates, therefore, we find it reasonable to assume that Congress was well aware that local rates varied from state to state, in large part because states base rates on a variety of different policies, in addition to cost.¹³⁹ Although we do not have readily available rural rate data from that period, we know from the Bureau's annual rate survey that, at the time of the 1996 Act, urban residential rates ranged from \$13.04 to \$30.62 and the average urban rate was \$20.01 in the ninety-five cities surveyed.¹⁴⁰ The highest urban rate in the survey was 234 percent of the lowest urban rate and 153 percent of the average urban rate.¹⁴¹ We find it reasonable to assume that Congress was aware of the variability of urban rates when it enacted the 1996 Act. We do not believe that Congress would have required rural rates to be any closer to the average urban rate than other urban rates.

41. We also find that the measure of reasonable comparability should be adjusted every year based on actual rate data, rather than set at a fixed percentage.¹⁴² By adjusting the rate benchmark each year, our reasonable comparability standard will reflect changes in urban rates as the marketplace changes. Since passage of the 1996 Act, residential urban rates have increased somewhat but the range of rates has remained approximately the same. In 2002, surveyed residential urban rates ranged from \$15.65 to \$35.19.¹⁴³ The highest urban rate in the *Reference Book* is 225 percent of the lowest urban rate and 151 percent of the average urban rate (\$23.38).¹⁴⁴ As explained below in part IV.D.2.a., we find that it is appropriate to use standard deviation analysis, rather than the range of rates in the *Reference Book*, to set the urban rate benchmark, because the standard deviation measures the dispersion from the average, thereby reflecting both the average urban rate and the variation of urban rates.¹⁴⁵ We also find below that setting the urban rate benchmark at the average urban rate in the *Reference Book* plus two standard deviations best serves the rate benchmark's intended purpose as a safe harbor, because it will require that states more closely scrutinize rural rates that approach the highest urban rates.¹⁴⁶ Based on the most recent Bureau data, an urban rate benchmark of two standard

¹³⁹ Under the high-cost support mechanisms in place in 1996, the non-rural companies received support if their average loop costs exceeded the national average loop cost by certain cost benchmarks. *See supra* notes 71, 84. *See also Recommended Decision*, 17 FCC Rcd at 20729, para. 35 & n.88.

¹⁴⁰ These rates are as of October 1, 1995. Because the Senate and House considered and passed telecommunications legislation in 1995 and adopted the 1996 Act in February 1996, these rates are closer in time to Congress' deliberations than the rates surveyed for 1996. As of October 1, 1996, residential urban rates ranged from \$13.04 to \$28.65, and the highest urban rate was 220 percent of the lowest urban rate and 144 percent of the average urban residential rate (\$19.95). *See 2003 Reference Book* at Tables 1.2, 1.4; *infra* Appendix B.

¹⁴¹ *See 2003 Reference Book* at Tables 1.2, 1.4; *infra* Appendix B.

¹⁴² The Joint Board suggested that it might be appropriate to use 135% for the safe harbor benchmark. *See Recommended Decision*, 17 FCC Rcd at 20740, para. 52.

¹⁴³ *See 2003 Reference Book* at Table 1.3; *infra* Appendix B.

¹⁴⁴ *2003 Reference Book* at Tables 1.1, 1.3; *infra* Appendix B.

¹⁴⁵ *See infra* para. 80.

¹⁴⁶ *See infra* para. 81.

deviations above the national average urban rate is \$32.28, or 138 percent of the nationwide average urban rate.

42. The definition of reasonably comparable rates we adopt today is primarily designed to permit us to compare relevant rates among states and to assess whether the non-rural mechanism provides sufficient support to enable high-cost states to achieve reasonably comparable rates. We find that our definition is consistent with the purpose of federal support under the non-rural mechanism. As discussed in detail above, the non-rural mechanism identifies and provides support to non-rural carriers in high-cost states. While most states have the resources to ensure reasonably comparable rates within their borders, high-cost states likely could not achieve rural rates comparable to urban rates in most other states without federal support.

43. We disagree with commenters who argue that a national urban rate benchmark cannot adequately define reasonably comparable rates because it does not compare rural and urban rates within states.¹⁴⁷ Currently, the range of variability of rural and urban rates within most states, based on the data in the GAO Report, is narrower than the range of variability of urban rates among states in the Bureau's *Reference Book*.¹⁴⁸ In addition, in most states the rates are generally within the range of nationwide urban rates. Thus, in most cases, a state's successful efforts to maintain rural rates below the rate benchmark would also result in rural and urban rates within the state that differ no more than urban rates nationwide.¹⁴⁹ Therefore, the national urban rate benchmark provides an adequate measure for comparing rural and urban rates at this time.

44. We find no support in the language of the Act, its legislative history, or in the actual rate data in the record to support the claim that "a 25% difference is the outer limit of being 'reasonably comparable'."¹⁵⁰ As set forth above, urban rates themselves varied more widely at the time of the 1996 Act and vary more widely today. A benchmark of 25 percent above the average urban rate would require rural rates to be closer to the average urban rate than other urban rates. As discussed above, we do not believe Congress would have required such a

¹⁴⁷ See Surewest Comments at 6-10. The national urban rate benchmark does not directly address the relationship to each other of rural and urban rates within a state that are below the benchmark. Urban and rural rates within a state may diverge significantly. For example, Surewest asserts that in California, Roseville's average monthly basic residential service rate is \$31.24 and SBC's in a neighboring jurisdiction is \$10.69. We note that, for reasons described above, we do not agree with Surewest that such a rate discrepancy represents a problem of insufficient federal support. See *supra* paras. 21-22.

¹⁴⁸ See GAO Report at Appendix IV.

¹⁴⁹ If a state were not able to maintain rural rates below the rate benchmark, it would be required to provide additional information to us, as discussed below in part IV.D. Rate comparisons within the state would then be useful in assessing the reason for the high rural rates. For example, if the states' urban rates were also above the benchmark, it may be that the federal support mechanism should be adjusted. If, on the other hand, the state's urban rates were much lower than its rural rates, the state should have the resources to lower its rural rates without additional support.

¹⁵⁰ See Maine Comments at 23.

result.¹⁵¹ The *Qwest* court suggested that a discrepancy between rural and urban rates of 70 to 80 percent would not be considered to be reasonably comparable.¹⁵² Based on our analysis of the relevant data, we believe that the rate benchmark we adopt in this Order, currently 38 percent above the nationwide average urban rate, is likely to remain well below 70 or 80 percent. Between 1993 and 2002, the nationwide average urban rate plus two standard deviations ranged from 133 percent to 143 percent above the average urban rate.¹⁵³ Although the court did not specify whether it was considering the relationship of the maximum to the average or to the floor when it addressed whether a 70 or 80 percent discrepancy would be reasonably comparable, we think that it is appropriate to measure the divergence from the average rate for purposes of interpreting section 254(b)(3). The average urban rate is more representative of urban rates nationwide than any single urban rate in the *Reference Book*. Measuring divergence from the lowest urban rate could be too heavily influenced by a particular state's rate policies. Measuring divergence from the national average urban rate more accurately captures the variability of rate policies among the states, and is, therefore, more consistent with the purposes of the non-rural mechanism.¹⁵⁴

45. We are not persuaded by SBC that the Commission should establish an affordability benchmark for local telephone service based on the median household income of a particular geographic area.¹⁵⁵ While the Joint Board and the Commission generally have considered affordability in implementing section 254, the Commission has not specifically identified an affordable rate, and we decline to do so now.¹⁵⁶ Because various factors, many of which are local in nature, affect rate affordability, the Commission agreed with the Joint Board that it would not be appropriate to establish a nationwide affordable rate.¹⁵⁷ The Commission also agreed with the Joint Board that states should exercise primary responsibility for

¹⁵¹ See *supra* para. 40.

¹⁵² *Qwest v. FCC*, 258 F.3d at 1201. Intervenors' assertion before the Tenth Circuit that some rural rates could be 70-80% higher than urban rates under the non-rural mechanism was based on their claim that *costs* were 70-80% higher in rural areas than in urban areas. Intervenors submitted cost data, but not rate data, to the court. Accordingly, the court's statement actually was based on *cost* rather than rate data.

¹⁵³ See *infra* Appendix B.

¹⁵⁴ As discussed below, the definition of reasonably comparable rates is primarily designed to evaluate the comparability of rates among states. In most cases, it will also effectively measure comparability of rates within states, because rural and urban rates in most states vary less than urban rates vary among states nationwide. In some cases, however, if urban rates in a state were very low, rural rates could be below the benchmark but further from the urban rates in that state than they are from the nationwide urban rate. Surewest, for example, argues that Roseville's residential rates are 85% higher than SBC's rates in California. See Surewest Comments at 8-9. We note that Roseville's rate of \$31.24 is below the benchmark we adopt, currently \$32.28.

¹⁵⁵ See SBC Comments at 15.

¹⁵⁶ See, e.g., *First Recommended Decision*, 12 FCC Rcd at 150-54, paras. 125-133; *First Report and Order*, 12 FCC Rcd at 8837-46, paras. 108-26; *Seventh Report and Order*, 14 FCC Rcd at 8095-97, paras. 36-40.

¹⁵⁷ See *First Report and Order*, 12 FCC Rcd at 8842, para. 118; see also *First Recommended Decision*, 12 FCC Rcd at 153, para. 131.

determining the affordability of rates.¹⁵⁸ The Commission previously rejected a proposal similar to the one SBC suggests now, concluding that it “would over-emphasize income levels in relation to other non-rate factors that may affect affordability and fail to reflect the effect of local circumstances on the affordability of a particular rate.”¹⁵⁹ Given the unique characteristics of each jurisdiction, we continue to find that states are better suited than the Commission to make determinations regarding affordability.¹⁶⁰ Moreover, the Commission has previously rejected a proposal to link non-rural high-cost support to income and stated that “section 254(b)(3) reflects a legislative judgment that all Americans, regardless of income, should have access to the network at reasonably comparable rates.”¹⁶¹

46. We disagree with some commenting states that, because non-rural high-cost support is based on costs, “reasonably comparable” must also be defined in terms of costs, not rates.¹⁶² Specifically, they claim that the Commission must provide a standard to measure whether cost levels net of support in rural areas are reasonably comparable to those in urban areas.¹⁶³ Two states argue that “[i]f ‘rates equal costs’ for support, then ‘rates equal costs’ for accountability.”¹⁶⁴ First, the court emphasized that the Act speaks in terms of reasonable comparability of rates, not costs.¹⁶⁵ Furthermore, rates do not “equal” costs for purposes of non-rural high-cost support.¹⁶⁶ Costs can be used as a “proxy” for rates only in a general sense.¹⁶⁷

¹⁵⁸ See *First Report and Order*, 12 FCC Rcd at 8837, 8842, paras. 108, 118; see also *First Recommended Decision*, 12 FCC Rcd at 154, para. 131.

¹⁵⁹ See *First Report and Order*, 12 FCC Rcd at 8841, para. 115.

¹⁶⁰ See *id.* at 8842, para. 118; *Seventh Report and Order*, 14 FCC Rcd at 8096, para. 38.

¹⁶¹ See *Seventh Report and Order*, 14 FCC Rcd at 8097, para. 39.

¹⁶² See Maine Comments at 6-8; Montana and Vermont Comments at 4-5; 26-29.

¹⁶³ See Maine Comments at 8; Montana and Vermont Comments at 26.

¹⁶⁴ See Montana and Vermont Comments at 30.

¹⁶⁵ See *Qwest*, 258 F.3d at 1201 (Commission’s cost-based definitions of “reasonably comparable” are not reasonable interpretations of the statutory language because “[t]he Act calls for reasonable comparability between rural and urban rates; these definitions simply substitute different standards.”). See also *Recommended Decision*, 17 FCC Rcd at 20729, para. 34; *supra* note 21 (“As the court observed, although non-rural high-cost support is distributed based on a comparison of national and statewide average costs, the benchmark must be ultimately based on attainment of the statutory principle of reasonable comparability of urban and rural rates.”).

¹⁶⁶ As noted earlier, the rate benchmark we adopt here for purposes of defining “reasonable comparability” has a different purpose than the cost benchmark we discuss below in part IV.C. The cost benchmark is used to measure the amount of federal high-cost support non-rural carriers in each state may receive, and it is set at a level intended to ensure that all states have relatively equal abilities to achieve rate comparability in light of their resources based on average costs. The rate benchmark we adopt here will be used to gauge the success of combined federal and state efforts to ensure rate comparability by measuring whether individual rural rates are reasonably comparable to nationwide urban rates.

¹⁶⁷ For example, a state may permit carriers to recover part of the cost of providing a particular service, such as residential telephone service, from revenues received for other services, such as call waiting, caller ID, or (continued....)

Rather, as discussed above, cost differences represent the best measure of the resources each state can bring to bear in exercising its primary responsibility for achieving local rate comparability, in light of the Act's dual regulatory structure.¹⁶⁸ Moreover, the approach advocated by these parties would fundamentally disregard the court's mandate that we induce states to establish reasonably comparable rates. Essentially, they maintain that "reasonably comparable" must be defined in terms of cost because the federal role is limited to providing support to high-cost states, and the Commission cannot encourage or induce state action to ensure rate comparability.¹⁶⁹ This is precisely what the court found was required of the Commission under the Act, however.¹⁷⁰

47. We also reject NASUCA's argument that the definition of reasonable comparability recommended by the Joint Board places too much emphasis on costs and rates, and should emphasize service quality issues, such as local calling areas, as well.¹⁷¹ While we agree with NASUCA that service quality is an important goal, we believe that states are in the best position to address service quality issues and will have ample opportunity to do so in the rate review and expanded certification process discussed in part IV.D. below. In the *First Report and Order*, consistent with the Joint Board's recommendations, the Commission concluded that federally-imposed service quality or technical standards were not required at the time.¹⁷² Because most states had established mechanisms designed to ensure service quality in their jurisdictions, the Commission found that additional efforts undertaken at the federal level would be largely redundant.¹⁷³

48. We conclude that our definition of reasonably comparable rates, combined with the rate review process we adopt below, will allow us "to assess whether [the FCC's] funding mechanism will be sufficient for the principle of making rural and urban rates reasonably comparable," as required by the court.¹⁷⁴ We find that this definition responds to the court's

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intrastate toll services. In particular, the cost of serving a high-cost wire center is not likely be a good proxy for rates in that specific area. To keep rates from being prohibitively high in high-cost areas, states generally require below-cost rates in high-cost areas and permit the carrier to recover some of these costs with above-cost rates in other areas. See *supra* para. 15.

¹⁶⁸ See *supra* para. 23.

¹⁶⁹ Montana and Vermont argue that the Commission cannot condition federal support on a state's certification that it has established reasonably comparable rates in rural and urban areas within its borders. They claim in a hypothetical example that a state with \$100 rural rates and \$10 urban rates "deserves" federal support as much as states that have equalized rural and urban rates by either rate averaging or explicit support. See Montana and Vermont Comments at 36-37.

¹⁷⁰ See *Qwest v. FCC*, 258 F.3d at 1202.

¹⁷¹ See NASUCA Comments at 7.

¹⁷² *First Report and Order*, 12 FCC Rcd at 8831, para. 98.

¹⁷³ *Id.* at 8833, para. 101.

¹⁷⁴ *Qwest v. FCC*, 258 F.3d at 1202; see *infra* part IV.D.

criticism of the Commission's previous definitions of "reasonably comparable" for failing to "help answer the questions that arise about reasonable comparability."¹⁷⁵ We also find that the rate review and expanded certification process responds to the court's admonition that section 254 "requires a comparison of rural and urban areas, not states."¹⁷⁶ Rates in rural areas served by non-rural carriers can easily be compared to the national urban rate benchmark to determine whether or not a state's rural rates are presumed to be reasonably comparable to urban rates nationwide. As discussed in detail below, states will be required to certify that their non-rural company rates in high-cost areas are reasonably comparable to a national urban rate benchmark or explain why they are not.¹⁷⁷ This process will allow the Commission to better assess whether or not the non-rural mechanism is achieving its goal of ensuring reasonably comparable rural and urban rates and will induce states to maintain and ensure rural and urban rate comparability as competition develops and market conditions change.

C. Cost Benchmark

49. We modify the non-rural mechanism by changing the cost benchmark to one based on two standard deviations above the national average cost per line. The cost benchmark is used to determine the amount of non-rural high-cost support that non-rural carriers in each state will receive.¹⁷⁸ As discussed below, modifying the benchmark ties it more directly to the relevant data, consistent with the court's directive, but does not alter the level of non-rural support in a major way. We agree with the Joint Board that the current benchmark level is supported by data from the GAO Report indicating that rural and urban rates generally are reasonably comparable today. In our analysis of the data in the GAO Report, we apply the definition of reasonably comparable rural and urban rates adopted in this Order. We also agree with the Joint Board that standard deviation analysis of the relevant cost data supports the current level of non-rural support. Based on our examination of the record, we find that a two-standard-deviation threshold provides sufficient non-rural high-cost support to achieve the statutory principle of making urban and rural rates reasonably comparable. We further conclude that setting the cost benchmark based on two standard deviations would address changes in the dispersion of statewide average costs per line more directly than the current 135 percent benchmark.

1. Background

50. In the *Ninth Report and Order*, the Commission set the cost benchmark for the non-rural high-cost support mechanism at 135 percent of the national average cost per line.¹⁷⁹ If

¹⁷⁵ *Qwest v. FCC*, 258 F.3d at 1201.

¹⁷⁶ *Id.* at 1204.

¹⁷⁷ See *infra* part IV.D.2.

¹⁷⁸ The urban rate benchmark adopted in this Order, in contrast, will be used to gauge the success of combined federal and state efforts to ensure rate comparability by measuring whether individual rural rates are reasonably comparable to nationwide urban rates.

¹⁷⁹ *Ninth Report and Order*, 14 FCC Rcd at 20463-6, paras. 55-59.

the statewide average cost per line for non-rural carriers, as calculated by the cost model, exceeds the benchmark, then the non-rural mechanism provides support for intrastate costs in excess of the benchmark.¹⁸⁰ The Commission stated several reasons for setting the benchmark at 135 percent of the national average cost per line. A benchmark of 135 percent, the Commission reasoned, “falls within the range recommended by the Joint Board” of 115 to 150 percent of the national average cost per line.¹⁸¹ The Commission also stated that a 135 percent benchmark was “consistent with the precedent of the existing support mechanism[.]”¹⁸² In addition, the Commission found that the 135 percent benchmark was a “reasonable compromise of commenters’ proposals[,]” which ranged from 80 to 200 percent of the nationwide average.¹⁸³ The Commission further stated that “a national benchmark of 135 percent strikes a fair balance between the federal mechanism’s responsibility to enable reasonable comparability of rates among states and the burden placed on below-benchmark states (and ratepayers) whose contributions fund the federal support mechanism.”¹⁸⁴

51. In *Qwest*, the court found that the Commission’s justifications in the *Ninth Report and Order* failed to adequately support the choice of a 135 percent national average cost benchmark, stating that the Commission’s duty is not to “pick the ‘midpoint’ or come to a ‘reasonable compromise’ among competing positions.”¹⁸⁵ Rather, the Commission must “make rational and informed decisions on the record before it in order to achieve the principles set by Congress.”¹⁸⁶ Nonetheless, the court recognized that the “determination of a benchmark will

¹⁸⁰ *Id.* at 20467, para. 63. The non-rural high-cost support mechanism provides support for 76 percent of statewide average costs that are above the national benchmark. The mechanism calculates support based on 75 percent of forward-looking loop costs and 85 percent of forward-looking port costs, as well as 100 percent of all other forward-looking costs determined by the cost model. The percentage of forward-looking costs that the intrastate portion of each of the items represents is equivalent to 76 percent of total forward-looking costs. *Id.*

¹⁸¹ *Id.* at 20464, para. 55. See also *Second Recommended Decision*, 13 FCC Rcd at 24761-2, para. 43.

¹⁸² *Ninth Report and Order*, 14 Rcd at 20464, para. 55. Prior to the *Ninth Report and Order*, both rural and non-rural carriers were eligible for federal support under the Commission’s high-cost loop support mechanism. That mechanism provides gradually more support for costs that exceed certain thresholds or “steps” above the national average based on carriers’ loop costs, as reflected in their books. *Id.* at 20440, para. 13. The Commission explained in the *Ninth Report and Order* that the 135 percent benchmark was “near the midpoint of the range” of the high-cost loop support mechanism, which “begins providing support for costs between 115 and 160 percent of the national average cost per line, ... and the vast majority of non-rural carriers receive all their current support for costs in this range.” *Id.* at 20464, para. 55.

¹⁸³ *Id.* at 20464, para. 55.

¹⁸⁴ *Id.* at 20465, para. 58; see *Seventh Report and Order*, 14 FCC Rcd at 8102, 8112, para. 48 and 70 (“Given that telephone service currently is largely affordable, and any significant increase in the size of federal support for local rates appears unnecessary, we conclude that we should limit the size of the federal mechanism, as recommended by the Joint Board.”)(citation omitted).

¹⁸⁵ *Qwest*, 258 F.3d at 1202.

¹⁸⁶ *Id.*

necessarily be somewhat arbitrary.”¹⁸⁷ The court also acknowledged that the Commission is “entitled to deference in its line-drawing when it makes a reasoned decision.”¹⁸⁸ The court directed the Commission to “address the relevant data and provide adequate record support and reasoning for whatever level of support it ultimately selects upon remand.”¹⁸⁹

52. In the *Recommended Decision*, the Joint Board recommended that the Commission continue using the 135 percent national average cost benchmark.¹⁹⁰ First, the Joint Board found that evidence of nationwide urban and rural rate comparability supported continued use of this benchmark. The Joint Board reasoned that attainment of reasonably comparable rural and urban rates is a key factor in determining an appropriate benchmark.¹⁹¹ The Joint Board stated that both the Joint Board and the Commission have previously considered rates to be affordable and reasonably comparable, and found that data from the recent GAO Report supports this conclusion.¹⁹² The Joint Board stated that “[b]ased on data contained in the GAO Report, it appears that six years after passage of the Act the national averages of rural, suburban and urban rates for residential customers diverge by less than two percent. We believe that the comparability of average rural and urban rates supports continued use of the 135 percent cost benchmark.”¹⁹³

53. In addition, the Joint Board concluded that standard deviation analysis supports continued use of the 135 percent benchmark.¹⁹⁴ Verizon argued that rural rates within two standard deviations of the mean urban rate, as reflected in the GAO Report, should be considered

¹⁸⁷ *Id.* (“That recognition might justify arbitrarily picking a point within a narrow range, but does not justify doing so in the wide range present here.”)

¹⁸⁸ *Id.*

¹⁸⁹ *Id.* at 1203.

¹⁹⁰ *Recommended Decision*, 17 FCC Rcd at 20728-29, para. 34, *supra* note 21.

¹⁹¹ *Id.*; citing *Qwest*, 258 F.3d at 1202.

¹⁹² See United States General Accounting Office, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding* (GAO-02-187, Feb. 4, 2002) (GAO Report). The GAO’s objectives were to report on rates and examine how the rates and costs of providing local telephone service varied throughout the United States. GAO Report at 28. To do so, the GAO gathered data on local telephone rates in 50 states and the District of Columbia. The GAO collected sample rate data from three different categories of population density – central city, suburban and rural. GAO Report at 28-29. Up to 11 samples of residential and business local service rates were collected from each state. See GAO Report at 28-30 for a further description of the process used in the selection of places for sample rates. The rate results of the data collection, which the GAO conducted from May to September 2001 and is explained in detail in the report, are displayed in a chart format in Appendix IV of the GAO Report.

¹⁹³ *Recommended Decision*, 17 FCC Rcd at 20728-29, para. 34; see also *id.* at 20732, para. 40 (“The GAO Report suggests that more federal support is not necessary because urban and rural rates are similar.”)

¹⁹⁴ *Id.* at 20729-30, para. 35.

reasonably comparable,¹⁹⁵ and that the cost benchmark level of 135 percent is justified because it is nearly equivalent to two standard deviations above the national average cost per line.¹⁹⁶ The Joint Board recognized that, unlike the rate data in the GAO Report, the cost data is not normally distributed. The Joint Board stated that the objective of the non-rural support mechanism is to provide support to states with the highest average costs, however, so it is appropriate to use the two-standard-deviation measurement to identify such high-cost states, even though this measurement may identify more than expected in a normal distribution.¹⁹⁷ Based on this information, the Joint Board concluded that the 135 percent benchmark is a reasonable dividing line separating high-cost states from the remainder of average and low-cost states.¹⁹⁸

54. The Joint Board also determined that cluster analysis supports the 135 percent cost benchmark.¹⁹⁹ Cluster analysis is an analytical technique that arranges information according to specified variables so that relatively homogeneous groups, or “clusters,” can be identified. The Joint Board used cluster analysis “to identify groups of states that had similar cost characteristics, thereby warranting different treatment regarding universal service support.”²⁰⁰ Based on cost estimates used to determine non-rural high-cost support in 2002, the cluster analysis identified a high-cost, rural cluster of states that matched the group of states currently receiving support under the non-rural mechanism. Accordingly, the Joint Board concluded that the current benchmark of 135 percent distributes support to states appropriately.

¹⁹⁵ Verizon reasoned that Congress’s intent was that federal support be sufficient to maintain the range of rates existing at the time the 1996 Act was adopted, and that rates have not changed substantially since 1996, so the range of existing rates, as reflected in the GAO Report, should be used to determine what is reasonably comparable. *Id.* In a normal distribution, data points within two standard deviations of the mean will comprise approximately 95 percent of all data points. *Id.* at 20728-30, paras. 34, 36.

¹⁹⁶ *Id.* at 20729-30, para. 35. With the cost data used to determine 2002 support, a benchmark of two standard deviations above the mean was equivalent to 132 percent of the national average cost. *Id.* at 20730, para. 36 n.93.

¹⁹⁷ *Id.* at 20730, para. 36 n.91 (“We are interested in providing support to states with more high-cost lines, so it is appropriate to use the two standard deviation measurement to identify outliers even though this measurement may identify more than expected in a normal distribution. The current non-rural high-cost support mechanism provides support to eight out of 52 jurisdictions (50 states, the District of Columbia and Puerto Rico), or 15% of the jurisdictions.”)

¹⁹⁸ *Id.* at 20730, para. 36.

¹⁹⁹ *Id.* at 20730-31, para. 37.

²⁰⁰ *Id.* (“Specifically, states were sorted from lowest- to highest-cost based on statewide average cost per loop. Clusters were identified in this ranking if the difference in average costs between states was greater than ‘cluster split differences’ ranging from 2.5 to 0.5. Under this analysis, Mississippi was the first to break out into a separate cluster, and the second was the District of Columbia. The first group of states to break out into a separate rural, high-cost cluster included Kentucky, Maine, Alabama, Vermont, Montana, West Virginia and Wyoming. The remaining states, ranging from New Jersey to Nebraska, formed a separate urban, low-cost cluster. When Mississippi and the District of Columbia, the respective high- and low-cost ‘outliers,’ were combined into the two larger clusters, ‘cluster stability’ was achieved for a wide range of numerical values from 2.5 to 0.85. ‘Cluster stability’ means that the same clusters are maintained even as the numerical values are varied, indicating a strong similarity among members of the cluster groups.”) (footnotes omitted).

2. Discussion

55. We agree with the Joint Board that the current level of non-rural high-cost support is supported by GAO Report data showing that most rural and urban rates are reasonably comparable.²⁰¹ We have expanded on the Joint Board's analysis of the GAO Report data by comparing individual rates in rural and high-cost areas served by non-rural carriers to the national urban rate benchmark adopted in this Order.²⁰² We recognize, of course, that our analysis is not conclusive. In particular, the rate review and expanded certification process will give states the option of submitting additional data to demonstrate that factors other than basic service rates affect the comparability of rates in their states. As discussed in more detail below, however, the GAO Report contains the best data available regarding rates in rural and high-cost areas nationwide. Our analysis of the GAO Report data indicates that rates in rural and high-cost areas are reasonably comparable to those in urban areas nationwide, with limited exceptions.

56. Our analysis of the GAO Report data is set forth in Appendix C. For purposes of this analysis, we considered residential rates in the individual rural and high-cost areas served by non-rural carriers.²⁰³ We adjusted these rates in the GAO Report to include all of the charges in the basic rate template recommended by the Joint Board.²⁰⁴ We then compared the adjusted residential rates to the national urban rate benchmark adopted in this Order.²⁰⁵ As discussed

²⁰¹ *Id.* at 20728-29, para. 34.

²⁰² *See supra* part IV.B.2; *see infra* part IV.D.2.a.

²⁰³ As discussed below, the Joint Board recommended that states review only residential rates at this time. *See infra* part IV.D. In addition, consistent with the definition of rural and high-cost areas that we adopt below for purposes of the rate review process, we considered only rates identified as "Non-MSA" by the GAO. *See infra* part IV.D.2.b. We also limited our analysis to rates in areas served by non-rural carriers. Our analysis responds to criticism by some commenters that the Joint Board's analysis of average rates reported in the GAO Report failed to consider large rate differences between states, and that its analysis included extraneous data such as rates from areas served by rural carriers. *See* Maine Comments at 13-15; Qwest Comments at 7; Montana and Vermont Comments at 9-11.

²⁰⁴ The Joint Board recommended that the Commission establish a basic service rate template including the items in the Bureau's annual rate survey. *See infra* part IV.D.1. We adjusted the rural rates from the GAO Report by adding \$8.78 to each rate to reflect additional charges included in the Bureau's rate survey data. Both the Bureau's *2003 Reference Book* and the rate data in the GAO Report use the monthly charge for flat-rate service, where available, and a "representative rate" in areas where only measured/message service is available. The rates in the *2003 Reference Book* also include subscriber line charges, taxes, 911 and other charges, whereas the rates in the GAO Report do not. *See 2003 Reference Book* at Table 1.1; GAO Report at 49. Thus, we adjusted the rates in the GAO Report to reflect these additional charges by adding the average 2002 charges reflected in the *2003 Reference Book* for federal and state subscriber line charges (\$5.64) and for taxes, 911, and other charges (\$3.14), for a total of \$8.78. *See 2003 Reference Book* at Table 1.1. Although we recognize that the charges excluded from the GAO Report likely vary from state to state, we believe it is appropriate to use average adjustments in the absence of more specific data. We note that the rate template that states will use in the rate review process to compare rates will include the charges in the *2003 Reference Book*. *See infra* part IV.D.2.c. In addition, we note that the GAO rate data include any additional monthly charges for touch-tone service. The average urban residential rate in the *2003 Reference Book* of \$23.38 includes \$0.04 to reflect the average additional charge for touch-tone service. *See* GAO Report at 46; *2003 Reference Book* at Table 1.1.

²⁰⁵ *See infra* part IV.D.2.a.

above, this benchmark presumes rates in rural and high-cost areas served by non-rural carriers to be reasonably comparable to urban rates nationwide if they deviate no further than two standard deviations above the national average urban rate in the Bureau's *Reference Book*.²⁰⁶

57. Our analysis of the GAO Report data indicates that, with limited exceptions, residential rates in rural and high-cost areas served by non-rural carriers are reasonably comparable to urban rates nationwide. Only three of the 51 jurisdictions included in the GAO Report – Michigan, Vermont and Wyoming – had residential rates in rural and high-cost areas served by non-rural carriers exceeding the national urban rate benchmark.²⁰⁷ Given the available data and based on our definition of reasonable comparability, we find that residential rates in rural and high-cost areas served by non-rural carriers generally are reasonably comparable to urban rates in most states. Those states where rates do not appear to be reasonably comparable, based on our analysis of the GAO Report data, will have the opportunity to provide additional information through the rate review and expanded certification process.²⁰⁸

58. Some commenters maintain that the GAO Report has a number of flaws, including the general criticism that the GAO lacks expertise in the complexities of local exchange rates and that the size of the study is too small to be statistically valid.²⁰⁹ We disagree. The GAO was established for the very purpose of evaluating public programs and activities for Congress, and conducts audits, reviews, analyses and investigations on a regular basis.²¹⁰ In this

²⁰⁶ See *supra* part IV.B.2. Based on the 2003 *Reference Book* survey, the national urban rate benchmark is 138 percent of the average urban rate, with a dollar equivalent of \$32.28. 2003 *Reference Book*, Table 1.1. The 2003 *Reference Book* shows that the average total monthly residential rate for local service in urban areas in 2002 is \$23.38 and the highest rate surveyed during that time was \$35.19. 2003 *Reference Book*, Tables 1.1, 1.3. As described in more detail in part IV.D.2.a., the urban rate benchmark is expressed as the percentage equivalent of two standard deviations above the average total monthly residential urban rate for local service in metropolitan areas surveyed in the 2003 *Reference Book*.

²⁰⁷ Based on the information before us, we believe that there are very different reasons for these three states to exceed the rate benchmark. For example, Michigan had a high monthly charge of \$43.95 for flat-rate service in 2001, but most customers subscribed to a low message-rate service of \$12.01 that includes 400 calls per month, considerably more calls than the “representative rate” the Bureau calculates when flat-rate service is not available. GAO Report at 59, note d. We note that the \$43.95 charge for monthly service in Michigan was applicable throughout the state. In Wyoming, rural residential rates were higher than the national urban rate benchmark in 2001, but single-line business rates were the same as residential rates, and most single-line business rates in Wyoming were lower than in many other states. *Id.* at 58. We discuss below various possible approaches for analyzing residential rates in states that have rebalanced their rates as Wyoming has. See *infra* part V.

²⁰⁸ See *infra* part IV.D.2.e. We note that states also will be able to present information explaining why rates that appear to be reasonably comparable should not be considered reasonably comparable. See *id.*

²⁰⁹ Maine Comments at 12-15; Montana and Vermont Comments at 11; Qwest Comments at 6-7; Wyoming Comments at 5-6.

²¹⁰ See GAO Report at 61 (“The General Accounting Office, the investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions.”).

case, the GAO gathered a representative sample of up to 11 residential and business local service rates from every rate-setting jurisdiction, and concluded that the sample pool size it used was appropriate for purposes of its study.²¹¹ Given the experience and expertise of the GAO in general, and upon review of the GAO Report as a whole, we find that the data and conclusions in the GAO Report are generally reliable.²¹²

59. We also reject criticisms that the GAO did not adjust rates in different areas for differences in calling area size, service quality, or other characteristics.²¹³ These commenters essentially argue that local rates cannot be compared unless adjusted for any conceivable difference in local rate design policy. We recognize that states apply different ratemaking policies.²¹⁴ We agree with the Joint Board, however, that basic service rates provide a valid basis for evaluating rate comparability.²¹⁵ The rate review process and expanded certification will allow states to bring factors other than basic service rates to our attention if they believe that such factors affect the comparability of rates in their jurisdictions.²¹⁶

60. Furthermore, we reject criticisms that the GAO Report excludes certain charges that may vary from state to state.²¹⁷ As discussed above, we have adjusted the individual rates in the GAO Report to include an average of the additional charges in the basic rate template recommended by the Joint Board.²¹⁸ We recognize that these additional charges may vary from state to state; however, we conclude that it is appropriate to use average adjustments in the absence of more specific data.²¹⁹

²¹¹ See GAO Report at 28-30; see also *supra* note 192 and accompanying text.

²¹² See *Recommended Decision*, 17 FCC Rcd at 20728-29, para. 34; see *supra* note 21. See also AT&T Comments at 3-7; California Comments at 8-9; Verizon Reply Comments at 6-9.

²¹³ Maine Comments at 15; Montana and Vermont Comments at 11-12.

²¹⁴ See *supra* paras. 22-23.

²¹⁵ *Recommended Decision*, 17 FCC Rcd at 20737-38, para. 51 (“When state basic service rates are at or below the rate benchmark level, then there should be a presumption that rates in that state are reasonably comparable to national urban rates.”).

²¹⁶ See *infra* part IV.D.

²¹⁷ Maine Comments at 15; Montana and Vermont Comments at 11-12. Although these commenters do not elaborate on which additional charges omitted in the GAO Report data are of concern, we assume that they refer to the list of excluded charges specifically described in the GAO Report. GAO Report at 49 (“the monthly tariff rates that we report exclude the federal Subscriber Line Change [sic]; federal, state, and local surcharges for items such as universal service funding, 911 service, and taxes; the federal excise tax; and long distance fees and associated universal service surcharges and other taxes.”).

²¹⁸ See *supra* note 204 and accompanying text.

²¹⁹ In the future, no rate adjustment will be necessary to standardize the data collected as part of the state rate review and expanded certification process, because the basic service rate template used in this process will include the same elements as the 2003 *Reference Book*. See *infra* para. 86.

61. Finally, we disagree with the claim by some commenters that the GAO did not choose consistent rates when more than one service plan was offered in an area, based on the single example of Michigan rates.²²⁰ The GAO Report states that rates listed are for unlimited service, where available. If unlimited service was not available, the GAO reports the tariffed rate for message service, assuming 100 5-minute calls per month for residential customers.²²¹ In its report of listed rates, the GAO does in fact include the rate for unlimited service in Michigan, which was \$43.95 in all non-rural carrier service areas reported.²²² The GAO notes, however, that, according to the Michigan Commission, most residential customers purchase a message-rate service that allows 400 calls per month at a base rate of \$12.01.²²³ From the example of Michigan rates, it appears that the GAO not only abides by its own parameters for the study and selects rates consistently, but also provides additional relevant information to enable an informed analysis of the data. Commenters provide no other examples of inconsistencies in the GAO's selection of rates, and we find none.

62. Turning to the Joint Board's use of standard deviation analysis, we agree with the Joint Board that standard deviation analysis of the relevant cost data supports the determination that the cost benchmark rejected by the court does in fact provide an appropriate level of non-rural high-cost support.²²⁴ Standard deviation analysis is a commonly used statistical analysis that measures dispersion of data points from the mean of those data points.²²⁵ Both the Commission and state commissions have employed standard deviation analysis as a statistical standard for determining parity or comparability.²²⁶ In this proceeding, we use standard deviation analysis to measure the dispersion of statewide average costs per line, as estimated by the cost model, in order to identify states with significantly higher costs than the national

²²⁰ Maine Comments at 15; Montana and Vermont Comments at 11-12.

²²¹ GAO Report at 49.

²²² *Id.* at 53. *See also id.* at 59, note d.

²²³ *Id.*

²²⁴ *Recommended Decision*, 17 FCC Rcd at 20730, para. 36; *See also* California Comments at 8; Sprint Comments at 2-3; Verizon Comments at 11; Worldcom Reply Comments at 2.

²²⁵ *Recommended Decision*, 17 FCC Rcd at 20730, para. 36; *See* Verizon Reply Comments, Declaration of Eugene J. Goldrick at 3-4, paras. 6-7.

²²⁶ *Recommended Decision*, 17 FCC Rcd at 20730, para. 36 & n.92; *see also* Verizon Reply Comments at 12. For example, the Commission has used standard deviation analysis to create thresholds for cost comparability. *See Bell Operating Companies' Tariff for the 800 Service Management System, Tariff F.C.C. No. 1 and 800 Data Base Access Tariffs*, 8 FCC Rcd 3242 (1993); *Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, 12 FCC Rcd 18730 (1997). We note that, prior to the passage of the 1996 Act, the Commission considered setting a support benchmark in a universal service proceeding based on standard deviations. *In the Matter of Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Notice of Inquiry, 9 FCC Rcd 7404 (1994); *In the Matter of Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, 10 FCC Rcd 12309, 12333, para. 55 (1995). The Commission did not resolve this proceeding due to the subsequent passage of the 1996 Act.

average. Consistent with the court's directive, standard deviation analysis provides an empirical method, based on relevant data, of identifying states with significantly higher costs than the national average that are likely to have difficulty maintaining comparable rates without federal support.²²⁷

63. The Joint Board staff analyzed state cost per line model run data for the year 2001.²²⁸ As some commenters observed, the graphed data have the characteristics of an asymmetrical lognormal curve.²²⁹ Following the Joint Board's analysis, Commission staff determined the standard deviation of the data for the years 2001 and 2002 and plotted where two standard deviations above the mean falls on the graph, as represented in the graphs provided in Appendix D. Based on 2002 data, a benchmark of two standard deviations above the national average cost defines ten states as having very high average costs for purposes of distributing non-rural support.²³⁰

64. We conclude that two standard deviations is an appropriate threshold for purposes of determining non-rural high-cost support.²³¹ As discussed above, to provide sufficient support for statutory purposes, the non-rural mechanism must provide enough support to enable states to achieve reasonable comparability of urban and rural rates, without overburdening consumers who indirectly fund the federal universal service support mechanisms through carrier universal service line items.²³² As the Joint Board noted, two standard deviations translates approximately to a 135 percent national average cost benchmark and, therefore, approximately the same level of

²²⁷ See *Qwest*, 258 F.3d at 1202-3. Sprint Comments at 3 (“standard deviation analysis limits the arbitrary nature of the process and provides a recognized approach for identifying extreme values in a data set, based on all the values in that data set”); California Commission Comments at 8; Verizon Reply Comments at 10-13; Worldcom Reply Comments at 2.

²²⁸ The state cost per line model run data for 2001 used year end 2000 lines.

²²⁹ See Verizon Reply Comments, Declaration of Eugene R. Goldrick at 4, n.1 (“the state cost per line has a distributional asymmetry that is typical of data with a fixed lower bound of zero but no corresponding upper bound; the lower tail of the distribution is shorter than the upper tail. As a result, a greater proportion of states lie more than 2 standard deviations above the mean than lie 2 standard deviations below it.”); see also Maine Comments, Statement of Dr. William Gillis at 30; Montana and Vermont Comments, Statement of Dr. William Gillis at 53 (“there exists credible analysis showing that the data are skewed to the right.”). An asymmetrical lognormal curve is defined as an asymmetrical bell shape with a long tail of high measurement values. Staff used the software package BestFit – Probability Distribution Fitting for Windows, Version 4.5 by Palisade Corporation to confirm that the data forms an asymmetrical lognormal curve.

²³⁰ Appendix D. The 2002 cost per line model run data used year-end 2001 lines and the Delphi version of the cost model adopted by the Commission in January 2003. See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 18 FCC Rcd 41 (2003) (*Delphi Order*). Upon review of the graphed data, staff also determined that a benchmark set at two standard deviations above the mean will typically identify an average of 16 percent of the jurisdictions as high-cost states.

²³¹ See *Recommended Decision*, 17 FCC Rcd at 20730, para. 36 (concluding, based on standard deviation analysis, that the current benchmark level is a “reasonable dividing line separating high-cost states from the remainder of average and low-cost states.”).

²³² See *supra* at part IV.B.; see also Worldcom Reply Comments at 2.

non-rural support as has been provided in the past.²³³ We agree with the Joint Board that this is an appropriate level of non-rural support, based on evidence in the record that urban and rural rates have been and continue to be reasonably comparable, and because the principle of sufficiency requires that support be only as large as necessary to achieve the statutory objective.²³⁴ In sum, we conclude that a two-standard-deviation threshold strikes a fair balance between ensuring that states have enough federal support to ensure reasonable comparability of urban and rural rates, and avoiding the risks of excessive support.

65. We reject the argument of some commenters that the Joint Board improperly applied standard deviation analysis.²³⁵ First, as the commenters acknowledge, the cost data need not be “normally distributed” in order to apply standard deviation analysis.²³⁶ Second, standard deviation analysis may be used to identify data points significantly different from the general population.²³⁷ In this case, standard deviation analysis identifies states that have average costs per line significantly higher than the average state cost per line. Standard deviation analysis is not applied here to perform “statistical hypothesis testing.”²³⁸ Third, the Joint Board specifically addressed the empirical distribution of the cost data and recognized that a threshold set at two standard deviations above the national average cost identifies more data points than expected in a normal distribution.²³⁹ Fourth, the Joint Board did not “mechanically” apply standard deviation analysis,²⁴⁰ but explained the reasons underlying its conclusion that two standard deviations is an appropriate threshold.²⁴¹ Finally, the Joint Board did not suggest a “new and different formulation of the statutory language.”²⁴² Rather, it recommended application of the two-

²³³ *Recommended Decision*, 17 FCC Rcd at 20729-30, para. 35.

²³⁴ *Id.* at 20724, para. 16; *see id.* at 20732, para. 40 (“The GAO Report suggests that more federal support is not necessary because urban and rural rates are similar.”); WorldCom Reply Comments at 2.

²³⁵ *See* Qwest Comments, Declaration of Dr. Aniruddha Banerjee at 6-9; Maine Comments, Statement of Dr. William Gillis at 29-31; Montana and Vermont Comments at 18-24; *id.*, Statement of Dr. William Gillis at 51-54.

²³⁶ *See* Qwest Comments, Declaration of Dr. Aniruddha Banerjee at 9; Maine Comments, Statement of Dr. William Gillis at 30; Montana and Vermont Comments at 23; *see also* Verizon Reply Comments at 11-12; *id.*, Declaration of Eugene R. Goldrick at 4. Finding the standard deviation among a set of data points is a mathematical calculation that may be performed regardless of how the data are distributed. *Id.*

²³⁷ *See* Verizon Reply Comments at 11-12; *id.*, Declaration of Eugene R. Goldrick at 3-4.

²³⁸ Maine Comments, Statement of Dr. William Gillis at 29; Montana and Vermont Comments, Statement of Dr. William Gillis at 51. In his statement, Dr. Gillis states that “statistical hypothesis testing” may be used to decide “whether the mean value of a sample is significantly different from the mean value of a population or whether two samples may derive from the same population.” *Id.*

²³⁹ *Recommended Decision*, 17 FCC Rcd at 20730, n.91; *see also* Verizon Reply Comments, Declaration of Eugene R. Goldrick at 5-6.

²⁴⁰ Qwest Comments, Declaration of Dr. Aniruddha Banerjee, Ph.D. at n.7.

²⁴¹ *Recommended Decision*, 17 FCC Rcd at 20730, n.91; *id.* at para 35-6; *see also* Verizon Comments at 11.

²⁴² Montana and Vermont Comments at 21.

standard-deviation measurement as a rational method of determining a benchmark level that is suited to the goals of the 1996 Act.²⁴³

66. We further conclude that we should modify the national average cost benchmark by basing it on two standard deviations. The Joint Board recommended the existing 135 percent benchmark in part because it reasoned that a percentage-based benchmark provides certainty in the funding process.²⁴⁴ We are not persuaded, however, that a percentage-based benchmark provides greater certainty. The dollar equivalent of a cost benchmark will change each year, as the national average cost changes, regardless of whether it is percentage-based or calculated based on two standard deviations. In addition, basing the cost benchmark on two standard deviations responds to the court's directive by tying the benchmark more directly to the relevant data.²⁴⁵ We believe that a benchmark based on two standard deviations is better justified than a 135 percent benchmark in light of the determination above that two standard deviations is an appropriate threshold for non-rural support.²⁴⁶ Moreover, setting the cost benchmark at two standard deviations will respond to annual changes in the dispersion of statewide average costs per line relative to the national average. Therefore, we conclude that a benchmark based on two standard deviations is better suited to ensuring sufficient non-rural high-cost support over time.²⁴⁷ For these reasons, we adopt a cost benchmark based on two standard deviations above the national average cost per line.²⁴⁸

67. We do not rely on the Joint Board's cluster analysis in our determination of a cost benchmark. The Joint Board identified through cluster analysis, using 2001 cost estimates, the same group of states as those receiving support.²⁴⁹ We have performed additional cluster analyses on simulated model cost estimates for future years to determine whether there is likely to be a similar correspondence between the group of high-cost states defined by cluster analysis

²⁴³ *Recommended Decision*, 17 FCC Rcd at 20730, para. 36.

²⁴⁴ *Id.* at 20731, para. 38.

²⁴⁵ *See Qwest*, 258 F.3d 1191, 1203 (10th Cir. 2001) (instructing Commission on remand to "address the relevant data").

²⁴⁶ *See supra* paras. 62-64; *see* Montana and Vermont Comments at 24.

²⁴⁷ The rate review and expanded certification process will serve as a final check on the success of the non-rural high-cost support mechanism in achieving the ultimate goal of reasonably comparable rates. *See infra* part IV.D. Missouri Comments at 2; NASUCA Comments at 12. As discussed below, we may adjust the benchmark as necessary in the future based on analysis of the rate data.

²⁴⁸ We note that, pursuant to its delegated authority, the Bureau upgraded the cost model's computer language and corrected programming errors in *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 18 FCC Rcd 41 (2003), *recons. pending*, but deferred calculating support using the revised version of the model until after this Order on Remand. We anticipate that the Bureau will release an order updating line counts and other discrete input values used in calculating non-rural high-cost support following release of this Order on Remand, and that the revised version of the model will be used to calculate support based on the modified non-rural high-cost support methodology adopted herein beginning January 1, 2004.

²⁴⁹ *Recommended Decision*, 17 FCC Rcd at 20730, para. 36.

and those states receiving support based on a cost benchmark set at two standard deviations above the national average cost.²⁵⁰ The resulting clusters of states on the high-cost end of the spectrum generally correspond to the benchmark level, but do not appear likely to correspond exactly to the states receiving non-rural high-cost support each year.²⁵¹ We find it unnecessary to rely on cluster analysis because we believe our determination of a cost benchmark based on two standard deviations above the national average cost has adequate record support.²⁵²

68. We agree with the Joint Board and commenters that we should reject proposals to establish a lower threshold for non-rural support based on average urban cost.²⁵³ Because urban average costs are likely to be lower than urban average rates due to state universal service actions, an urban average cost benchmark would tend to exaggerate the need for federal support to ensure rural and urban rate comparability. Proponents of the urban cost benchmark maintain that the urban average cost is representative of rates in urban areas, and that statewide average costs are similarly representative of rates in rural areas, net of federal support.²⁵⁴ Yet, an average of urban costs – however “urban” is defined – does not proportionately relate to an urban rate because it does not take into account the effect of state mechanisms to balance rates.²⁵⁵ Rates in

²⁵⁰ Staff performed ten trials of cluster analysis on simulated cost data. A random number generator was applied to the fitted lognormal curve, described above, to simulate ten data sets of 52 cost data points, representing 52 jurisdictions. *See supra* note 229 and accompanying text. Staff used computer program XLSTAT version 5.1 to perform the “agglomerative hierarchical classification” of the “single-linkage” method of cluster analysis on the simulated data. *See* Qwest Comments, Declaration of Aniruddha Banerjee, Ph.D. at 11-12 & n.11. The computer program produced a dendrogram, a tree of clusters whose root is the class that contains all of the data points, for each simulated data set. From the dendrograms, staff was able to identify high-cost clusters with cluster stability. *See* Appendix E; *see also supra* note 200 and accompanying text.

²⁵¹ We believe that the cluster analysis results generally support a benchmark set at two standard deviations above the mean. The simulated clusters on the high-cost end of the scale identify between three and thirteen states, with an average of six states. *See* Appendix E. A benchmark of two standard deviations above the mean using current actual data identifies ten states as having very high average costs for purposes of distributing non-rural high-cost support. This figure falls within the range of the simulated clusters.

²⁵² We disagree with commenters who are opposed to use of cluster analysis because it does not provide insight into the amount of support sufficient for rate comparability. *See* Maine Comments at 16; Montana and Vermont Comments at 13. We do not believe the Joint Board intended to use cluster analysis as anything more than a verification to confirm that states with similar cost characteristics at the high-cost end of the spectrum receive support under the 135% benchmark. *See* Verizon Reply Comments at 6-7.

²⁵³ *Recommended Decision*, 17 FCC Rcd at 20731-32, paras. 39-41; AT&T Comments at 15; California Comments at 9-10; Verizon Comments at 10; *see supra* paras. 27-28.

²⁵⁴ *See* Montana and Vermont Comments at 26. The commenters maintain that if support is to be cost-based, the mechanism must provide that cost levels net of support in rural areas are reasonably comparable to urban areas. In using an urban cost benchmark, with “urban” defined by population density, the commenters suggest that the urban cost benchmark represents “urban” costs. The commenters, however, do not recommend that the Commission compare the urban cost benchmark to specifically-defined rural costs, but generally to statewide averages. *See also* Maine Comments at 19-23.

²⁵⁵ These commenters include in their definition of urban average cost (by study area, wire center, density zone and area overlap) only those areas that they define as “urban.” Maine Comments at 19-23; Montana and Vermont Comments at 40-44.

urban areas will tend to be driven up due to contributions in the aggregate made for state universal service funds, rate averaging or other state universal service mechanisms. Rates in rural areas will tend to be driven down in the aggregate due to the receipt of implicit and explicit support from such mechanisms. While a statewide average cost takes into account a state's efforts to achieve reasonable comparability of rates within the state by driving urban rates up and rural rates down through explicit or implicit support mechanisms, an urban average cost does not. In other words, the urban average cost will likely be disproportionately lower than the actual average urban rate. The imbalanced comparison of urban and statewide average costs, therefore, creates the appearance of urban and rural rate differences that are far greater than in reality. As a result, using an urban cost benchmark would cause the federal mechanism to provide more support than necessary to fulfill statutory requirements and to shoulder both federal and state responsibility in providing support.²⁵⁶

69. Proponents of a lower threshold based on average urban cost point out that the 135 percent national average cost benchmark when defined in terms of urban average cost is close to the 70-80 percent discrepancy that the court stated it doubted was within a "fair range" for purposes of determining rate comparability.²⁵⁷ We find this argument misplaced. The court referred to a 70 to 80 percent discrepancy between urban and rural rates, yet the proponents of an urban cost benchmark rely on a discrepancy between urban and rural costs.²⁵⁸ As discussed above, we define reasonable comparability for statutory purposes in terms of rates, not costs, and, based on our analysis of the relevant data, the discrepancy between urban and rural rates likely will remain well below 70 or 80 percent.²⁵⁹ Moreover, we reject the premise underlying this argument that the appropriate comparison for purposes of determining non-rural high-cost support is average urban cost, rather than national average cost. The threshold for non-rural high-cost support we adopt here is based on our analysis of the data in the record, which indicates that the current level of non-rural support is sufficient to achieve rate comparability. Adoption of a lower threshold without evidence that such a measure is required to ensure rate comparability would violate an aspect of sufficiency reaffirmed by the Joint Board – that the amount of support should be only as large as necessary to achieve the statutory goals.²⁶⁰

D. Rate Review and Expanded Certification Process

70. In order to induce states to achieve reasonably comparable rates, we adopt with minor changes the rate review and expanded certification process recommended by the Joint Board.²⁶¹ This rate review process will require the states to regularly examine whether the

²⁵⁶ AT&T Comments at 15-16.

²⁵⁷ *Qwest*, 258 F.3d at 1201. A 135 percent national cost benchmark yields roughly the same support amount and distribution as an average urban cost benchmark of 165 percent.

²⁵⁸ *Id.*; Maine Comments at 18; Montana and Vermont Comments at 25 and 47.

²⁵⁹ *See supra* at para. 44.

²⁶⁰ *Recommended Decision*, 17 FCC Rcd at 20724, para. 16.

²⁶¹ *Id.* at 20736-40, paras. 50-56.

residential rates paid by consumers in rural, high-cost areas served by non-rural carriers are reasonably comparable to those paid by urban consumers nationwide. We also will require each state annually to file with the Commission a certification stating whether its rural rates are reasonably comparable to urban rates nationwide. As part of the rate review and expanded certification process, we adopt a nationwide urban rate benchmark, below which rural rates may be presumed reasonably comparable to urban rates nationwide.²⁶² In addition, we establish a basic service rate template for states to use to compare rates. We adopt, with slight modifications, the definition of “rural area” already contained in section 54.5 of the Commission’s rules for the purpose of the rate review and expanded certification process. Finally, we adopt the Joint Board’s recommendation that states be allowed to request further federal action based upon a demonstration that, despite the state’s best efforts, federal non-rural support and state action together have not achieved reasonable comparability of rural and urban rates.²⁶³

1. Background

71. In the *Ninth Report and Order*, the Commission determined that the primary federal role in achieving the statutory goal of reasonably comparable rural and urban rates is to enable reasonable comparability among states and the primary role of each state is to ensure reasonable comparability of rural and urban rates within its borders.²⁶⁴ The Commission adopted the Joint Board’s earlier recommendation that the Commission “abstain from requiring any state action as a condition for receiving federal high-cost support.”²⁶⁵ The Commission found it most appropriate for states to determine how non-rural high-cost support is used, “[b]ecause the support . . . is intended to enable the reasonable comparability of *intrastate* rates, and states have primary jurisdiction over intrastate rates.”²⁶⁶ As a regulatory safeguard, the Commission required states that wish to receive non-rural high-cost support to certify annually that all such support will be used in a manner consistent with section 254(e).²⁶⁷

72. As noted above, in *Qwest*, the Tenth Circuit required the Commission on remand to develop a mechanism to induce state action to ensure the reasonable comparability of rural and urban rates.²⁶⁸ Specifically, the court noted that the non-rural support mechanism adopted in

²⁶² This rate benchmark is consistent with the definition of reasonable comparability that we adopt above. *See supra* paras. 38-44.

²⁶³ In the attached Further Notice of Proposed Rulemaking, we seek further comment on certain discrete aspects of the rate review and expanded certification process. *See infra* part V. We also seek comment on the rules, procedures and required showings for further federal action. *Id.*

²⁶⁴ *Ninth Report and Order*, 14 FCC Rcd at 20454, para. 38.

²⁶⁵ *Id.* at 20469, para. 67.

²⁶⁶ *Id.* at 20483, para. 95.

²⁶⁷ *Id.* at 20483, para. 97; *see* 47 C.F.R. § 54.313(a) (state must certify that support “will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended”).

²⁶⁸ *Qwest*, 258 F.3d at 1203-04.

the *Ninth Report and Order* would result in reasonably comparable rates only if states implement their own universal service policies, but that the *Ninth Report and Order* did not include any inducements for state action or future inducements in the absence of reasonable comparability of rural and urban rates.²⁶⁹ The court acknowledged that the Commission may not be able to implement universal service by itself, and that it is therefore appropriate or even necessary for the Commission to rely on state action to implement universal service goals.²⁷⁰ The court concluded, however, that the Commission may not simply assume that the states will act on their own to preserve and advance universal service and that it must create some inducement--“a ‘carrot’ or a ‘stick,’ for example, or simply a binding cooperative agreement with the states”--for the states to implement universal service provisions.²⁷¹

73. In its *Recommended Decision*, the Joint Board recommended that the Commission implement a rate review and expanded certification process.²⁷² Specifically, each state would be required to review its rural rates to determine if they were reasonably comparable to urban rates nationwide.²⁷³ The Joint Board recommended that the Commission establish a nationwide urban rate benchmark to facilitate this review.²⁷⁴ Each state would be required to file a certification with the Commission annually stating whether its residential rates in rural and high-cost areas served by non-rural carriers were reasonably comparable to urban rates nationwide.²⁷⁵ Rates less than the nationwide urban rate benchmark would be presumed reasonably comparable, and states could certify that their basic service rates in rural, high-cost areas are reasonably comparable without submitting rate information.²⁷⁶ A state would have the option of submitting additional rate data to demonstrate that factors other than basic service rates affect the comparability of their rates in high-cost areas.²⁷⁷ The Joint Board concluded that this process would satisfy the court’s requirement for inducement of state action by “encourag[ing] states to scrutinize their rates . . . , to determine whether they are reasonably comparable, and if not, to take actions to make them reasonably comparable.”²⁷⁸ The Joint Board also emphasized that its recommended

²⁶⁹ *Id.* at 1203.

²⁷⁰ *Id.* at 1203-04.

²⁷¹ *Id.* at 1204.

²⁷² *Recommended Decision*, 17 FCC Rcd at 20736-40, paras. 50-56.

²⁷³ *Id.*

²⁷⁴ *Id.* at 20736-38, para. 50, 52-53.

²⁷⁵ *Id.* at 20736-40, paras. 50-51, 55-56.

²⁷⁶ *Id.* at 20736-38, paras. 50-51, 53.

²⁷⁷ For example, if its rural rates exceeded the benchmark, a state would be permitted to explain in its certification why its rural rates were reasonably comparable. *Id.* at 20736-40, paras. 50-51, 55-56. Similarly, a state could explain in its certification that its rural rates were not reasonably comparable to nationwide urban rates, despite being within the safe harbor created by the nationwide urban rate benchmark. *Id.* at 20736-40, paras. 50, 53, 55-56.

²⁷⁸ *Id.* at 20737-38, para. 51.

approach affords the states maximum flexibility to regulate basic services and rates.²⁷⁹

74. The Joint Board made several specific recommendations with respect to the rate review and expanded certification process, and suggested that the Commission seek further comment with respect to certain issues. The Joint Board recommended that the Commission base the rate benchmark on the most recent average urban residential rate shown in the Wireline Competition Bureau's annual *Reference Book*, as modified to reflect the most recent changes in subscriber line charges.²⁸⁰ The Joint Board suggested that a benchmark level of 135 percent of the nationwide average urban rate "[might] be appropriate," but suggested that the Commission seek further comment on this issue.²⁸¹ The Joint Board further recommended that the Commission establish a basic service rate template that instructs the states which rate elements to compare to the rate benchmark as part of their rate review.²⁸² The Joint Board recommended that this basic service rate template include the same items as the Bureau's *Reference Book*.²⁸³ The Joint Board suggested that rural, high-cost areas be defined as all wire centers with a line density less than 540 lines per square mile, but recommended that the Commission seek further comment on whether a different definition of rural, high-cost areas would be more appropriate.²⁸⁴ The Joint Board recommended that states review only residential rate information at this time.²⁸⁵

75. The Joint Board further recommended that a state be permitted to request further federal action based on a showing that federal support and state action together were not sufficient to yield basic service rates in rural and high-cost areas served by non-rural carriers that were reasonably comparable to urban rates nationwide.²⁸⁶ This further action could include, but would not be limited to, additional targeted federal support or actions to modify calling scopes or improve quality of service where states have limited jurisdiction.²⁸⁷ The Joint Board recommended that further federal action be available only when the state demonstrates that it has already taken all reasonably possible steps and used all available state and federal resources to make basic service rates reasonably comparable.²⁸⁸ The Joint Board also recommended that the

²⁷⁹ *Id.*

²⁸⁰ *Id.* at 20736, 20738, paras. 49 & n.124, 52.

²⁸¹ *Id.* at 20736-38, paras. 50, 52-53.

²⁸² *Id.* at 20739, para. 54.

²⁸³ *Id.* These elements include the rate for a line with access to the public switched network, federal subscriber line charge, state subscriber line charge (if any), federal universal service fund charge, state universal service fund charge (if any), local number portability charge, telecommunications relay service charge, 911 charges, federal universal service credits (if any), state universal service credits (if any), and the federal excise tax. *Id.*

²⁸⁴ *Id.* at 20736-37, para. 50 & n.125.

²⁸⁵ *Id.* at 20738, para. 53.

²⁸⁶ *Id.* at 20736-37, para. 50. The Joint Board also suggested that it may be appropriate to seek comment on whether states should eventually review business rates as well.

²⁸⁷ *Id.*

Commission develop exact procedures to be used in filing and processing requests for further federal action.²⁸⁹

2. Discussion

76. We agree with the Joint Board and commenters that, consistent with the court's decision in *Qwest*, the rate review and expanded certification process will induce state action to ensure that rates in rural and high-cost areas served by non-rural carriers are reasonably comparable to urban rates nationwide.²⁹⁰ Each state will be required to review its rates in rural, high-cost areas served by non-rural carriers annually to assess their comparability to urban rates nationwide, and then to file a certification with the Commission regarding the comparability of rates. Moreover, a state that has not achieved reasonably comparable rural and urban rates must make a public certification explaining why it has not been able to achieve rate comparability, and must do so annually until it can certify that it has achieved reasonable rate comparability. We believe that this mandatory rate review will induce states to fulfill their obligations under the federal-state universal service partnership. As discussed above, our review of the record indicates that states generally are succeeding, some with federal support, in ensuring rate comparability.²⁹¹ The rate review and expanded certification process will ensure that state action to ensure rate comparability continues and, where state action has not achieved reasonable comparability, will create significant pressure on states to take action to achieve reasonable comparability. The annual certification will be a state's public representation that it has engaged in the required rate review. We believe that a state will make significant efforts to achieve rate comparability to avoid making repeated certifications that its rates are not reasonably comparable.²⁹²

77. We do not adopt other proposed state inducements at this time, which would pose significant jurisdictional or policy issues. We find that the record does not support claims that, to comply with the court's remand, we must require or induce all states to immediately remove implicit subsidies from intrastate rates through substantial increases in federal support.²⁹³ Our

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²⁸⁸ *Id.* at 20736-37, 20740, paras. 50, 56.

²⁸⁹ *Id.* at 20740, para. 56. The Joint Board specifically noted that the Commission should establish a time limit for determining whether further federal action would be provided. *Id.*

²⁹⁰ *See Id.* at 20737-38, para. 51; *see also* California Comments at 11, Missouri Comments at 2. In part V.D., below, we seek comment on providing additional inducements for state action to preserve and advance universal service through additional targeted federal support for high-cost wire centers in states that adopt explicit universal service mechanisms.

²⁹¹ *See supra* paras. 43, 57.

²⁹² *See Ninth Report and Order*, 14 FCC Rcd at 20483, para. 97 (“As a regulatory safeguard, . . . we adopt rules in this Order requiring states that wish to receive federal universal service high-cost support for non-rural carriers within their territory to file a certification with the Commission . . . Each certification shall become part of the public record maintained by the Commission.”).

²⁹³ *See supra* para. 26. *Qwest* warns that, without strong encouragement from the Commission, states are unlikely to replace implicit subsidies with explicit, competitively neutral funding mechanisms until a crisis point where implicit subsidies have been virtually eliminated. *See e.g.*, *Qwest* Comments at 7-8. SBC similarly claims that (continued. . .)

analysis of the GAO Report data confirms the Joint Board's finding that, six years after passage of the 1996 Act, urban and rural rates nationwide generally remained reasonably comparable.²⁹⁴ Carriers arguing that immediate, nationwide rate rebalancing is urgently needed have not provided data to quantify the implicit support in intrastate rates.²⁹⁵ Moreover, they do not seem to consider the possibility that competition may drive costs down so that the total amount of support needed may decrease as competition increases.²⁹⁶ We agree with the Wisconsin Commission that the impact of competition has not been geographically ubiquitous or long-lived enough to assess definitively its effect on rates for universal service purposes.²⁹⁷ As discussed above, we find that states continue to be in the best position to determine when to eliminate implicit support in their rate designs and establish explicit, sustainable universal service mechanisms.²⁹⁸ In the event that our review of the states' rate comparability certifications indicates that states are not, in fact, making sufficient efforts to achieve rate comparability, we will then consider whether it is necessary to institute stronger inducements. We do not foreclose the possibility of withdrawing non-rural support from a state or conditioning non-rural support on specific state action, if such action is found appropriate in the future.²⁹⁹

78. The steps we take today represent a measured response to the court's decision, and we will assess in the future whether additional inducements are necessary. Consistent with the Joint Board's recommendations, we believe that the approach we adopt establishes effective state inducements while affording the states maximum flexibility to regulate basic rates and services. We anticipate that the erosion of implicit support by competition will, in time, compel

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many states give no sign of addressing the erosion of traditional cross-subsidies due to the growth of competition and warns that the "predictable train wreck . . . is now an imminent reality." See SBC Reply Comments at 3, 12.

²⁹⁴ See *supra* part IV.C.

²⁹⁵ NASUCA disputes SBC's claim that all residential rates are below cost and argues that for most companies residential service is "self-supporting." See NASUCA Reply Comments at 3-4. NASUCA argues that many non-rural carriers have the resources to ensure reasonably comparable rates without additional federal support, and urges the Commission to withhold support from carriers earning a healthy overall return, for example, in excess of 11.25%. See NASUCA Comments at 5, 9. NASUCA provides interstate rate of return information for BellSouth, Qwest, SBC, and Verizon. See NASUCA Comments, Attachment A. We agree with NASUCA that carriers claiming their residential rates are below cost should be required to substantiate their claims, but we believe that the states are in the best position to evaluate these claims. See NASUCA Reply Comments at 4.

²⁹⁶ Congress thought that lower costs would be a likely result of increased competition. See S. Rep. No. 23, 104th Cong., 1st Sess. 26 ("The Committee expects that competition and new technologies will greatly reduce the actual cost of providing universal service over time, thus reducing or eliminating the need for universal service support mechanisms as actual costs drop to a level that is at or below the affordable rate for such service in an area . . .").

²⁹⁷ See Wisconsin Comments at 4.

²⁹⁸ See *supra* para. 22.

²⁹⁹ Although we do not foreclose future action, we find that it would be inappropriate at this time to condition non-rural support on the achievement of rate comparability. Denying non-rural support to a high-cost state would have very serious effects on the rates paid by consumers in that state. We therefore decline to place such conditions on non-rural support without additional information regarding rate comparability and state action to achieve rate comparability.

states to replace those implicit support mechanisms with explicit support mechanisms, which will be sustainable in a competitive marketplace.³⁰⁰ We also believe that incentives in terms of additional federal support may be appropriate where states have eliminated implicit support and the resulting rebalanced rates are significantly higher than rates in other states.³⁰¹ In the Further Notice, therefore, we propose to make available additional targeted federal support for high-cost wire centers in most states as a positive incentive for those states to reform their implicit universal service mechanisms.³⁰²

79. The rate review and expanded certification process also will add a dynamic element to the non-rural high-cost support mechanism by enabling the Commission to assess on an ongoing basis whether combined federal and state actions continue to result in reasonably comparable rural and urban rates nationwide. With the information collected through this process, the Commission will be better able to assess how successfully the non-rural support mechanism ensures the reasonable comparability of rates, and to respond accordingly. For example, the data will better enable the Commission to identify any systemic problems with rate comparability that may arise with the advent of competition, and to determine whether any such problems should be addressed through adjustments to the cost benchmark level, further inducements for state action, or other measures.

a. Nationwide Urban Rate Benchmark

80. We adopt the Joint Board's recommendation that we establish an annually adjusted nationwide urban rate benchmark for the purpose of the rate review and expanded certification process.³⁰³ This rate benchmark will be used by the states and the Commission as a tool to assess the reasonable comparability of rates in rural and high-cost areas served by non-rural carriers to nationwide urban rates.³⁰⁴ As recommended by the Joint Board, we base the urban rate benchmark on the most recent average urban residential rate shown in the Bureau's *Reference Book*.³⁰⁵ The Bureau's annual *Reference Book* includes a sample of flat-rate services

³⁰⁰ See *supra* para. 22. As competition increases, it will be helpful to know whether more states are establishing explicit support mechanisms. See, e.g., SBC Comments at 6 (“[T]he Joint Board and the Commission do not even have any information that would allow them to analyze state universal service mechanisms.”). In the attached Further Notice, we seek comment on collecting additional information from the states to enhance our ability to assess whether or not federal and state mechanisms are resulting in reasonably comparable rates and to take appropriate action if they are not. See *infra* part V.A.

³⁰¹ See *infra* part V.

³⁰² See *infra* part V.D.

³⁰³ *Recommended Decision*, 17 FCC Rcd at 20736-38, paras. 50-53. As explained above, the nationwide urban rate benchmark also will be used to define reasonable comparability of urban and rural rates. See *supra* paras. 38-42.

³⁰⁴ In contrast, the cost benchmark, discussed above in part IV.C., is used to identify the amount of federal support that, in combination with state action, is sufficient to achieve the Act's universal service goals, including reasonable comparability of rural and urban rates.

³⁰⁵ *Recommended Decision*, 17 FCC Rcd at 20738, para. 52.

available in 95 cities from many regions of the country.³⁰⁶ The weighted average of urban rates in the *Reference Book* provides an appropriate baseline for the purpose of determining whether rates in rural areas are reasonably comparable to those in urban areas nationwide. However, because of the great variation in urban rates nationwide, we are not convinced that we should focus solely on the average urban rate in determining whether rural rates are reasonably comparable to urban rates.³⁰⁷ We find that using a standard deviation analysis, which measures the dispersion of urban rates from the average, to set the urban rate benchmark will appropriately reflect both the average and the variation of urban rates.³⁰⁸

81. We adopt an urban rate benchmark level of two standard deviations above the average urban rate in the *Reference Book*. Based on the most recent data, the current benchmark level is \$32.28, or 138 percent of the nationwide average urban rate.³⁰⁹ This benchmark level is similar to the 135 percent benchmark level that the Joint Board suggested we consider.³¹⁰ This benchmark level is also consistent with our conclusion above that Congress did not intend the 1996 Act to narrow the permissible range of urban and rural rates, but rather to ensure continued rate comparability with the advent of competition.³¹¹ The rate benchmark should therefore be set at a level that permits a rural rate to be presumed reasonably comparable to urban rates

³⁰⁶ The most recent survey includes data as of October 15, 2002. *2003 Reference Book*, at 1-10.

³⁰⁷ See *supra* para. 39. See also Dixon, W., and Massey, F., Introduction to Statistical Analysis, Third Edition, McGraw-Hill Book Company, 1969. pp. 26-27 (“An important concept in statistics is that any average does not in itself give a clear picture of a distribution [of data]. . . . Another type of measure which helps to clarify the shape of the distribution is one that indicates how the observations are spread out from the average. Such a measure could be called a measure of dispersion, spread, or variability.”).

³⁰⁸ For this reason, we reject arguments by commenters that ignore the variation in urban rates in suggesting appropriate urban rate benchmarks. For example, NASUCA notes that, using a 135 percent urban rate benchmark, customers in rural areas could potentially pay rates that are up to \$7.82 per month higher than the national average urban rate, and concludes without further analysis that rates greater than this could not be found reasonably comparable. NASUCA Comments at 15-16. NASUCA does not address the variation of urban rates or the fact that some urban areas have rates higher than 135 percent of the urban average rate. Similarly, Montana, Vermont, and Maine suggest that reasonably comparable rural rates must be within 125 percent of the nationwide average urban rate because a consumer would likely view price differences exceeding 25 percent as excessive, but fail to address how variation in urban rates nationwide should be reflected in the permissible variation of rural rates. Montana and Vermont Comments at 44-47, Maine Comments at 23-27; see also *supra* para. 44.

³⁰⁹ Based on the urban rate data in the *2003 Reference Book*, the nationwide average urban rate currently is \$23.38. See Appendix B. We direct the Bureau to publish in future editions of the *Reference Book* both the average urban rate on which the benchmark will be based and the benchmark level as a dollar amount and as a percentage of the average, in order to facilitate the states’ use of the benchmark in the rate review and expanded certification process. The 2003 and prior editions of the *Reference Book* are available on the Commission website at www.fcc.gov/wcb/iatd/lec.html.

³¹⁰ The Joint Board’s suggested urban rate benchmark of 135 percent would place the benchmark at \$31.56, or 72 cents less than the benchmark we adopt. The Joint Board suggested that the Commission consider setting the rate benchmark at 135 percent of the average urban rate--because it had also recommended a cost benchmark level of 135 percent of the average cost per loop--but further develop the record to establish the appropriate rate benchmark. We have further developed the record through our analysis of rate data in the *Reference Book*.

³¹¹ See *supra* paras. 39-40.

nationwide if it does not deviate from the average urban rate more than urban rates generally. For the purpose of establishing a safe harbor, two standard deviations is an appropriate measure of the amount of deviation commonly found in urban rates. We estimate that, based on the data in the *Reference Book*, 96 percent of urban rates nationwide are below the average urban rate plus two standard deviations.³¹² Although a rate benchmark of the average urban rate plus three standard deviations would encompass 98.5 percent of urban rates,³¹³ we find that the average plus two standard deviations better serves the rate benchmark's intended purpose of a safe harbor. A rate benchmark level of two standard deviations above the average urban rate will permit most states to presume that their rates in rural areas served by non-rural carriers are reasonably comparable to urban rates nationwide, thereby providing an effective safe harbor, but will require that states more closely scrutinize rural rates that approach the highest margin of urban rates nationwide and, therefore, are more likely to present problems of reasonable comparability.

82. Consistent with the Joint Board's recommendations, we emphasize that this benchmark merely creates a presumption regarding the reasonable comparability of rural and urban rates, and is not the sole test of whether rural and urban rates are reasonably comparable.³¹⁴ Factors such as the quality of service, the size of calling areas, or the availability of alternative rate plans could impact a state's review of the comparability of rural and urban rates. A state may conclude that its rural rates are reasonably comparable to nationwide urban rates even if they exceed the urban rate benchmark. Similarly, a state with rural rates below the urban rate benchmark may still conclude that its rural rates are not reasonable comparable to urban rates nationwide. We are not persuaded by the argument that setting a nationwide urban rate benchmark will effectively create a target rate for local service rates.³¹⁵ States are unlikely to abdicate their ratemaking authority due to the existence of this rate benchmark. Nor are we persuaded by the argument that we should not set a rate benchmark because administrative hurdles would prevent adjustments if costs or other factors used to calculate the rate benchmark change.³¹⁶ The nationwide urban rate benchmark we adopt will change annually based on

³¹² Our analysis of the urban rate data in the *Reference Book* demonstrates that a log-logistic distribution, rather than a normal distribution, best fits the data. In this log-logistic distribution, approximately 96 percent of the total area under the log-logistic curve (and, therefore, 96 percent of urban rates) is to the left (*i.e.*, below) the average plus two standard deviations. In contrast, if the data were normally distributed, approximately 97.5 percent of the total area under the normal curve would be to the left of the average plus two standard deviations.

³¹³ The average urban rate plus three standard deviations is also normally a better estimate of the highest urban rate nationwide than the highest rate shown in the *Reference Book's* survey.

³¹⁴ *Recommended Decision*, 17 FCC Rcd at 20738, para. 53.

³¹⁵ Wisconsin Comments at 5.

³¹⁶ *Id.* We also do not agree with the Wisconsin Commission's suggestion that the nationwide urban rate benchmark should be indexed to household income levels. *Id.* at 6. As the Commission has previously found, using income to set an affordability benchmark "would over-emphasize income levels in relation to other non-rate factors that may affect affordability and fail to reflect the effect of local circumstances on the affordability of a particular rate." *First Report and Order*, 12 FCC Rcd at 8841, para. 115; *see supra* para. 45. Moreover, household income does not, in itself, provide probative information with regard to whether rates in rural areas are reasonable comparable to rates in urban areas.

changes to the urban rates identified in the Bureau's *Reference Book*. Thus, the rate benchmark level will automatically change to reflect marketplace trends in rates, including changing costs and other factors in ratemaking.³¹⁷

b. Definition of Rural and High-Cost Areas

83. Based on our examination of the record in this proceeding, we adopt a modified version of the existing definition of "rural area" contained in section 54.5 of our rules for the purpose of determining whether rates in rural, high-cost areas served by non-rural carriers are reasonably comparable to urban rates.³¹⁸ Under this definition, a "rural area" is, with the exceptions discussed further below, any non-metropolitan county or county-equivalent, as identified by the Office of Management and Budget. The Commission adopted this definition in the *First Report and Order* as a relatively simple and effective means to determine which health care providers were located in rural areas and, therefore, eligible for support under the rural healthcare mechanism.³¹⁹ The Commission found that political divisions like counties are more easily identified than density-based definitions of rural and urban areas and that the use of this definition was consistent with Congress's intent to secure telecommunications services for rural healthcare providers at rates that were reasonably comparable to those received by urban health care providers.³²⁰ For the same reasons, we find that this definition will provide a simple and effective means for states to determine whether areas are rural for the purposes of identifying rural, high-cost areas served by non-rural carriers in their states.³²¹ A state should easily be able to determine how its rate zones overlap well-established political divisions and determine rates within those areas.

84. We believe that a state's rates in non-metropolitan counties will, in the vast majority of instances, be a reliable indicator of rural rates in the state. To provide states with additional flexibility, however, we also adopt a provision that will permit a state to identify as rural areas wire centers served by non-rural carriers within the state that are not covered by the definition of rural area in the Commission's current Part 54 rules, if the state concludes that consideration of those areas is necessary and appropriate for purposes of the rate review and expanded certification process to develop a complete picture of rate comparability in the state.³²²

³¹⁷ See *supra* para. 41; see also *Recommended Decision*, 17 FCC Rcd at 20738, para 52.

³¹⁸ Section 54.5 defines rural area as "a non-metropolitan county or county equivalent as defined in the Office of Management and Budget's (OMB) Revised Standards for Defining Metropolitan Areas in the 1990s and identifiable from the most recent Metropolitan Statistical Area (MSA) list released by OMB, or any contiguous non-urban Census Tract or Block Numbered Area within an MSA-listed metropolitan county identified in the most recent Goldsmith Modification published by the Office of Rural Health Policy of the U.S. Department of Health and Human Services." 47 C.F.R. § 54.5.

³¹⁹ *First Report and Order*, 12 FCC Rcd at 9113-17, paras. 646-52.

³²⁰ *Id.* at 9115-16, para. 649.

³²¹ See Verizon Comments, filed April 10, 2002, at 3-4.

³²² We note that the second part of the definition of "rural area" currently used in the rural health care program includes a modification ("Goldsmith modification") to identify rural areas within metropolitan counties. We (continued....)

A state choosing to identify an area as rural under this provision must do so on a wire center basis, and must explain its conclusion that the area should be treated as a rural area for purposes of the rate review process. We anticipate that few states will find it necessary to identify additional wire centers as rural areas under this provision, but conclude that providing an additional degree of flexibility to states in applying the definition of a rural area for purposes of the rate review process is appropriate to permit them to address any extraordinary circumstances that exist in their boundaries.

85. We do not adopt a wire-center based definition of rural, high-cost areas for the purposes of the rate review and expanded certification process. The Joint Board suggested that we consider defining rural, high-cost areas as all wire centers with a line density less than 540 lines per square mile.³²³ Some commenters criticized the proposed wire-center definition as difficult to use and inconsistent with the non-rural support methodology's treatment of "high-cost" wire centers.³²⁴ Moreover, if we were to base such a definition on current data, as the Joint Board suggested, the areas considered rural under the definition would likely change every year as the line density of the average cost wire center changes. We believe that the definition we adopt will enable states to more readily identify their rural, high-cost areas than a wire-center definition.

c. Basic Service Rate Template

86. We adopt the Joint Board's recommended basic service rate template for states to use to compare rates.³²⁵ This basic service rate template, which consists of the rate elements

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 understand that the Office of Rural Health Care Policy in the Department of Health and Human Services no longer utilizes the Goldsmith modification and that no Goldsmith modification has been prepared for the 2000 Census data. When identifying additional areas as "rural" for purposes of determining whether rates in rural, high-cost areas served by non-rural carriers are reasonably comparable, states are free, but not required, to consider what areas were deemed rural in the last Goldsmith modification.

³²³ *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50 & n. 125. The Joint Board suggested that a definition based on this line density might be appropriate because, based on the data before the Joint Board, lower line densities were above the average national cost estimated by the cost model and higher line densities were below the average national cost. The Joint Board also recommended that the Commission consider whether another definition may be more appropriate. *Id.* at 20736-37 n.125.

³²⁴ NASUCA Comments at 14 n. 37; *see also* Wyoming Comments at 7. We agree with NASUCA that the Joint Board's suggested definition inappropriately implies that any area with above-average costs is "high cost" and any area with below-average costs is "low cost," because the Commission has traditionally treated as high-cost only those areas which had costs exceeding specific above-average cost benchmarks. NASUCA Comments, at 14 n.37.

³²⁵ *Recommended Decision*, 17 FCC Rcd at 20739, para. 54. The elements of the basic service rate template specifically identified by the Joint Board are: the rate for a line with access to the public switched network, federal subscriber line charge, state subscriber line charge (if any), federal universal service fund charge, state universal service fund charge (if any), local number portability charge, telecommunications relay service charge, 911 charges, federal universal service credits (if any), state universal service credits (if any), and the federal excise tax. *Id.* These rate elements are all currently included in the annual rate survey contained in the Bureau's *Reference Book*. The basic service rate template also includes other rate elements that are included in the survey. *See* Appendix F. The Joint Board recommended that in states where 911 fees are not established on a statewide basis, the state should use a statewide average 911 fee for purposes of the standard rate template. *Id.* at 20739 n.132. The Joint Board found, and we agree, that the use of a statewide average will maintain the proper role of federal (continued....)

included in the Bureau's annual *Reference Book*, instructs each state which rate elements should be included in its rate review. This template will permit the Commission and each state to compare rate data with assurance that each state's data include the same rate elements. The comparison of rural and urban rates among states will be more meaningful as a result and permit more accurate assessment of the overall success of the combined federal and state efforts to achieve rate comparability.³²⁶ The template will also simplify the rate review for states and reduce the burden of completing the expanded certification by explicitly directing states which rate elements must be included and which, by their exclusion from the template, need not be included.

87. We do not include within the basic service rate template any specific reference to quality of service or scope of calling, as proposed by NASUCA.³²⁷ These factors, by their nature, are difficult to quantify and cannot be systematically incorporated in the template in a manner that appropriately reflects all circumstances. Moreover, as we discuss above, we believe that each state may be in a better position to address service quality issues within the state, and can best determine how the quality of service or calling scopes available to consumers in the state should be incorporated into its rate comparability analysis.³²⁸ The approach that we adopt minimizes administrative burdens on states, while allowing a state to show that calling scope is a significant factor in determining whether rates in its jurisdiction are reasonably comparable to urban rates nationwide.³²⁹ We seek comment in the attached Further Notice, however, on whether we should provide guidelines for states as to whether and how to address calling scopes in their rate comparability analyses.

88. We clarify that the availability and pricing of services provided by competitive carriers or pursuant to alternate rate plans offered by the incumbent carrier should be treated as relevant additional factors in each state's rate review, but need not be formally compared to the nationwide urban rate benchmark or included in a state's certification unless such services and rates are relevant to the state's conclusion regarding the reasonable comparability of rates. The availability and pricing of competitive services in rural and high-cost areas may be relevant to determining whether rates are reasonably comparable to urban rates nationwide. For example, the widespread availability in rural, high-cost areas of competitive services at low rates may

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support for state, rather than local rates, and will reduce the number of separate rates in states where 911 fees are set locally. *Id.*

³²⁶ See New York Comments at 2.

³²⁷ See NASUCA Comments at 7-8.

³²⁸ See *supra* para. 47. Similarly, we conclude that it is not necessary for each state to certify separately that all of its rural consumers have calling areas comparable to those of the state's urban consumers. NASUCA Comments at 15. Each state will have the flexibility to include considerations like the scope of calling area in its determination of whether rural rates are reasonably comparable to urban rates. We note that some commenters challenge NASUCA's premise that calling area size is pertinent to rate comparability. See Sprint Comments at 7.

³²⁹ *Recommended Decision*, 17 FCC Rcd at 20739, para. 55 ("For example, the state could show that the local calling area size is too small to be considered comparable service, and that toll or extended area service charges should be included to produce a reasonably comparable rate.").

permit a state to conclude that rates in those areas are reasonably comparable to urban rates nationwide, even if the incumbent eligible telecommunications carrier's (ETC's) basic service rate exceeds the nationwide urban rate benchmark. Thus, we agree with the Joint Board's recommendation that rates and services provided by all ETCs should be included in the rate review process.³³⁰ We agree, however, with CUSC that the basic service rate template cannot necessarily be applied to the rates of competitive carriers, whose rates generally are not regulated by the Commission or the states and do not always include the rate elements specified in the template.³³¹ The basic service rate template also is not necessarily applicable to alternate, non-flat rate plans provided by incumbent local exchange carriers. We believe the approach we adopt provides appropriate flexibility for states to address competitively-provided services and alternative rate plans, without requiring states to "fit" non-conforming rates into the basic service rate template.

d. Expanded Certification Process

89. As recommended by the Joint Board, we adopt an expanded certification process in which each state will provide information to the Commission regarding the comparability of the rates in rural areas served by non-rural carriers within the state to urban rates nationwide.³³² The existing certification process requires states to certify that all ETCs receiving federal universal service funding pursuant to the non-rural high-cost mechanism are using the funds to achieve the goals of the Act.³³³ The new certification process will expand reporting requirements to address reasonable rate comparability. Pursuant to the expanded certification process, each state will be required to state whether its rates in rural areas served by non-rural carriers are reasonably comparable to urban rates nationwide and explain the basis for its conclusion as well as its proposed remedies, if necessary.

90. In the expanded certification process, states will report on rate comparability in one of several ways. If a state's rural rates are within the safe harbor provided by the urban rate benchmark, its rates may be presumed reasonably comparable. We anticipate that most states will certify to this effect and will not be required to file any additional explanation or supporting data. Other states, however, will be required to support their certifications with explanations and supporting data, including the rate data for residential customers in rural areas served by non-rural carriers. A state with rural rates within the safe harbor that nevertheless certifies that its rural rates are not reasonably comparable to urban rates nationwide based on its analysis of other relevant factors must fully explain its analysis, its proposed method of identifying and implementing a means of achieving rate comparability, and supporting data that show the rates

³³⁰ *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50.

³³¹ CUSC Comments at 8-10.

³³² *Recommended Decision*, 17 FCC Rcd at 20739-40, para. 55.

³³³ 47 C.F.R. § 54.313(a); see *Ninth Report and Order*, 14 FCC Rcd at 20483, para. 97.

paid by its residential consumers in rural areas served by non-rural carriers.³³⁴ Rural rates outside the safe harbor may be presumed not reasonably comparable, and a state so certifying must explain its proposed course of action to address its failure to achieve reasonable comparability and submit rate data for the rural areas within the state served by non-rural carriers. A state's consideration of other relevant factors, however, may overcome the presumption that its rural rates are not reasonably comparable to urban rates nationwide.³³⁵ In this case, the state should explain its rate analysis and submit relevant rate data.

91. We conclude that this expanded certification should be filed at the same time as the existing certification that states must file pursuant to section 254(e) of the Act, according to the schedule set forth in section 54.313(d)(3) of the Commission's rules, using the rates in effect as of the prior July 1.³³⁶ Using the existing filing schedule will minimize burdens and simplify filings for the states. Using rates as of the prior July 1 will give the states maximum time to review their rates and prepare their certifications, while still ensuring the use of rates from the same federal tariff year that the filing occurs. As with the existing certification, the expanded certification must be filed with the Universal Service Administrative Company and the Commission.³³⁷ In order to provide states with adequate time to conduct their initial rate review and begin complying with the rules we adopt today, we conclude that the initial filing pursuant to the expanded certification shall not be due until October 1, 2004. We believe that this will provide states with adequate time to develop processes for conducting their rate reviews.

92. We agree with NASUCA that the certification will effectively induce states to adopt measures to promote reasonable comparability only if it is a condition of receiving non-rural high-cost support.³³⁸ Given the importance of state rate review to ensuring the continued achievement of reasonably comparable rural and urban rates nationwide, we find that it is appropriate to condition the receipt of non-rural high-cost support on the completion of the expanded certification process. Moreover, the conditioning of support on completion of the expanded certification is consistent with the existing section 254(e) certification, which is also a condition of support. Accordingly, non-rural carriers in any state that does not complete the certification will not receive non-rural high cost support.

e. Ability of States to Request Further Federal Action

93. We adopt the Joint Board's recommendation to permit states to request further

³³⁴ Other relevant factors that might lead a state to reach this conclusion may include, but are not limited to, poor service quality or small calling areas that materially limit the value of the service received. *See Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50.

³³⁵ For example, a state could conclude that a high degree of subscribership in rural areas to a non-flat rate basic service plan indicates that many of those subscribers in fact receive basic service at a rate reasonably comparable to urban rates nationwide.

³³⁶ 47 U.S.C. § 254(e); 47 C.F.R. § 54.313(d)(3).

³³⁷ 47 C.F.R. § 54.313(a).

³³⁸ NASUCA Comments at 14.

federal action, if necessary, based on a showing that federal and state action together are not sufficient to achieve reasonable comparability of basic service rates in rural, high-cost areas served by non-rural carriers within the state to urban rates nationwide.³³⁹ Further federal actions could include, but are not limited to, additional targeted federal support or actions to modify calling scopes or improve quality of service where state commissions have limited jurisdiction.³⁴⁰ The ability to request further federal action provides a means to address any isolated failures to achieve reasonable comparability of rural rates that may require extraordinary efforts to resolve. Consistent with the Joint Board's recommendations, we will require that any request for further federal action fully explain the basis of the request, including a demonstration that the state's rural rates are not reasonably comparable to urban rates nationwide and that the state has taken all reasonably possible steps to achieve reasonable comparability through state action and existing federal support.³⁴¹

94. On receipt of a request for further federal action, the Wireline Competition Bureau will expeditiously issue a public notice seeking comment on the request.³⁴² Although we expect the Commission to act as rapidly as possible, we note that a request for further federal action will necessarily involve consideration of a wide range of issues, including rates in non-rural carriers' service areas throughout the state and state universal service mechanisms. We further note that, although we expect requests for further federal action to be rare, it is possible that multiple requests for further federal action may be filed at the same time.³⁴³

95. We reject arguments that we should not adopt the Joint Board's recommendation to permit states to seek further federal action because the process is ill-defined.³⁴⁴ Because the ability to request further federal action is intended to address isolated, unique circumstances, we concur with the Joint Board's recommendation that states should be afforded great flexibility in showing that further federal action is required.³⁴⁵ Moreover, we agree with the Wisconsin Commission that flexibility in making the required showings is appropriate because it is not possible at this time to predict all future circumstances that may require further federal action, and retaining flexibility will permit states to adapt their showings to fit the circumstances.³⁴⁶ We recognize, however, that the process should also be as clearly defined as possible. We seek

³³⁹ *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50.

³⁴⁰ *Id.*

³⁴¹ *Recommended Decision*, 17 FCC Rcd at 20736-37, 40, paras. 50, 56.

³⁴² The public notice will set forth the pleading schedule. *See also* 47 C.F.R. §§ 1.4, 1.45.

³⁴³ The Commission does not anticipate acting on any state requests for further action while the Further Notice is pending. *See infra* part V.C.

³⁴⁴ California Comments at 14, CUSC Comments at 13-14, Montana and Vermont Comments at 39, New York Comments at 2-3.

³⁴⁵ *Recommended Decision*, 17 FCC Rcd at 20740, para. 56.

³⁴⁶ Wisconsin Comments at 3-4.

comment in the attached Further Notice of Proposed Rulemaking, therefore, on proposals that will better define the process for states and ensure predictable results. In particular, we seek comment on the timing of such requests, and on a flexible showing including the factors identified by the Joint Board. We also seek comment on a methodology to determine any additional targeted federal support on a wire-center basis using model cost estimates.

96. We reject arguments that permitting states to request further federal action, including additional targeted federal support, raises sufficiency concerns.³⁴⁷ Above, we conclude that the non-rural support mechanism is sufficient to achieve the goal of making rural and urban rates reasonably comparable.³⁴⁸ The availability of further federal action, based upon a state's request, to address isolated and unique problems does not undermine that conclusion. Moreover, we reject arguments that further federal action cannot be conditioned on a state's request because it may be necessary to achieve reasonable comparability of rates.³⁴⁹ We agree with the Joint Board that the burden must fall on the state to demonstrate the reasons underlying the failure to achieve reasonable comparability, because only the state is in a position to identify the existence and sources of problems that may be unique to that state.³⁵⁰ Additionally, those commenters argue, essentially, that the Commission's obligation to provide sufficient support to assure the reasonable comparability of rates among states prevents the Commission from conditioning further federal action on a state's demonstration that it has made full use of its resources in attempting to achieve reasonable comparability of rates.³⁵¹ To the contrary, the *Qwest* court recognized that state action is an integral part of achieving the Act's universal service goals, and expressly held that the Commission could not simply provide support without also providing an inducement for state action.³⁵² Where state action is necessary to achieve the Act's goals--such as the reasonable comparability of rates--the Commission has an obligation to ensure that states fulfill their part of the federal-state partnership.

E. Complete Plan for Supporting Universal Service

97. In this section, we review our comprehensive plan for supporting universal service in high-cost areas. As discussed below, the Commission has taken important steps to reform the federal high-cost support system and to ensure its overall sufficiency, but our task is

³⁴⁷ California Comments at 15; New York Comments at 2 & n.5; *see also* AT&T Reply at 9; Michigan Reply at 3; Worldcom Reply at 4.

³⁴⁸ *See supra* paras. 55-61.

³⁴⁹ Montana and Vermont Comments at 32-33.

³⁵⁰ *Recommended Decision*, 17 FCC Rcd at 20740, para. 56, *see also supra* para. 22; NASUCA Comments at 14-15, Verizon Comments at 6.

³⁵¹ Montana and Vermont Comments, at 33-39.

³⁵² *Qwest*, 258 F.3d at 1203-04. As Verizon notes, the only inducements available to the Commission derive from its ability to condition some federal action--whether non-rural universal service support or further federal action--on a state's showing that it has taken the actions necessary to achieve the Act's universal service goals. Verizon Comments at 16-17.

not done. The Commission continues to adapt the overall plan to meet changing conditions, and to implement the various components of the plan on a sequenced, coordinated basis.

98. The Tenth Circuit recognized that it could not “properly assess the total level of federal support for universal service to ensure ‘sufficiency’” because the *Ninth Report and Order* concerns only intrastate high-cost support for non-rural carriers.³⁵³ In particular, the court noted that the Commission had reserved the possibility of applying a different funding mechanism for rural carriers. In addition, the court noted that in the *Ninth Report and Order*, which deals with reforming explicit federal support, the Commission had stated its intention to address the implicit federal support built into interstate access charges in a separate order.³⁵⁴ The court did not “necessarily require the FCC to resolve finally all of these issues at once,” but stated that “[o]n remand, the FCC will have an opportunity to explain further its complete plan for supporting universal service.”³⁵⁵

99. Prior to the court’s decision, the Commission had adopted significant universal service and interstate access charge reforms, in particular for the larger, price cap carriers.³⁵⁶ In May 1997 companion orders, the Commission modified the existing federal universal service support mechanisms to make them explicit, competitively neutral, and sustainable in an increasingly competitive telecommunications marketplace.³⁵⁷ The Commission also adopted measures to remove implicit subsidies from interstate access charges and move them toward lower, cost-based levels for price cap carriers, by phasing out loop and other non-traffic sensitive costs from per-minute charges, and providing for recovery of such costs through more economically efficient, flat charges.³⁵⁸ In 1999, the Commission adopted a forward-looking cost

³⁵³ *Qwest*, 258 F.3d at 1204.

³⁵⁴ *Id.* at 1205.

³⁵⁵ *Id.* at 1205.

³⁵⁶ The term “price cap carrier” refers to local exchange carriers (LECs) that are subject to price cap regulation of interstate revenues. The Commission implemented price cap regulation for the largest LECs in 1991. Almost all non-rural carriers are subject to price cap regulation.

³⁵⁷ See *First Report and Order*, 12 FCC Rcd 8776; *Access Charge Reform*, CC Docket No. 96-262, *First Report and Order*, 12 FCC Rcd 15982 (1997) (*Access Charge Reform First Report and Order*). Local switching support and high-cost loop support, previously funded entirely by interexchange carriers, now are funded by all telecommunications carriers that provide interstate telecommunications services on an equitable and nondiscriminatory basis. See *First Report and Order*, 12 FCC Rcd 8940-42, para. 303-304; 47 U.S.C. § 254(d). In addition, the Commission adopted rules to make federal high-cost support available or “portable” to all ETCs on a competitively- and technologically-neutral basis. *First Report and Order*, 12 FCC Rcd at 8932-8934, paras. 286-290, 8944-8945, paras. 311-313.

³⁵⁸ *Access Charge Reform Order*, 12 FCC Rcd at 15998, para. 35. The Commission recognized that rate structure modifications alone might not “create a system that accurately reflects the true cost of service in all respects.” *Id.* at 16001, para. 42. But it concluded that relying primarily on competition to drive access charges down to cost-based levels would serve the public interest better than prescribing rates. *Id.* at 16001-02, paras. 44-46. The Commission reasoned that a market-based approach was more consistent with the 1996 Act, and that tools for accurately prescribing rates at economic cost levels were not yet available. The Commission also (continued....)

model for calculating intrastate high-cost support for non-rural carriers and the order at issue in this proceeding.³⁵⁹ In 2000, it adopted additional access charge reforms and created a new, explicit support mechanism for price cap carriers in the *CALLS* proceeding.³⁶⁰ The Commission decided to proceed more cautiously in reforming universal service and access charges for the smaller, rate-of-return carriers, in recognition of the differences between these carriers and the larger carriers.³⁶¹

100. In 2001, the year the Tenth Circuit remanded the *Ninth Report and Order* to the Commission, the Commission completed the universal service and interstate access charge reforms it initiated following passage of the 1996 Act. In particular, in the May 2001 *Rural Task Force Order*, the Commission adopted a modified embedded cost mechanism for rural carriers for a five-year period.³⁶² The Commission found that continuing to base intrastate high-cost support for rural carriers on embedded costs for five years, rather than attempting to modify the forward-looking high-cost support mechanism for non-rural carriers so that it could be applied to rural carriers, was a reasonable and prudent approach to take in light of the record in the

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reasoned that, even if it were possible to identify all implicit subsidies in interstate access charges, immediately removing them might have an inequitable impact on LECs. The Commission determined that a phased-in approach was fully in accord with the Act.

³⁵⁹ See *supra* para. 6.

³⁶⁰ *Access Charge Reform, Price Cap Performance Review for LECs*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, Low-Volume Long-Distance Users, CC Docket No. 99-249, Eleventh Report and Order, 15 FCC Rcd 12962, 13046, para. 201 (2000) (*CALLS Order*) (subsequent history omitted). In a subsequent Order on Remand in the *CALLS* proceeding, the Commission concluded, among other things, that the \$650 million Interstate Access Support amount included in the integrated *CALLS* plan more appropriately balanced than would a higher or lower support amount the Commission's various policy goals, including the availability of service in all areas at rates that are affordable and reasonably comparable to nationwide rates, the promotion of competition and efficient investment in rural America, and the facilitation of the transitional reforms of the access rate structure adopted in the *CALLS Order*. *Access Charge Reform, Price Cap Performance Review for LECs, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, FCC 03-164 (released July 10, 2003).

³⁶¹ See *First Report and Order*, 12 FCC Rcd at 8899, 8936, paras. 224, 294; *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16126-27, paras. 330-332. The term "rate-of-return carrier" refers to LECs subject to rate-of-return regulation of interstate revenues. Most, but not all, rate-of-return carriers also meet the definition of rural telephone company. See *supra* note 1.

³⁶² *Rural Task Force Order*, 16 FCC Rcd 11244. In the *First Report and Order*, the Commission determined that federal high-cost support should be based on forward-looking economic costs, but that non-rural carriers would transition to forward-looking mechanisms first. See *First Report and Order*, 12 FCC Rcd at 8899, 8935-36, paras. 224, 293-294. Subsequently, the Joint Board established the Rural Task Force to assist in developing a forward-looking mechanism appropriate for rural carriers. The Rural Task Force recommended modifying the existing high-cost loop support mechanism for a five-year period, rather than attempting to modify the non-rural mechanism so that it could be applied to rural carriers. The Joint Board recommended that the Commission use the Rural Task Force recommendation as a foundation for implementing a universal service plan for rural carriers for five years, and undertake a comprehensive review of the high-cost support mechanisms for rural and non-rural carriers to ensure that both mechanisms function efficiently and in a coordinated fashion. See *Federal-State Joint Board on Universal Service*, Recommended Decision, CC Docket No. 96-45, 16 FCC Rcd 6153, 6158, 6162, paras. 13, 21 (2000).

proceeding.³⁶³ The Commission also found that the modified embedded cost mechanism would provide sufficient support for purposes of section 254.³⁶⁴ The Commission stated that it would use the transitional period during which a modified embedded cost mechanism is in place to develop a long-term universal service plan that better targets support to rural carriers serving the highest cost areas, while recognizing the significant distinctions among rural carriers and between rural and non-rural carriers.³⁶⁵

101. Then, in November 2001, the Commission reformed the interstate access charge system for rate-of-return carriers and established the interstate common line support (ICLS) mechanism, building on interstate access charge reforms previously implemented for price cap carriers, consideration of the Multi-Association Group (MAG) plan, and the record developed in several interrelated proceedings.³⁶⁶ The Commission designed the ICLS mechanism to provide support equal to the interstate loop costs that rate-of-return carriers do not recover through revenues from Subscriber Line Charges, which are capped to ensure affordability.³⁶⁷ ICLS ensures recovery of revenues that rate-of-return carriers previously recovered through per-minute access charges containing implicit support. The Commission explained that this cautious approach was appropriate based on examination of the record in the proceeding, and that ICLS would safeguard this important revenue stream for rate-of-return carriers.³⁶⁸

³⁶³ See *Rural Task Force Order*, 16 FCC Rcd at 11248-49, paras. 8-10.

³⁶⁴ See *Rural Task Force Order*, 16 FCC Rcd at 11258, para. 28. Although a number of commenters argued generally that the Rural Task Force plan would provide support that is either inadequate or excessive, neither side of the debate proffered specific evidence supporting their positions. *Id.* at 11257-58, para. 27. The Commission also specifically rejected the contention that no increase in high-cost loop support was warranted, concluding that it was reasonable to modify the high-cost loop support levels established in 1997 for rural carriers to account for changes in costs and technology, in order to ensure that rural carriers can maintain existing facilities and make prudent facility upgrades until such time as a long-term rural plan is adopted. *Id.* at 11258, para. 28.

³⁶⁵ See *Rural Task Force Order*, 16 FCC Rcd at 11310-13, paras. 169-177.

³⁶⁶ See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent LEC and IXCs*, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613, 19615-16, para. 1 (2001) (*MAG Order and MAG Further Notice*). With limited exceptions, the interstate access charge reforms adopted in the 1997 *Access Charge Reform Order* applied only to price cap carriers. See *Access Charge Reform Order*, 12 FCC Rcd at 16126-27, paras. 330-332. In 1998, the Commission created a separate docket to undertake more comprehensive review of the issues and circumstances specific to rate-of-return carriers. See *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd 14238, 14240, paras. 3-4 (1998). While it proposed reforms similar to those adopted for price cap carriers, the Commission recognized that differences between the two groups might warrant a different approach in some matters, including a different transition to more efficient, cost-based rates. *Id.* at 14250-52, paras. 35-36, 39. This docket remained open when the MAG plan was submitted by four LEC associations in 2000.

³⁶⁷ See 47 C.F.R. § 54.901. See also *MAG Order*, 16 FCC Rcd at 19673-74, para. 142.

³⁶⁸ *MAG Order*, 16 FCC Rcd at 19668-69, paras. 130-131. The Commission observed in the *CALLS Order*, which continued the process of access charge reform for price cap carriers, that “identifying an amount of implicit support in our interstate access charge system is an imprecise exercise.” *CALLS Order*, 15 FCC Rcd at 13046, (continued....)

102. Thus, today, in addition to non-rural high-cost support, universal service support is provided in rural and high-cost areas through the following mechanisms: high-cost loop support; local switching support (LSS); interstate access support (IAS); and interstate common line support (ICLS).³⁶⁹ Each of these other mechanisms provides support to eligible telecommunications carriers for a portion of the cost of providing telephone service in rural and high-cost areas, based generally on costs averaged at the study-area level.³⁷⁰ With the exception of LSS, each of these mechanisms defrays the costs of the common line or loop that connects an end user to the LEC central office.³⁷¹ The non-rural high-cost support mechanism is a relatively small portion of overall federal high-cost support: roughly \$233 million out of \$3.2 billion provided in 2002.³⁷²

103. The amount of federal high-cost support available to an incumbent carrier differs according to the size, population density, and topography of the incumbent carrier's study area, whether the costs of service are allocated to the state or federal jurisdiction, and whether the incumbent carrier's interstate access service is subject to price cap or rate-of-return regulation. Rural carriers are eligible for high-cost loop support to cover intrastate loop costs, based on the degree to which their average embedded loop costs exceed 115 percent of the national average

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para. 201. The Commission explained that the "various implicit support flows (*e.g.*, business to residential, high-volume to low-volume, and geographic rate averaging) are not easily severable and quantifiable. Moreover, the competitive pricing pressures present during this transitional period between monopoly and competition present additional complexities in identifying a specific amount of implicit support." *Id.* In the *MAG Order*, the Commission noted that the difficulty of determining the amount of implicit support contained in interstate access charges is even greater for rate-of-return carriers than for price cap carriers, given their size, diversity, and regulatory history. *MAG Order*, 16 FCC Rcd at 19668-69, para. 130.

³⁶⁹ See 47 C.F.R. §§ 36.601-36.631 (high-cost loop support), 54.301 (LSS), 54.800-809 (IAS), 54.901-54.904 (ICLS). In the *MAG Further Notice*, the Commission tentatively concluded that Long Term Support should be merged into ICLS beginning July 1, 2003. See *MAG Further Notice*, 11 FCC Rcd at 19725-26, para. 274. Under each of the federal high-cost support mechanisms, competitive ETCs serving customers in the incumbent carrier's service area normally receive the same per-line amount of support that the incumbent carrier would receive. 47 C.F.R. § 54.307(a). In a November 2002 *Referral Order*, the Commission requested that the Joint Board review and provide recommendations regarding the Commission's rules related to the calculation of support in study areas with multiple ETCs. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 17 FCC Rcd 22642 (2002) (*Referral Order*); *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, Public Notice, 18 FCC Rcd 1941 (2003).

³⁷⁰ Non-rural high-cost support is generally targeted to high-cost wire centers, and IAS is targeted to state-created unbundled network element (UNE) zones, where such zones exist. See 47 C.F.R. §§ 54.309, 54.803. The Commission's rules also permit disaggregation and targeting of high-cost loop support, LSS, and ICLS to geographic areas below the study-area level. See 47 C.F.R. §§ 54.307(a)(1); 54.315.

³⁷¹ See *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Fifth Report and Order, 13 FCC Rcd 21, 323, 21,335 (1998) ("Outside plant, or loop plant, rather than switching or interoffice transport plant, constitutes the largest portion of total network investment, particularly in rural areas.").

³⁷² See *Federal Universal Service Support Mechanisms Fund Size Projections and Contribution Base for the Fourth Quarter 2002*, Appendix HC 01 (Universal Service Administrative Company, August 2, 2002).

loop cost.³⁷³ LSS is designed to cover some of the intrastate switching costs of carriers serving study areas with 50,000 or fewer lines, in recognition of such carriers' high average fixed switching costs compared to larger carriers with greater economies of scale.³⁷⁴ ICLS was created to replace implicit support in the rate-of-return carriers' interstate access charges, and recovers the difference between each carrier's permitted common line revenues and its actual revenues from capped subscriber line changes (SLCs).³⁷⁵ Similarly, IAS provides price cap carriers with support for a portion of their price cap CMT revenues that cannot be recovered through capped SLCs.³⁷⁶

104. In implementing the provisions of the 1996 Act, the Commission consistently has taken into consideration the differences between large, price-cap regulated non-rural carriers and small, rate-of-return regulated rural carriers and will continue to do so. The Commission also has taken into account the appropriate federal and state roles in supporting reasonable, affordable and reasonably comparable local rates. In the case of each federal high-cost support mechanism, the Commission has used its expertise and informed judgment to make a reasonable determination as to what constitutes "sufficient" support for purposes of section 254(e), in light of the particular circumstances and the statutory policies the mechanism serves. In doing so, the Commission has kept close track of the total size of the federal universal service fund. As a result of the Commission's reforms, there are explicit, specific, predictable, and sufficient federal high-cost support mechanisms in place to defray both the intrastate- and the interstate-allocated costs of the common line or loop, the largest portion of total network investment, particularly in rural areas.³⁷⁷

105. Overall, we believe that the federal high-cost support system has proved sufficient to preserve and advance universal service, consistent with the mandate of section 254. Local telephone service subscribership is currently at 95.3%, and within the last year subscribership

³⁷³ See 47 C.F.R. § 36.631. Specifically, high-cost loop support is available for 65% of costs exceeding 115% of the national average loop cost and 75% of costs exceeding 150% of the national average loop costs. The national average loop cost has been frozen at \$240.00. See 47 C.F.R. § 36.621. High-cost loop support is subject to an indexed cap which limits the growth in the total support available each year. See *id.* at 36.601(c). As discussed above, the term "rural carrier" refers to LECs that meet the "rural telephone company" definition in section 153(37) of the Act. 47 U.S.C. § 153(37). See *supra* note 1.

³⁷⁴ LSS is the product of a LEC's annual unseparated local switching revenue requirement multiplied by its local switching support factor, which is defined as the difference between the 1996 weighted interstate Dial Equipment Minutes (DEM) factor and the 1996 unweighted DEM factor. See 47 C.F.R. § 54.301.

³⁷⁵ See 47 C.F.R. § 54.901. See also *MAG Order*, 16 FCC Rcd at 19673-74, para. 142.

³⁷⁶ 47 C.F.R. § 54.804; see *CALLS Order*, 15 FCC Rcd at 13049-55, paras. 206-13. The Commission established the IAS mechanism in the *CALLS Order* as part of a five-year transitional access charge and universal service reform plan for price cap carriers. *Id.* at 12962. The total amount of IAS is limited to \$650 million each year: the IAS mechanism applies mathematical formulas to apportion support among ETCs in price cap carrier service areas. 47 C.F.R. § 54.801. The term "price cap CMT revenues" refers to a price cap carrier's common line, marketing, and transport interconnection charge revenues. 47 C.F.R. § 54.800.

³⁷⁷ As discussed above, the LSS mechanism also defrays high fixed local switching costs for small LECs. See *supra* para. 103.

was 95.5%, the highest level of subscribership ever recorded.³⁷⁸ As the Joint Board observed, the GAO Report findings generally support the conclusion that basic local service rates in rural and high-cost areas are reasonably comparable to those in urban areas.³⁷⁹ In concert with other reforms to the interstate access rate structure adopted in the *CALLS* and *MAG Orders*, the IAS and ICLS mechanisms have reduced the recovery of interstate common line costs through inefficient rate elements containing implicit support and facilitated the transition toward fuller, more rational competition, while ensuring that rates and services in rural and high-cost areas remain affordable and reasonably comparable to those in urban areas.³⁸⁰

106. Although the Commission has taken important steps to reform universal service, our task is not done. The Commission has taken a market-based approach to interstate access charge reform, relying largely on competition to identify and remove implicit subsidies from access charges and drive them down to cost-based levels.³⁸¹ The IAS mechanism was adopted as part of the integrated, five-year *CALLS* plan for transitioning to more efficient competition, lower rates for consumers, and secure universal service support mechanisms.³⁸² As the term of the *CALLS* plan nears its end, the Commission will need to consider what measures are appropriate for the future. Likewise, the access charge and universal service reforms for rate-of-return carriers adopted in the *MAG Order* “are not designed as a permanent solution.”³⁸³ The pending intercarrier compensation proceeding, in which the Commission is fundamentally re-examining all currently-regulated forms of intercarrier compensation, raises implications for our universal service plan.³⁸⁴

107. Furthermore, as discussed above, the *Rural Task Force Order* adopted modifications to the high-cost loop support mechanism for rural carriers for an interim, five-year

³⁷⁸ See Industry and Technology Analysis Division, Wireline Competition Bureau, Telephone Subscribership in the United States (April 2003) (*Telephone Subscribership Report*). See also AT&T Comments at 11 (citing November 2002 *Telephone Subscribership Report*).

³⁷⁹ *Recommended Decision*, 17 FCC Rcd at 20728-29, para. 34, *supra* note 21. According to Bureau of Labor Statistics figures, urban households continue to spend more on telephone service, including local and long-distance service, than do rural households. See *Reference Book*, Table 2.1 (average annual expenditures on telephone service by household locations).

³⁸⁰ In particular, the IAS mechanism has helped to reduce by \$2.6 billion the recovery of common line costs by price cap carriers through inefficient rate elements containing implicit support. *Access Charge Reform, Price Cap Performance Review for LECs*, CC Docket Nos. 96-262 and 94-1, Order on Remand, 15 FCC Rcd 12962, 13046, para. 201 (released July 10, 2003).

³⁸¹ See *supra* note 358.

³⁸² See *supra* note 360 and accompanying text.

³⁸³ *MAG Order*, 16 FCC Rcd at 19620, para. 13 (“In particular, as the terms of the *CALLS* plan and the Rural Task Force plan near their respective ends, we anticipate that the Commission will review whether the measures we adopt here continue to be consistent with our competitive goals for the local exchange and exchange access services markets, as well as with our long-term universal service plans.”).

³⁸⁴ *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001).

period. The Commission must and will initiate a proceeding to address the appropriate intrastate high-cost support mechanism for rural carriers after the Rural Task Force plan expires, as well as how to ensure that the intrastate support mechanisms for rural and non-rural carriers function efficiently and in a coordinated fashion.³⁸⁵ The Commission also has pending proceedings to re-examine its assessment methodology for contributions to universal service, and its rules for determining high-cost support in areas served by multiple ETCs, to ensure that its policies remain competitively neutral and ensure a sustainable universal service fund in light of changes in the telecommunications marketplace.³⁸⁶ As the Commission previously has recognized, “[o]ur universal service rules cannot remain static in a dynamic marketplace.”³⁸⁷ We will continue to develop and refine our universal service rules and policies in a coordinated manner to fulfill the mandate of the 1996 Act.

V. FURTHER NOTICE OF PROPOSED RULEMAKING

108. In this Further Notice of Proposed Rulemaking, we seek further comment on issues related to the rate review and expanded certification process that we adopt in the foregoing Order.³⁸⁸ First, we seek comment on whether we should require states to file, in connection with their reasonable comparability certifications, additional data that might enhance the Commission’s ability to assess the non-rural mechanism and state actions to achieve comparability of urban and rural rates, including business rate data, rate data for non-rural areas served by non-rural carriers, and rate data from states that would not otherwise be required to file data under the rules we adopt today. Second, we seek comment on the role of calling scopes in the rate review process. Third, we seek comment on how to treat any state requests for further federal action, including procedures for states to submit any such requests, required showings by requesting states, and how to calculate any additional targeted federal support. In addition, we propose a method for calculating additional targeted federal support on a wire-center basis using forward-looking model cost estimates. Finally, we seek comment on a proposal to further encourage states to advance the Act’s universal service goals by making available additional targeted federal support to states that implement explicit universal service mechanisms, without regard to their achievement of rate comparability.

³⁸⁵ See *Rural Task Force Order*, 16 FCC Rcd at 11310, para. 169; *Remand Notice*, 17 FCC Rcd at 3011, paras. 27-28.

³⁸⁶ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *1998 Biennial Regulatory Review—Streamlined Contributor Reporting Requirements Associated With Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, CC Docket No. 98-171, *Telecommunications Services for Individuals With Hearing and Speech Disabilities, and the Americans With Disabilities Act of 1990*, CC Docket No. 90-571, *Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size*, CC Docket No. 92-327, NSD File No. L-00-72, *Number Resource Optimization*, CC Docket No. 99-200, *Telephone Number Portability*, CC Docket No. 95-116, *Truth-In-Billing and Billing Format*, CC Docket No. 98-170, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952 (2002); *Referral Order*, 17 FCC Rcd 22642.

³⁸⁷ *Rural Task Force Order*, 16 FCC Rcd at 11249, para. 11.

³⁸⁸ See *supra* part IV.D.

A. Collection of Additional Rate Data

109. We seek comment on whether all states should submit rate data to the Commission in connection with the rate review and expanded certification process, in order to establish a more complete picture of state efforts to achieve rate comparability. In the foregoing Order, we adopt rules that require a state to file, in connection with its expanded certification, rate data for rural areas served by non-rural carriers only if its rural rates exceed the nationwide urban rate benchmark or if it certifies that its rural rates are not reasonably comparable to urban rates nationwide, despite being within the safe harbor established by the nationwide urban rate benchmark.³⁸⁹ These data, along with the expanded certifications filed by all states, will aid the Commission in its review of the reasonable comparability of rural and urban rates nationwide.³⁹⁰ We seek comment on whether collecting additional rate data from a larger number of states, either on a mandatory or voluntary basis, would provide the Commission with a better basis for its review.³⁹¹ To what extent would collecting additional rate data from all states improve the Commission's ability to assess the reasonable comparability of rural and urban rates nationwide through the rate review and expanded certification process? To what extent would the availability of this additional rate data improve the ability of each state to analyze its own rate comparability issues? To what extent would the availability of this additional rate data improve the ability of other interested parties to monitor the reasonable comparability of rural and urban rates nationwide? We anticipate that each state will have assembled much of the additional data in the course of performing its rate review. Would it be unduly burdensome if all states were to file such data?

110. We seek comment on whether we should require states to file data related to business rates, in addition to residential rates.³⁹² A meaningful comparison of rates across different states may necessarily include business rates in addition to residential rates. For example, because Wyoming, unlike many other states, has rebalanced its single-line business rates to levels equivalent to residential rates, Wyoming's residential rates no longer rely on implicit support flows from its business rates, and its business customers pay lower rates than they would in a state that relied on such implicit support flows.³⁹³ Collecting data only on residential rates, therefore, may not permit the Commission to identify the specific nature of any problems with reasonable comparability. Would collecting data on business rates provide the Commission with a more useful picture of the local rates charged in rural areas? Would

³⁸⁹ See *supra* part IV.D.2.d.

³⁹⁰ See *supra* para. 79.

³⁹¹ See WorldCom Reply at 3.

³⁹² In its *Recommended Decision*, the Joint Board "suggest[ed] that it may be appropriate to solicit comment as to whether . . . residential and business rates should eventually be reviewed by the states." *Recommended Decision*, 17 FCC Rcd at 20738, para. 53. We do not seek comment at this time on whether business rates should be included in the rate review process. We do believe, however, that collecting business rate data for some period of time might prepare us to better address the issue of whether business rates should be included in the rate review or expanded certification at a later date.

³⁹³ See Wyoming Comments, at 2, 8.

requiring states to file business rate data unduly increase the administrative burdens on states associated with the rate review and expanded certification process? Is there any reason why the Commission should or should not concentrate solely on residential rates in assessing the state of rate comparability nationwide?

111. We also seek comment on whether we should collect data related to rates in non-rural areas served by non-rural carriers.³⁹⁴ While the rules we adopt today will result in the collection of some data regarding the rates in rural areas served by non-rural carriers, collecting non-rural rate data would provide the Commission with more complete data. To what extent would collecting rate information for non-rural areas in addition to rural areas provide the Commission with useful data to assess the reasonable comparability of rural and non-rural rates nationwide? To what extent would the collection of such data permit the Commission to assess the reason for high rural rates? For example, if a state's rates in areas other than rural areas were also above the benchmark, would it indicate that an adjustment to the federal support mechanism was warranted? To what extent would collecting non-rural rate information aid the Commission in assessing whether states are fulfilling their obligations to promote the Act's goals? To what extent would requiring states to file non-rural rate data unduly increase the administrative burdens on the states associated with the rate review process?

112. With additional rate data, should states be required to file information annually related to their efforts to advance universal service by adopting explicit universal service mechanisms, such as the establishment of explicit state universal service funds? To what extent would such information aid the Commission in assessing the sources of any problems with rate comparability to determine whether additional actions are necessary at the federal level? If we conclude that such information should be collected, what specific information should each state be required to file? For example, should each state be required to file data related to the existence and size of any explicit universal service support mechanisms established in the state? Should states be required to identify implicit support flows in the rate structure, including implicit support flowing from business line rates to residential line rates, from geographically averaged rates, and from intrastate access charges? Commenters should identify any other information related to the establishment of explicit universal service policies that would assist the Commission in refining our comprehensive plan for supporting universal service in high-cost areas over time.

B. Calling Scopes

113. We seek comment on the role of calling scopes in the rate review process. The foregoing Order permits a state to consider the calling scopes available in rural areas served by non-rural carriers when reviewing whether rates in those areas are comparable to urban rates nationwide.³⁹⁵ Calling scopes are not included in the rate template, however, and states need not consider them if they choose to certify based on the safe harbor. To what extent should states be

³⁹⁴ In this section, non-rural areas are those areas that are not "rural" as defined in the foregoing Order. *See supra* paras. 83-84.

³⁹⁵ *See supra* paras. 87 and 90.

encouraged to consider the calling scopes available in rural areas served by non-rural carriers in assessing rate comparability? Should the Commission incorporate calling scopes into the safe harbor? If so, how would the Commission do so? To what extent would consideration of calling scopes increase the burdens associated with the rate review process? Commenters should describe in detail any proposed methodologies for normalizing the impact of calling scopes on rates. Alternatively, should the Commission provide states with additional guidance as to how calling scopes may be factored into their rate comparability analyses, if states decide that this is appropriate? What data would be useful for analyzing the calling scopes available in rural and urban areas?

C. Procedures for Filing and Processing Any State Requests for Further Federal Action

114. Consistent with the Joint Board's recommendation, we recognize that the procedures for filing and reviewing state requests for further federal action should be as specific and predictable as possible, while also providing the necessary flexibility for each state to demonstrate the unique circumstances involved in its request.³⁹⁶ We also note that the Joint Board did not recommend a specific method for calculating any additional targeted federal support, if necessary, and the present record does not provide an adequate basis for us to determine an appropriate method.³⁹⁷ Accordingly, we seek comment below on several interrelated issues. First, we seek comment on the timing of state requests for further federal action. Second, we seek comment on the showing that a state should be required to make in order to demonstrate a need for further federal action. Third, we seek comment on the types of further federal action that may be provided to requesting states if the Commission determines that further federal action is necessary in a particular instance, including possible methods of calculating any additional targeted federal support.

1. Timing of Requests for Further Federal Action

115. The Joint Board recommended that the Commission develop exact procedures to be used in the filing and processing of requests for further federal action. We propose that a state should be permitted to make a request for further federal action only concurrently with the filing of its expanded certification regarding the comparability of its rural rates in areas served by non-rural carriers.³⁹⁸ We anticipate that any state request for further federal action will arise from the state rate review process and the expanded certification, and any state requests for further federal action are likely to rely on the same data. Therefore, we believe that requiring the filing of any state requests at the time of the expanded certification will promote administrative simplicity.

³⁹⁶ See *supra* para. 93; *Recommended Decision*, 17 FCC Rcd at 20736-37, 40, paras. 50, 56.

³⁹⁷ *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50. Several commenters raise questions in the record regarding the specific details of requests for further federal action, such as the conditions upon which further federal action would be provided and the means of calculating any additional targeted federal support.

³⁹⁸ See *supra* part IV.D.2.d. Such certifications will be filed according to the schedule set forth in section 54.313(d) of the Commission's rules.

We seek comment on this proposal.

116. We also seek comment on how frequently a state should be required to seek further federal action if the state's request is granted the first time. Should a state be required to seek further federal action every year? Should further federal action be provided for a specified period of years? If so, should that period be dependent on the specific circumstances of a particular request?

2. Required Showings

117. We seek comment on the showings that a state should be required to make in support of a request for further federal action, in the interest of making the process as specific and predictable as possible. The Joint Board's *Recommended Decision* suggests that two showings should be required: (1) a demonstration that rural rates in non-rural carrier service areas in the state are not reasonably comparable to urban rates nationwide, including an analysis of the rates in the basic service template and other relevant factors; and (2) a demonstration that the state has taken all reasonable actions to achieve reasonable comparability of its rural rates to urban rates nationwide, including an explanation of how the requesting state has used any federal support currently received to achieve comparable rates and whether it has implemented a state universal service fund.³⁹⁹ We propose that these showings should be required in support of a state's request for further federal action. We further propose that each state should bear the responsibility of fully explaining the basis for each element of its showing. As discussed in the foregoing Order, each state has rate-setting jurisdiction and primary responsibility for ensuring rate comparability within its border and, therefore, is in the best position to explain any problems it may have in achieving rate comparability and the actions it has taken to address those problems.⁴⁰⁰ In addition to these showings, are there any additional types of showings that a state should be required to make in support of a request for further federal action? Should different showings be required for different types of further federal action (*e.g.*, Commission action to address calling areas or quality of service where the state lacks jurisdiction)?

118. We also seek comment on what a state should be required to show to satisfy the first element of the Joint Board's recommended test, a demonstration that rural rates within the state are not reasonably comparable to urban rates nationwide. In making the required showing,

³⁹⁹ See *infra* para. 119. Specifically, the Joint Board recommended that a state requesting further federal action be required to show that it has already taken all actions reasonably possible and used all available state and federal resources to make basic service rates in rural areas served by non-rural carriers reasonably comparable, but that rural rates are nonetheless not reasonably comparable to urban rates nationwide. *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50. Factors to be addressed, pursuant to the Joint Board's recommendation, include, but are not limited to, "rate analysis and a demonstration why the state contends that rates are not reasonably comparable; any other factors that should be considered in evaluating rates; and a demonstration that the state has taken all reasonably possible steps to develop maximum support from within the state." *Id.* at 20740, para. 56. The Joint Board also recommended that the state should fully explain how it has used any federal support currently received to help achieve comparable rates and whether the state has implemented a state universal service fund to support rates in high-cost areas of the state. *Id.*

⁴⁰⁰ See *supra* paras. 21-22, 76, 95.

to what extent should a state be permitted to rely on the presumption created by the nationwide urban rate benchmark? Should the Commission consider residential and business rates or only residential rates? What weight, relative to the presumption created by the rate benchmark, should the Commission accord additional non-rate factors that the state contends are relevant in determining whether rural rates in a state are reasonably comparable to urban rates nationwide?

119. Consistent with the Joint Board's recommendation, we also seek comment on what state actions should be considered reasonable and, therefore, necessary to support a request for further federal action for purposes of the second element of the Joint Board's recommended showing. In particular, we seek comment on the extent to which states must reform their universal service support mechanisms in order to be able to demonstrate that they have taken all reasonably possible actions to achieve rate comparability. In this regard, we note that the Act strongly favors explicit support mechanisms, which are less vulnerable to erosion in competitive markets than implicit support mechanisms.⁴⁰¹ Although states are not required to adopt explicit mechanisms to support universal service, we propose that a state that has not done so cannot be deemed to have taken all reasonably possible steps to support rate comparability within the state, the requirement recommended by the Joint Board. We seek comment on this proposal.

120. We further propose that, in order to enable the Commission to determine whether a state has made its universal service mechanisms explicit, a state requesting further federal action should be required to explain the extent to which it has made its universal service mechanisms explicit, and file supporting data, including rate data for residential and business lines in rural and urban areas served by non-rural carriers. We seek comment on these proposals. We also seek comment on the extent of reform that should be required for further federal action. Some commenters argue that it is necessary for states to rebalance their residential and business rates in order to eliminate implicit support flows.⁴⁰² For example, Wyoming has rebalanced its residential and business rates, while other states have not rebalanced rates. As a result, Wyoming's residential rates presumably will be higher than a state with comparable resources that has chosen to maintain implicit support flows through higher business rates. Should the rebalancing of residential and business rates be required in support of a request for further federal action?

3. Types of Further Federal Action

121. We seek comment on the types of further federal action that should be available to a requesting state if the Commission determines that further federal action is appropriate. The Joint Board recommended that further federal action could include additional targeted federal support, as well Commission action to address scope of local calling areas or quality of service where the state commission lacked the authority to do so.⁴⁰³ Are there any other types of further federal action that the Commission should consider in addition to the Joint Board's

⁴⁰¹ See *supra* para. 16 and note 35.

⁴⁰² Qwest Comments at 7; SBC Comments at 22; Wyoming Comments at 8.

⁴⁰³ *Recommended Decision*, 17 FCC Rcd at 20736-37, para. 50.

recommendations? Should the Commission specify in advance all possible forms of further federal action, or, in light of the Joint Board's recommendation that the Commission provide maximum flexibility for states, should the Commission retain the ability to develop additional types of further federal action in response to the specific circumstances underlying a particular state's request?⁴⁰⁴ Are there any reasons that the Commission should not consider making certain types of federal action available on request?

122. We propose that any additional targeted federal support should equal a set percentage of estimated forward-looking wire-center costs in excess of two standard deviations above the average cost per line.⁴⁰⁵ We believe that a method for calculating any additional targeted federal support based on forward-looking wire-center cost estimates would be specific and predictable, and provide consistency with the non-rural support mechanism, which also uses model cost estimates to calculate and target support.⁴⁰⁶ We also believe that such a method would provide a fair and equitable means of determining any additional targeted federal support and avoid inappropriate incentives that might be created if we were to base any additional targeted federal support on rate levels in a particular area.⁴⁰⁷ Furthermore, a forward-looking cost estimate-based method would permit any additional support to be targeted specifically to high-cost wire-centers, consistent with the Joint Board's recommendation.⁴⁰⁸ We seek comments on this proposal. Is there another proposed method that, based on some measure other than forward-looking cost estimates, would provide a more appropriate basis for calculating any additional targeted federal support? If so, a commenter should describe the method with specificity and provide any relevant supporting data. If any commenters contend that a rate-based method would be more appropriate, they should support their contentions with a detailed explanation of how rate-based support would be calculated under their proposal and any relevant supporting data.

123. To determine any additional targeted federal support based on forward-looking cost estimates, we propose that any additional federal support should be provided to wire centers in qualifying states with costs per line exceeding a benchmark of two standard deviations from

⁴⁰⁴ *Id.* at 20740, para. 56; *see also* Wisconsin Comments at 2-4

⁴⁰⁵ The Joint Board did not specify any particular method of calculating any additional targeted support.

⁴⁰⁶ Although non-rural support is determined based on statewide averages, the forward-looking cost model estimates costs at the wire-center level--which are then aggregated to determine the statewide average cost estimate--and targets non-rural support to individual wire centers. *See supra* para. 24.

⁴⁰⁷ Using rates to calculate any additional targeted federal support would require the Commission to attempt to normalize the rates in different states in order to compare them. California Comments at 13-14; New York Comments at 3; AT&T Reply at 9. No specific method for normalizing rates has been suggested in the record.

⁴⁰⁸ *See Recommended Decision*, 17 FCC Rcd at 20736-37, paras. 50 & n.125. The Joint Board recommended that any additional targeted federal support be targeted and suggested that a wire-center basis would be an appropriate method of identifying high-cost areas. *Id.*

the average cost per line among all non-rural carrier wire centers nationwide.⁴⁰⁹ Based on recent forward-looking high-cost model results, a wire center with per-line costs that are two standard deviations above the average wire center would have an average cost per line of \$40.85, or 189 percent of the nationwide average cost per line.⁴¹⁰ Wire centers with costs per line exceeding the proposed nationwide average cost per loop would be very high cost wire centers in which it is likely to be more difficult to achieve rate comparability, despite otherwise sufficient state resources and federal support. Because most states have wire centers that exceed two standard deviations from the national average wire center cost per line, we believe that this benchmark would provide an effective means of calculating any additional targeted federal support for any qualifying state in a specific, predictable and consistent manner.⁴¹¹ We seek comment on this proposed method for calculating additional targeted federal support. Is two standard deviations an appropriate threshold for this purpose?

124. We also propose that any additional targeted federal support for eligible wire centers in qualifying states should be calculated as a set percentage of costs in excess of the benchmark.⁴¹² For example, if the Commission were to set the percentage at 5 percent of costs in excess of two standard deviations above the average and Wyoming were to qualify for additional targeted federal support, it would be eligible for approximately \$546,000. If the Commission were to set the percentage at 25 percent of costs in excess of two standard deviations above the average and Wyoming were to qualify, it would be eligible for approximately \$2,731,000 in additional targeted federal support.⁴¹³

125. We believe that this proposal is consistent with the current and past methodologies for determining high-cost support for non-rural carriers and would provide meaningful support to assist states in resolving any rate comparability issues that combined federal and state action have failed to resolve. Under the non-rural support mechanism, a non-rural carrier in a state with an average cost per loop for areas served by non-rural carriers that exceeds the cost benchmark of two standard deviations above the average is eligible for support for 76 percent of its costs in excess of the benchmark.⁴¹⁴ This percentage represents an estimate

⁴⁰⁹ The non-rural support mechanism, as amended in the foregoing Order, calculates support by comparing the statewide average cost per line, as estimated by the Commission's cost model, to a nationwide benchmark of two standard deviations above the average cost per line.

⁴¹⁰ These results are based a run of the Delphi version of the model, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 18 FCC Rcd 41 (2003), *recons. pending*, using 2001 year-end line count data. The nationwide average cost per line in this model run is \$21.67. Two standard deviations above the average wire center cost per line is higher in percentage terms than two standard deviations above the average statewide cost per line because wire center costs are dispersed differently than the statewide costs on which non-rural support is based.

⁴¹¹ We note that 48 states plus Puerto Rico have such high-cost wire centers.

⁴¹² In Appendix G, we set forth, for exemplary purposes, the amount of support that each state would receive, if eligible, at various percentages between 5 and 25 percent.

⁴¹³ See Appendix G.

⁴¹⁴ See *supra* note 180 and accompanying text.

of the costs above the benchmark that are assigned to the intrastate jurisdiction. Because any additional targeted federal support would supplement the non-rural support mechanism in order to address exceptional problems, we do not believe that it would be necessary that such support be provided for the same percentage of costs in excess of the benchmark as covered by the non-rural support mechanism.⁴¹⁵ We seek comment on what percentage of costs in excess of the benchmark should be supported for purposes of additional targeted federal support. Is there another proposed method of calculating any additional targeted federal support based on forward-looking cost estimates that would better address the purpose for which the support would be intended?

D. Additional Inducements for State Action

126. Finally, we seek comment on whether we should make additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms. The purpose of this proposal is to create a positive incentive for states to reform their implicit universal service mechanisms. Under this proposal, as discussed below, any additional targeted federal support would be determined using a methodology similar to that proposed above in connection with state requests for further federal action. Unlike state requests for further federal action, states would not be required to demonstrate that combined state and federal efforts had failed to achieve rate comparability.

127. As discussed above, section 254 states a clear preference for explicit, rather than implicit, support, but the 1996 Act does not require states to adopt explicit universal service support mechanisms.⁴¹⁶ In the foregoing Order, therefore, we decline to adopt measures to require or induce all states to immediately remove implicit subsidies from intrastate rates through substantial increases in federal support. Nevertheless, we agree with commenters that states should be encouraged to replace implicit support with explicit support mechanisms that will be sustainable in a competitive environment.⁴¹⁷ To what extent should the Commission encourage states to replace their implicit universal service support mechanisms with explicit mechanisms? We seek comment on whether the Commission has an interest, other than the aspirational provisions of the Act, in states' decisions to adopt explicit mechanisms or to rely on implicit support flows. How do state universal service mechanisms, explicit and implicit, interact with the federal universal service support mechanisms? We note that some states have made progress in making explicit their universal service support mechanisms.⁴¹⁸ Can we expect states to adopt, in advance of or concurrently with the local development of competition, reforms that will reduce the vulnerability of the states' universal service mechanisms to competition? If states

⁴¹⁵ See *supra* para. 95.

⁴¹⁶ See *Seventh Report and Order*, 14 FCC Rcd at 8102, para. 45; see also *supra* para. 22. As discussed above, many states have adopted explicit universal service support mechanisms since passage of the 1996 Act, but most states continue to provide at least some implicit support to residential customers through their rate designs. See *supra* note 55 and accompanying text.

⁴¹⁷ See *e.g.*, CUSC Comments at 12; SBC Comments at 4-7, 18-26; Qwest Comments at 7-10.

⁴¹⁸ See, *e.g.*, Wyoming Comments at 2-3.

have not yet taken action to adopt explicit universal service mechanisms, can we assume that they will do so?

128. We seek comment on whether providing additional targeted federal support to states that replace implicit universal service mechanisms with explicit universal service mechanisms would be an appropriate means of inducing reforms of state universal service support mechanisms. The availability of additional targeted federal support would provide each state with a direct incentive to make its universal service support mechanisms explicit, rather than implicit. This method of inducement would pose less risk to our universal service goals than conditioning receipt of existing non-rural high-cost support on state action. Moreover, providing states that implement universal service reforms with additional targeted federal support might mitigate possible transitional issues associated with the replacement of implicit support with explicit support and encourage states to adopt a long-term approach to universal service. To what extent are there transitional issues associated with moving from implicit support mechanisms to explicit support mechanisms? If such transitional issues are a significant deterrent to state adoption of universal service reforms, should any additional targeted federal support be limited for the period of time during which the transition takes place? If commenters contend that another form of inducement would be better suited for achieving the Commission's goals, the commenters should provide a detailed explanation of their inducement.

129. We further propose that any additional targeted federal support that is provided to induce states to adopt explicit universal service mechanisms should be based on forward-looking wire-center cost estimates. Basing any additional targeted federal support on forward-looking cost estimates will make such support specific and predictable, consistent with the Act, and would target the support to high-cost areas, which may ease a state's implementation of explicit universal service mechanisms. Similar to the additional targeted federal support proposed above with respect to state requests for further federal action to achieve rate comparability, we propose that any additional targeted federal support provided for inducement purposes should be calculated based on a percentage of forward-looking costs in excess of a particular threshold for high-cost wire centers.⁴¹⁹

130. Specifically, we propose that, if a state meets the necessary conditions, it should receive additional targeted federal support equal to a specific percentage of costs in excess of two standard deviations above the average cost wire center. We seek comment on this proposed method of calculating additional targeted federal support for inducement purposes. We specifically seek comment on the appropriate percentage of costs in excess of the threshold that we should support with additional targeted federal support. We note that 48 states and Puerto Rico would have at least one wire center with costs per loop above the benchmark of the average cost per loop plus two standard deviations.⁴²⁰ We estimate that if the support amount were set at

⁴¹⁹ See *supra* paras. 123-124. We do not believe that there is any reason to assume that the same amounts of additional targeted federal support should be provided as further federal action to achieve rate comparability, discussed above, and to induce state action to adopt explicit support mechanisms.

⁴²⁰ New Jersey, Rhode Island and the District of Columbia do not have any high-cost wire centers with per loop costs exceeding this benchmark. See Appendix G. In contrast, Qwest's proposal would provide federal non-rural support to between 47 and 49 states. See Qwest Comments at 5. Qwest's preferred proposal would provide "Tier (continued...)

10 percent of costs exceeding the proposed high-cost wire center benchmark, the 48 states and Puerto Rico would be eligible to receive a total of approximately \$116 million if they met the conditions for additional targeted federal support, in addition to the support provided under the rules we adopt today.⁴²¹

131. Would the proposed methodology provide significant inducement to each state to reform its universal service mechanisms? Would the benefits of inducing state action to reform state universal service mechanisms outweigh the cost of the additional contributions to the universal service fund that this additional targeted federal support could entail? Commenters should address how this proposal relates to the Act's requirement that universal service should be sufficient to achieve the Act's goals and, specifically, that sufficiency requires that support should not exceed the amount necessary to achieve the Act's goals.⁴²²

132. We also seek comment on what showings a state should be required to make in order to receive any additional targeted federal support, if such an inducement mechanism were adopted. Above, we seek comment on what showings a state must make in support of a request for further federal action, in addition to showing the failure to achieve rate comparability. To what extent should the showings that a state is required to make in order to receive additional targeted federal support for inducement purposes differ from the showings the state should be required to make in order to demonstrate that it has taken all reasonably possible actions to achieve rate comparability? Should a state be required to show that it has established an explicit support mechanism of a particular size relative to the number of lines in the state or some other measure? Should a state be required to demonstrate that it has rebalanced its residential and business rates? Should a state be required to demonstrate that it has eliminated geographic rate averaging through implicit support flows? Are there any specific actions reasonably calculated to eliminate or reduce implicit support in intrastate rates that a state should be required to show?

VI. ORDER ON RECONSIDERATION

133. In this Order on Reconsideration, we address requests to reconsider portions of the *Ninth Report and Order* filed by AT&T Corp. (AT&T), the Puerto Rico Telephone Company, Inc. (Puerto Rico Tel. Co.), SBC Communications Inc. (SBC), Personal Communications Industry Association (PCIA), and the Wyoming Public Service Commission

(Continued from previous page) _____

1" support based on wire center costs and "Tier 2" support based on statewide average costs, after taking into account Tier 1 support. See Qwest Joint Board Comments at 12-20 (filed April 10, 2002). If the Commission continues basing support on statewide average costs, Qwest argues that it must lower the benchmark to include more states. See Qwest Comments at 10-16.

⁴²¹ We note that about half the states have established explicit support mechanisms, but most still rely to some extent on geographic rate averaging, unbalanced residential and business rates, or other implicit support mechanisms. The amounts of additional targeted federal support potentially available to each state, if it qualified, at several points between 5 and 25 percent of costs over the proposed benchmark are set forth in Appendix G.

⁴²² See *supra* para. 37.

(Wyoming Commission).⁴²³

A. AT&T Petition

1. Background

134. In its petition, AT&T requests reconsideration of the rule governing calculation of non-rural high-cost support for a competitive eligible telecommunications carrier (CETC) providing service through unbundled network elements (UNEs).⁴²⁴ AT&T also requests that the Commission target non-rural high-cost support based on UNE zones, rather than targeting support to high-cost wire centers.⁴²⁵ Finally, AT&T requests that the Commission clarify that states, to comply with section 254(e) certification requirements, must direct carriers to spend non-rural high-cost support within the group of wire centers to which the support is targeted.⁴²⁶

2. Discussion

135. We deny AT&T's request for reconsideration of the rule governing calculation of non-rural high-cost support for a CETC providing service through UNEs. Section 54.307 of the Commission's rules provides that a CETC using UNEs to provide supported services will receive a level of universal service support not to exceed the price of the UNEs to which it purchases access.⁴²⁷ AT&T contends that there is no basis for maintaining this limitation of universal service support because the Commission adopted it as an interim measure pending implementation of a forward-looking support mechanism.⁴²⁸ Although the Commission emphasized in the *First Report and Order* that a forward-looking, more precisely-targeted support methodology should alleviate concerns that providing high-cost support to CETCs using UNEs would create uneconomic incentives,⁴²⁹ the Commission did not adopt the challenged limitation as an interim measure.⁴³⁰ AT&T's broader underlying argument that a CETC "should get the *full* measure of high-cost support that the incumbent had received for the line, regardless

⁴²³ AT&T Petition (January 3, 2000), Puerto Rico Tel. Co. Petition (January 3, 2000), SBC Petition (January 3, 2000), PCIA Petition (January 3, 2000) and Wyoming Commission Petition (January 3, 2000).

⁴²⁴ AT&T Petition at 1-5; *See Ninth Report and Order*, 14 FCC Rcd at 20480, para. 91.

⁴²⁵ AT&T Petition at 5-6.

⁴²⁶ AT&T Petition at 7.

⁴²⁷ 47 C.F.R. 54.307; *see also First Report and Order*, 12 FCC Rcd at 8873, para. 174.

⁴²⁸ AT&T Petition at 2-3.

⁴²⁹ *First Report and Order*, 12 FCC Rcd at 8872-73, para. 173.

⁴³⁰ *First Report and Order*, 12 FCC Rcd at 8933, para. 288, n.746 ("When the support is based on the forward-looking costs of serving lines in a particular geographic area, the carrier that serves the line, either the ILEC or the CLEC, will receive the support for that line, sharing only if the CLEC takes the loop as an unbundled network element at a rate less than the universal service support for that line.").

of whether the entrant is using entirely its own facilities or providing service via UNEs⁴³¹ is within the scope of the separate proceeding to comprehensively reexamine the Commission's rules governing portability of high-cost support, which is currently before the Joint Board.⁴³² We therefore decline to address that argument here, and emphasize that our denial of AT&T's petition for reconsideration here does not in any way prejudge what action we ultimately may take in the portability proceeding.

136. We also deny AT&T's request that the Commission require support to be targeted based on UNE zones and distributed on a uniform per-line basis within each zone. The Commission's rules target non-rural high-cost support to wire centers, but permit states to file waiver petitions to target support to other areas, such as UNE zones.⁴³³ The Commission determined that a wire-center targeting approach best suits the non-rural high-cost support mechanism.⁴³⁴ AT&T contends that states should be required to target support to UNE zones "so that support and the underlying costs of the elements used to provide service are more closely aligned."⁴³⁵ In achieving the different goals of deaveraging non-rural high-cost support and UNEs, however, we need not adopt identical approaches.⁴³⁶ Moreover, the Commission fully explained why it decided to target non-rural high-cost support to wire centers in the *Ninth Report and Order*.⁴³⁷ AT&T has presented no new arguments on reconsideration that persuade us to reconsider at this time the Commission's prior decision to target non-rural high-cost support on a wire-center basis.

137. Finally, we deny AT&T's request that the Commission clarify that non-rural high-cost support must be used in wire centers to which it is targeted. Under the Commission's rules, states must certify that high-cost support flowing to non-rural carriers within their territories will be used in a manner consistent with section 254(e) of the Act.⁴³⁸ AT&T asks the Commission to

⁴³¹ AT&T Petition at 4.

⁴³² See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 17 FCC Rcd 22642 (2002) (*Referral Order*); *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, Public Notice, 18 FCC Rcd 1941 (2003) (*Referral Order Public Notice*).

⁴³³ 47 C.F.R. § 54.309(b) and (c); see *Ninth Report and Order*, 14 FCC Rcd at 20473, para. 76.

⁴³⁴ *Ninth Report and Order*, 14 FCC Rcd at 20471-72, para. 72 ("The cost model, by design, calculates costs at the wire center level. The wire center costs generated by the model can then be averaged together, as desired, at higher levels of aggregation, such as the UNE cost zone level.").

⁴³⁵ AT&T Petition at 5.

⁴³⁶ See *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, Low-Volume Long-Distance Users, CC Docket No. 99-249, Report and Order, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962, 13054, para. 211 n.484 (holding that interstate access support and non-rural high-cost support need not be targeted on same basis in light of different goals of mechanisms).

⁴³⁷ *Ninth Report and Order*, 14 FCC at 20472-73, para. 75.

⁴³⁸ 47 C.F.R. § 54.313.

clarify that, in order to comply with this requirement, states must direct non-rural carriers to use support only within the wire centers to which it is targeted. Because non-rural high-cost support is intended to enable reasonably comparable intrastate rates, and states have primary jurisdiction over those rates, the Commission determined that states should decide how support will be used to advance the goals of section 254(e).⁴³⁹ We conclude that the requested clarification is inconsistent with the Commission's stated intention in the *Ninth Report and Order*.⁴⁴⁰ To the extent this argument overlaps with arguments raised in the pending Joint Board proceeding on portability of support, we emphasize that our decision here does not prejudge how we ultimately may resolve issues raised in the portability proceeding.

B. Puerto Rico Tel. Co. Petition

1. Background

138. In its petition, Puerto Rico Tel. Co. challenges the sufficiency of the non-rural high-cost support methodology implemented in the *Ninth Report and Order*.⁴⁴¹ Puerto Rico Tel. Co. maintains that its loss of intrastate high-cost support since the phasedown of interim hold-harmless support began in 2001 increases the challenges it faces in serving an insular area with high costs and low income levels.⁴⁴² Puerto Rico Tel. Co. points to Puerto Rico's low subscribership levels as evidence that the Commission should act to restore the intrastate support it has lost since the phasedown began. Specifically, Puerto Rico Tel. Co. requests that the Commission treat it as a "rural" carrier rather than as a "non-rural" carrier for purposes of

⁴³⁹ *Ninth Report and Order*, 14 FCC Rcd at 20482-83, para. 95.

⁴⁴⁰ *Ninth Report and Order*, 14 FCC Rcd at 20476-77, para. 83 ("states can direct carriers to spend the federal support in a manner consistent with section 254(e), *though not necessarily in the wire center to which the support was targeted.*")(italics added); *id.* at 20482-83, para. 95 ("Because the support that will be provided by the methodology described in this Order is intended to enable the reasonable comparability of intrastate rates, and states have primary jurisdiction over *intrastate* rates, we find that it is most appropriate for states to determine how the support is used to advance the goals set out in section 254(e)").

⁴⁴¹ Puerto Rico Tel. Co. Petition at 2-3.

⁴⁴² Puerto Rico Tel. Co. does not qualify for non-rural high-cost support under the methodology adopted in the *Ninth Report and Order*. Before the transition to forward-looking support for non-rural carriers, Puerto Rico Tel. Co. received over \$40 million annually in intrastate high-cost support based on its embedded costs. *See supra* n. 71 and accompanying text. The Commission included in the *Ninth Report and Order* an interim hold-harmless provision that provided a gradual transition to the non-rural high-cost support mechanism. Under the hold-harmless provision, no carrier was to receive less support on a per-line basis than it would have received under the previous mechanism based on embedded costs. *Ninth Report and Order*, 17 FCC Rcd at 20474, para. 78. In the *Thirteenth Report and Order*, the Commission implemented a phasedown of the hold-harmless provision. *See Federal-State Joint Board on Universal Service*, CC Docket 96-45, Thirteenth Report and Order and Further Notice of Proposed Rulemaking, 15 FCC Rcd 24422 (2000) (*Thirteenth Report and Order*). We note that Puerto Rico Tel. Co. continues to receive almost \$90 million annually in interstate support. *See* Federal Universal Service Support Mechanisms Fund Size Projections and Contribution Base for the Fourth Quarter 2002, Appendix HC 17 (Universal Service Administrative Company, August 1, 2003).

intrastate high-cost support because it serves an insular area.⁴⁴³ In the alternative, Puerto Rico Tel. Co. requests that the Commission revise the non-rural high-cost support mechanism so that support is both calculated and targeted on a wire-center basis with a cost benchmark adjusted according to the statewide subscribership rate.⁴⁴⁴

2. Discussion

139. We reject Puerto Rico Tel. Co.'s request for reconsideration of the non-rural high-cost support methodology adopted in the *Ninth Report and Order*. For the reasons discussed above, we find that the methodology reflects the appropriate division of federal and state responsibility for ensuring reasonable comparability of local rates in urban and rural areas served by non-rural carriers.⁴⁴⁵ The Commission previously rejected Puerto Rico Tel. Co.'s argument that it should be treated as a rural carrier for purposes of intrastate high-cost support because it serves an insular area. The Commission explained that large telephone companies such as Puerto Rico Tel. Co. "should possess economies of scale and scope to deal efficiently with the cost of providing service in their areas, and thus, the level of that support will be determined through a forward-looking mechanism."⁴⁴⁶ Puerto Rico Tel. Co. has not justified reconsideration of the Commission's prior decisions. In particular, Puerto Rico Tel. Co. has offered no evidence that the decline in its intrastate high-cost support has caused rate shock or rate comparability problems.⁴⁴⁷ We note that we do not address here Puerto Rico Tel. Co.'s request in an *ex parte* letter, filed on June 6, 2003, that the Commission create a separate category of "non-rural insular" carriers for purposes of intrastate high-cost support.⁴⁴⁸

⁴⁴³ Puerto Rico Tel. Co. Petition at 14-15. See also Puerto Rico Tel. Co. Petition for Reconsideration, CC Docket No. 96-45 (filed July 17, 1997); Proposal of Puerto Rico Telephone Company, CC Docket Nos. 96-45 and 97-160 (filed April 27, 1998).

⁴⁴⁴ Puerto Rico Tel. Co. Petition at 8-11. Puerto Rico Tel. Co. also requests that the Commission clarify that Long Term Support (LTS) was not affected by the *Ninth Report and Order* and will continue to be distributed as it has been in the past. We need not address this issue here as the Commission subsequently addressed the status of LTS in the *Thirteenth Report and Order* and the *MAG Order*. See *Thirteenth Report and Order*, 15 FCC Rcd at 24426, para. 9; *MAG Order*, 16 FCC Rcd at 19724-26, paras. 272-276.

⁴⁴⁵ See *supra* part IV.A.

⁴⁴⁶ *First Report and Order*, 12 FCC Rcd at 8946, para. 315. The *First Report and Order* noted that Puerto Rico Tel. Co. was the twelfth largest company, as measured by access lines, in the United States at the time. *Id.* at n.791. Puerto Rico Tel. Co. is now a Verizon subsidiary as a result of Puerto Rico Tel. Co.'s acquisition by GTE and the subsequent Bell Atlantic-GTE merger to form Verizon.

⁴⁴⁷ In 2000, the Commission rejected Puerto Rico Tel. Co.'s arguments that phasing down hold-harmless support would lead to rate shock in Puerto Rico, noting that the Puerto Rico Commission actually supported the phasedown. *Thirteenth Report and Order*, 15 FCC Rcd at 24428-29, para. 13 & n.47.

⁴⁴⁸ Letter to Marlene H. Dortch, Secretary, Federal Communications Commission, from Gregory J. Vogt, Counsel for Puerto Rico Telephone Company, Inc., CC Docket Nos. 96-45, 00-256, 98-77, 98-166 (June 6, 2003) (*June 2003 Letter*). See also *Federal-State Joint Board on Universal Service: Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas*, CC Docket No. 96-45, Notice of Proposed Rulemaking, 14 FCC Rcd 21177, 21232-35, paras. 135-140 (1999).

140. In addition, we are not persuaded that providing more high-cost support to Puerto Rico Tel. Co. would effectively address the underlying concern it identifies: low subscribership levels in Puerto Rico.⁴⁴⁹ As discussed above, the purpose of non-rural high-cost support is to ensure reasonable comparability of rates among states.⁴⁵⁰ Puerto Rico Tel. Co. has not shown that the low subscribership levels in Puerto Rico are related to local rate levels or that providing additional non-rural high-cost support would have any direct impact on subscribership levels.⁴⁵¹ As the Commission stated in the *Seventh Report and Order*, federal high-cost support is not the appropriate federal program for addressing issues of affordability and subscribership.⁴⁵² The Consumer and Governmental Affairs Bureau is committed to engaging in outreach to increase the awareness in Puerto Rico of our existing Lifeline and Link-Up programs. We also note that the Commission currently is considering whether to adopt income-based eligibility default standards for participation in Lifeline and Link-Up, which could have a significant effect on subscribership in Puerto Rico.

C. SBC and PCIA Petitions

141. SBC requests that the Commission require reporting of cost and line count data by carriers operating in territories of non-rural carriers on an annual rather than a quarterly basis. We dismiss the request to reduce the frequency of cost data reporting as moot, and deny the request to reduce line count reporting. In the *Rural Task Force Order*, the Commission amended section 36.611 of the rules to require non-rural carriers to submit loop cost data on an annual basis, rather than on a quarterly basis.⁴⁵³ Accordingly, we dismiss SBC's request to require reporting of cost data on an annual basis as moot. In the *Twentieth Order on Reconsideration*, the Commission clarified that carriers must report line count data quarterly in order to receive support on a regular quarterly basis.⁴⁵⁴ The Commission determined that non-rural high-cost support must be determined based on line reported on a quarterly basis "to ensure portability of

⁴⁴⁹ Puerto Rico Tel. Co. Petition at 2-3.

⁴⁵⁰ *See supra* at para. 6.

⁴⁵¹ Puerto Rico Tel. Co. stated in the *June 2003 Letter* that its subscribership has dropped slightly (from 74.5% to 71.2%) since 2001. *June 2003 Letter* at 5. Overall subscribership in Puerto Rico, however, increased (from 74.2% to 76%) from December, 1999 to November, 2002, apparently due to competition. *See* Centennial Communications Corp. Reply Comments to *Referral Order Public Notice*. In addition, other factors contribute to the low penetration rate in Puerto Rico, including the low per capita annual income level in Puerto Rico. *Id.* at 10.

⁴⁵² *Seventh Report and Order*, 14 FCC Rcd at 8097, para. 39. ("Affordability problems, as they relate to low-income consumers, raise many issues that are unrelated to the need for support in high-cost areas, and section 254(b)(3) reflects a legislative judgment that all Americans, regardless of income, should have access to the network at reasonably comparable rates.")

⁴⁵³ *Rural Task Force Order*, 16 FCC Rcd at 11270, para. 59. The Commission found that, because the national average loop cost was frozen at \$240.00, NECA would no longer need to calculate the national average loop cost on a quarterly basis, and, thus, it would be unnecessary for non-rural carriers to file loop cost data on a quarterly basis.

⁴⁵⁴ *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twentieth Order on Reconsideration, 15 FCC Rcd 12070, 12078, para. 18 (2000)(*Twentieth Order on Reconsideration*).

support among carriers.”⁴⁵⁵ SBC has not provided any new information or arguments on reconsideration that warrant alteration of the requirement of quarterly line count reporting.

142. We also deny the PCIA’s request that the Commission reconsider aspects of its decision in the *Ninth Report and Order* affecting the portability of non-rural high-cost support to mobile wireless CETCs.⁴⁵⁶ The issues raised by PCIA are within the scope of the separate proceeding to comprehensively reexamine the Commission’s rules governing portability of high-cost support, which is currently before the Joint Board.⁴⁵⁷ We emphasize that our denial of PCIA’s petition here does not in any way prejudice what action we ultimately may take in the portability proceeding.

D. Wyoming Commission Petition

1. Background

143. In its petition, the Wyoming Commission argues that the *Ninth Report and Order* fails to fulfill the comparability and sufficiency objectives of the 1996 Act.⁴⁵⁸ The Wyoming Commission explains that Wyoming’s customers pay local rates that are above the national average, yet non-rural high-cost support to the state has been reduced due to the changes implemented by the *Ninth Report and Order*.⁴⁵⁹ The Wyoming Commission maintains that it has done its share to promote competition in its state, including eliminating implicit subsidies and deaveraging unbundled elements and local prices, and that the Commission must do more to support universal service and to promote competition in the state. The Wyoming Commission asks that non-rural high-cost support be calculated at the wire center level rather than statewide.⁴⁶⁰ As an alternative, the Wyoming Commission asks that the Commission provide additional federal support where a non-rural carrier’s average forward-looking cost exceeds a designated threshold and the state has a universal service fund of a certain size.⁴⁶¹

⁴⁵⁵ *Id.*

⁴⁵⁶ In particular, PCIA requests that the Commission (1) allow wireless CETCs to self-certify that they will use non-rural high-cost support in a manner consistent with section 254(e), (2) clarify the terms “new” and “captured” in section 54.307 of the Commission’s rules, 47 C.F.R. § 54.307, (3) address how to determine a mobile wireless customer’s service location, and (4) define the term “working loop” in section 54.307, 47.C.F.R. § 54.307, as a working phone number with regard to wireless CETCs.

⁴⁵⁷ *Referral Order*, 17 FCC Rcd 22642; *Referral Order Public Notice*, 18 FCC Rcd 1941.

⁴⁵⁸ Wyoming Commission Petition at 4-5.

⁴⁵⁹ *Id.* at 2-5.

⁴⁶⁰ *Id.* at 5-9.

⁴⁶¹ *Id.* at 9-12. Specifically, Wyoming recommends that the Commission provide additional federal funding when a non-rural carrier’s average forward-looking cost exceeds \$30 per month and the surcharge on intrastate revenues exceeds 4% for the state universal service fund. *See id.* at 11. We note that the Wyoming Petition also includes a request for a review of model inputs, specifically a review of loop lengths. *Id.* at 12-13. We do not (continued....)

2. Discussion

144. The Commission commends the Wyoming Commission for implementing pro-competitive policies by deaveraging rates and eliminating implicit subsidies. We recognize that Wyoming is in a unique position as the only state with significant rural territories that has implemented such policies. However, we deny the Wyoming Commission's petition for reconsideration of the *Ninth Report and Order*. As we explain above, the distribution of support on a statewide basis in the non-rural high-cost support mechanism reflects the appropriate division of federal and state responsibility.⁴⁶² Statewide averaging also is consistent with the *Qwest* court's view that the Commission is not required by the Act to replace implicit state support with explicit federal support or to support the full costs of universal service.⁴⁶³ We conclude that the Wyoming Commission has not provided any new information or arguments on reconsideration that require us to alter our decision to determine support on a statewide basis, as the Joint Board recommended. As part of the rate review and expanded certification process described above in Section IV.D., each state will have the opportunity to request further federal action based upon a demonstration that, despite the state's best efforts, federal non-rural support and state action together have not achieved reasonable comparability of rural and urban rates.⁴⁶⁴ Wyoming therefore has an avenue to pursue its argument that additional support is warranted.

145. We also deny the Wyoming Commission's request to award additional support to non-rural carriers based on above-average costs and high state universal service contributions at this time. In the Further Notice, we propose to make available additional targeted federal support for states that adopt explicit universal service mechanisms.⁴⁶⁵ We anticipate that this proposal, if adopted, would help to address the concerns raised by the Wyoming Commission in its petition.

VII. PROCEDURAL MATTERS

A. Final Regulatory Flexibility Analysis

146. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),⁴⁶⁶ an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the *Remand Notice*.⁴⁶⁷ The

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address this issue at this time because it concerns the model's inputs adopted by the Commission in the *Tenth Report and Order*, which is not before us in this Order. See *Tenth Report and Order*, 14 FCC Rcd 20156.

⁴⁶² See *supra* part IV.A.

⁴⁶³ See *Qwest*, 258 F.3d at 1203-4.

⁴⁶⁴ See *supra* part IV.D.

⁴⁶⁵ See *supra* part V.

⁴⁶⁶ See 5 U.S.C. § 603. The RFA, see 5 U.S.C. § 601-612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

⁴⁶⁷ See *Remand Notice*, 17 FCC Rcd at 3012-5, paras. 30-41.

Commission sought written public comment on the proposals in the *Remand Notice*, including comment on the IRFA. This Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA.⁴⁶⁸

1. Need for, and Objectives of, the Report and Order

147. This Order is necessary to respond to the remand by the United States Court of Appeals for the Tenth Circuit of the *Ninth Report and Order* and also to respond to the Joint Board's *Recommended Decision*. Along with fulfilling the court's remand requirements, the objectives of this Order are to implement a non-rural high-cost support mechanism that fulfills the relevant principles in section 254(b) of the Act. The rules we adopt in this Order reflect the Commission's careful and considered determination to implement the mechanism consistently with section 254(b) and with the Joint Board's recommendations.

148. In this Order, we take the following actions in response to the Tenth Circuit's remand and the Joint Board's recommendations to modify the non-rural high-cost support mechanism and to induce states to ensure reasonably comparable rural and urban rates in areas served by non-rural carriers:

- Consistent with the Joint Board's recommendations, we reaffirm that comparing statewide average costs to a nationwide cost benchmark reflects the appropriate federal and state roles in determining federal non-rural high-cost support. We find no evidence in the record either for radically altering the current non-rural mechanism or for establishing a substantially larger federal subsidy to lower local telephone service rates, as some commenters advocate.
- In response to the Tenth Circuit's remand, we define the relevant statutory terms "sufficient" and "reasonably comparable" more precisely for purposes of the non-rural mechanism. As recommended by the Joint Board, we define "sufficient" in terms of the statutory principle in section 254(b)(3), as enough federal support to enable states to achieve reasonable comparability of rural and urban rates in high-cost areas served by non-rural carriers. We also agree with the Joint Board that the principle of sufficiency means that non-rural support should be only as large as necessary to achieve the statutory goals. We define "reasonably comparable" in terms of a national urban rate benchmark recommended by the Joint Board. As part of the rate review process discussed below, the rate benchmark will be used in determining whether a state's local rates in rural, high-cost areas served by non-rural carriers are reasonably comparable to urban rates nationwide.
- We modify the non-rural mechanism by basing the cost benchmark, which is used to determine the amount of non-rural high-cost support, on two standard deviations above the national average cost per line. Modifying the cost benchmark ties it more directly to the relevant data, consistent with the court's directive, but does not alter the level of non-

⁴⁶⁸ See 5 U.S.C. § 604.

rural support in a major way. We agree with the Joint Board that the current level of non-rural support is supported by data from the GAO Report indicating that rural and urban rates generally are reasonably comparable today.

- To induce states to achieve reasonably comparable rates, we adopt with minor changes the rate review and expanded certification process recommended by the Joint Board. Each state will be required to review its rates in rural, high-cost areas served by non-rural carriers annually to assess their comparability to urban rates nationwide, and then to file a certification with the Commission stating whether its rural rates are reasonably comparable to urban rates nationwide or explaining why they are not.
- For purposes of the rate review process, we adopt the Joint Board’s recommendation that we establish an annually-adjusted nationwide rate benchmark based on the most recent urban residential rates in the *Reference Book*, the Wireline Competition Bureau’s annual rate survey. Specifically, we adopt a rate benchmark of two standard deviations above the average urban rate, which, based on the most recent *Reference Book* survey, is \$32.28 or 138 percent of the average urban rate. The rate benchmark will establish a “safe harbor,” that is, a presumption that rates in rural, high-cost areas that are below the rate benchmark are reasonably comparable to urban rates nationwide. States with rural rates below the rate benchmark may certify that their rates are reasonably comparable without providing additional information, or rebut the presumption by demonstrating that factors other than basic service rates affect the comparability of their rates.
- For purposes of the rate review process, we also establish a basic service rate template for states to use in comparing rates in rural, high-cost areas served by non-rural carriers to the nationwide urban rate benchmark. In addition, we adopt, with slight modifications, the definition of “rural area” already contained in section 54.5 of the Commission’s rules for purposes of the rate review process.
- We adopt the Joint Board’s recommendation to permit states to request further federal action, if necessary, based on a demonstration that the state’s rates in rural, high-cost areas served by non-rural carriers are not reasonably comparable to urban rates nationwide and that the state has taken all reasonable steps to achieve reasonable comparability through state action and existing federal support.
- In response to the Tenth Circuit’s remand, we review and explain our comprehensive plan for supporting universal service in high-cost areas.
- In the attached Further Notice, we seek comment on issues related to the rate review and expanded certification process. In particular, we propose a method for calculating any additional targeted federal support that may be provided in response to a state request for further federal action, based on forward-looking cost estimates. Under this proposal, any such support would be targeted on a wire-center basis, based on a set percentage of per-line costs exceeding a threshold above the national average cost for wire centers.

- We also seek comment in the attached Further Notice on whether we should make additional targeted federal support available for high-cost wire centers in states that implement explicit universal service mechanisms, without regard to their achievement of rate comparability, in order to encourage states to adopt universal service mechanisms that will be sustainable in a competitive environment.

2. Summary of Significant Issues Raised by Public Comments in Response to the IRFA

149. The Commission received no comments specifically addressing the IRFA. Nonetheless, the Commission considered the potential impact of the adopted rules on small entities and, based on analysis of the relevant data, determined that the compliance burden for small entities directly impacted will not be significant.

150. We note that the Commission did receive some general small entity-related comments not specifically addressing the rules and policies presented in the IRFA. Some commenters suggested that eligible communications carriers (ETCs) should be treated differently than the incumbent non-rural carriers.⁴⁶⁹ CUSC stated that the certification process should apply only to the incumbent non-rural carriers.⁴⁷⁰ RICA stated that ETCs and incumbent non-rural carriers should receive support through separate mechanisms.⁴⁷¹ In making the determination reflected in the Order, we have considered the impact of our actions on these small entities. We have determined that any impact on small entities will be negligible.

151. Other small-entity related comments concerned the rural high-cost support mechanism and were not relevant to this Order, which modifies the non-rural high-cost support mechanism only.⁴⁷² The federal non-rural high-cost support mechanism, revised and implemented by this Order, calculates and distributes federal support to non-rural carriers providing service in high-cost areas. For purposes of the mechanism, “non-rural carriers” are those that do not meet the statutory definition of a rural telephone company.⁴⁷³ As stated above,

⁴⁶⁹ See Competitive Universal Service Coalition (CUSC) Comments; Rural Independent Competitive Alliance (RICA) Comments.

⁴⁷⁰ See CUSC Comments at 8.

⁴⁷¹ See RICA Comments at 5.

⁴⁷² See e.g. NRTA and OPASTCO Comments.

⁴⁷³ *Ninth Report and Order*, 14 FCC Rcd at 20439, para. 2. Rural telephone carriers are defined as follows:

The term “rural telephone company” means a local exchange carrier operating entity to the extent that such entity --

- (A) provides common carrier service to any local exchange carrier study area that does not include either-
 - (i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
 - (ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;
- (B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(continued....)

the rural and non-rural high-cost support mechanisms are separate.⁴⁷⁴

3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply

152. The RFA directs agencies to provide a description of, and, where feasible, an estimate of the number of small entities that will be directly affected by the rules adopted herein.⁴⁷⁵ The RFA generally defines the term “small entity” as having the same meaning as the terms “small business,” “small organization,” and “small governmental jurisdiction.”⁴⁷⁶ In addition, the term “small business” has the same meaning as the term “small business concern” under the Small Business Act, unless the Commission has developed one or more definitions that are appropriate to its activities.⁴⁷⁷ Under the Small Business Act, a “small business concern” is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the Small Business Administration (SBA).⁴⁷⁸

153. The Commission has determined that the group of small entities directly affected by the rules adopted in this Order are eligible telecommunications carriers (ETCs)⁴⁷⁹ providing service in areas served by non-rural carriers. Within the category of ETCs we find competitive local exchange carriers (CLECs), which are all wired telecommunications carriers, and wireless carriers. Further descriptions of these entities are provided below.

154. **Wired Telecommunications Carriers.** The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such companies having 1,500 or fewer employees.⁴⁸⁰ According to Census Bureau data for 1997, there were

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(C) provides telephone exchange service to any local exchange carrier study areas with fewer than 100,000 access lines; or

(D) has less than 15% of its access lines in communities of more than 50,000 on February 8, 1996.

47 U.S.C. § 153(37). *See also First Report and Order*, 12 FCC Rcd at 8944, para. 310.

⁴⁷⁴ *See supra* at para. 25.

⁴⁷⁵ 5 U.S.C. § 604(a)(3).

⁴⁷⁶ 5 U.S.C. § 601(6).

⁴⁷⁷ 5 U.S.C. § 601(3) (incorporating by reference the definition of “small business concern” in 5 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies “unless an agency after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition in the Federal Register.”

⁴⁷⁸ 15 U.S.C. § 632.

⁴⁷⁹ *See infra* para. 157.

⁴⁸⁰ 13 C.F.R. § 121.201, North American Industry Classification System (NAICS) code 517110.

2,225 firms in this category, total, that operated for the entire year.⁴⁸¹ Of this total, 2,201 firms had employment of 999 or fewer employees, and an additional 24 firms had employment of 1,000 or more.⁴⁸² Thus, under this size standard, the great majority of firms can be considered small.

155. Competitive Local Exchange Carriers (CLECs), Competitive Access Providers (CAPs) and “Other Local Exchange Carriers.” Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to providers of competitive exchange services or to competitive access providers or to “Other Local Exchange Carriers.” The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.⁴⁸³ According to Commission data,⁴⁸⁴ 532 companies reported that they were engaged in the provision of either competitive access provider services or competitive local exchange carrier services. Of these 532 companies, an estimated 411 have 1,500 or fewer employees and 121 have more than 1,500 employees.⁴⁸⁵ In addition, 55 carriers reported that they were “Other Local Exchange Carriers.” Of the 55 “Other Local Exchange Carriers,” an estimated 53 have 1,500 or fewer employees and two have more than 1,500 employees.⁴⁸⁶ Consequently, the Commission estimates that most providers of competitive local exchange service, competitive access providers, and “Other Local Exchange Carriers” are small entities that may be affected by the rules and policies adopted herein.

156. Cellular and Other Wireless Telecommunications Carriers.⁴⁸⁷ The SBA has developed a small size standard for Cellular and Other Wireless Telecommunications Carriers which consists of all such companies having 1,500 or fewer employees. According to the Commission’s most recent data,⁴⁸⁸ 1,761 companies reported that they were engaged in the provision of wireless service. Of these, 1,761 companies, and estimated 1,175 have 1,500 or fewer employees and 586 have more than 1,500 employees.⁴⁸⁹ Consequently, the Commission

⁴⁸¹ U.S. Census Bureau, 1997 Economics Census, Subject Series: Information, “Establishment and Firm Size (Including Legal Form of Organization),” Table 5, NAICS code 517110.

⁴⁸² *Id.* The census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is “Firms with 1,000 employees or more.”

⁴⁸³ 13 C.F.R. § 121.201, NAICS code 517110.

⁴⁸⁴ FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, Trends in Telephone Service, Table 5.3 (May 2002).

⁴⁸⁵ *Id.*

⁴⁸⁶ *Id.*

⁴⁸⁷ 13 C.F.R. § 121.201, NAICS code 517212.

⁴⁸⁸ FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, Trends in Telephone Service, Table 5.3 (May 2002).

⁴⁸⁹ *Id.*

estimates that most wireless service providers are small entities that may be affected by the rules and policies adopted herein.

157. **Eligible Telecommunications Carriers (ETCs) that Provide Service in Areas Served by Non-Rural Carriers.** Neither the SBA nor the Commission has developed a definition of small entities specifically applicable to ETCs. ETC designation allows a carrier to receive universal service support in accordance with section 254 of the Act. An entity is designated as an ETC by a state commission or, if there is no state jurisdiction, by the Commission upon meeting the requirements of section 214(e) of the Act. Any entity offering services supported by federal universal service mechanisms that uses its own facilities or a combination of its own facilities and resale of another carrier's services and advertises such charges and rates can seek designation as an ETC.⁴⁹⁰ ETCs are competitive carriers that are not dominant in the field. The group of ETCs providing service in areas served by non-rural carriers is composed of mostly competitive local exchange carriers (CLECs) and wireless carriers. We have indicated above that, pursuant to SBA standards, ETCs are CLECs or wireless carriers. In addition, we note that the only ETCs affected by this Order are those that provide service in areas served by non-rural carriers. If we had no further information concerning the specific ETCs affected by this rulemaking, we would estimate that numerous ETCs, which are either CLECs or wireless service providers that provide service in areas served by non-rural carriers, are small businesses that may be affected by the rules adopted herein.

158. At this time, however, the Commission is aware of approximately 30 ETCs providing service in areas served by non-rural carriers. We have determined that at least 9 of these ETCs are subsidiaries of public companies – not independently owned and operated – and, therefore, not small businesses under the Small Business Act.⁴⁹¹ We do not have data specifying whether the remaining ETCs, or other ETCs not accounted for, are independently owned and operated, and therefore we are unable to estimate with greater precision the number of these carriers that would qualify as small business concerns under SBA's definition. Consequently, we estimate that there are 20 or fewer small entities that may be affected directly by the proposed rules herein adopted.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

159. This Order does not impose directly any change in projected reporting, record keeping or other compliance requirements on small entities. No changes have been made to the reporting or recordkeeping requirements of carriers receiving federal non-rural high-cost support.

5. Steps Taken To Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

160. The RFA requires an agency to describe any significant alternatives that it has

⁴⁹⁰ 47 C.F.R. § 54.201

⁴⁹¹ 15 U.S.C. § 632.

considered in reaching its proposed approach, which may include the following four alternatives (among others): “(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.”⁴⁹²

161. In this Order, in response to the Tenth Circuit’s remand and the Joint Board’s *Recommended Decision*, we modify the high-cost universal service support mechanism for non-rural carriers and adopt measures to induce states to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers. Our actions will affect the amount of support distributed to non-rural carriers and ETCs providing service in areas served by non-rural carriers. Based on our analysis of the relevant data, the Commission believes that there will be minimal, if any, economic impact on small entities in adopting modifications to the federal non-rural high-cost support mechanism and rate review and expanded certification process. The modifications to the current federal non-rural high-cost support mechanism, as adopted in the Order, should maintain or increase the current level of non-rural high-cost support to carriers receiving such support. As such, based on the relevant data, we anticipate little, if any, negative economic effects on any small businesses directly affected by the modifications to the non-rural high-cost mechanism implemented by this Order.

6. Report to Congress

162. The Commission will send a copy of the Order, including the FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act.⁴⁹³ In addition, the Commission will send a copy of the Order, including this FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this Order and FRFA (or summaries thereof) will also be published in the Federal Register.⁴⁹⁴

B. Paperwork Reduction Act Analysis

163. The action contained herein has been analyzed with respect to the Paperwork Reduction Act of 1995 and found to impose new or modified reporting and recordkeeping requirements or burdens on the public. Implementation of these new or modified reported and recordkeeping requirements will be subject to approval by the Office of Management and Budget (OMB) as prescribed by the Act, and will go into effect upon announcement in the Federal Register of OMB approval.

⁴⁹² 5 U.S.C. § 603(c)(1)-(4).

⁴⁹³ See 5 U.S.C. § 801(a)(1)(A).

⁴⁹⁴ See 5 U.S.C. § 604(b).

C. Initial Regulatory Flexibility Act Analysis

164. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),⁴⁹⁵ the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of policies and rules proposed in this Further Notice of Proposed Rulemaking (Further Notice). Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Further Notice.⁴⁹⁶ The Commission will send a copy of this Further Notice, including this IRFA, to the Chief Counsel of Advocacy of the Small Business Administration (SBA).⁴⁹⁷ In addition, the Further Notice and IRFA (or summaries thereof) will be published in the Federal Register.⁴⁹⁸

1. Need for and Objectives of the Proposed Rules

165. Consistent with the Tenth Circuit's remand of the *Ninth Report and Order* and the recommendations of the Federal-State Joint Board on Universal Service (Joint Board), we modify the high-cost universal service support mechanism for non-rural carriers and adopt measures to induce states to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers in the Order.⁴⁹⁹ As discussed, the Further Notice is necessary to develop the record on specific issues that relate to the rate review and expanded state certification process recommended by the Joint Board.⁵⁰⁰ The rate review and expanded state certification process will fulfill the requirement of the Tenth Circuit remand by inducing state action to ensure that rates in rural and high-cost areas served by non-rural carriers are reasonably comparable to urban rates nationwide in compliance with section 254(b) of the Act.⁵⁰¹

166. First, in this Further Notice, we seek comment on whether we should require states to file, in connection with their reasonable comparability certifications, additional data that might enhance the Commission's ability to assess the non-rural mechanism and state actions to achieve comparability of urban and rural rates, including business rate data, urban rate data, and rate data from states that would not otherwise be required to file data under the rules we adopt today. Second, we seek comment on how to treat any state requests for further federal action, including procedures for states to submit any such requests; how to review required showings by requesting states; and how to calculate any additional targeted federal support. In addition, we

⁴⁹⁵ See 5 U.S.C. § 603. The RFA, see 5 U.S.C. § 601–612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

⁴⁹⁶ See *infra* para. 175.

⁴⁹⁷ See 5 U.S.C. § 603(a).

⁴⁹⁸ See 5 U.S.C. § 603(a).

⁴⁹⁹ See *supra* para. 1.

⁵⁰⁰ See *supra* part V.

⁵⁰¹ See *supra* part IV.D.

propose a method for calculating additional targeted federal support on a wire-center basis using forward-looking model cost estimates. Finally, we also seek comment on a proposal to further encourage states to advance the Act's universal service goals by making available additional targeted federal support to states that implement explicit universal service mechanisms, without regard to their achievement of rate comparability.⁵⁰²

2. Legal Basis

167. The legal basis as proposed for this *Further Notice* is contained in sections 4(i), 4(j), 201-205, 218-220, 254, 403 and 410 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 4(i), 4(j), 201-205, 218-220, 254, 403, 410.

3. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

168. The RFA directs agencies to provide a description of, and, where feasible, an estimate of the number of small entities that may be affected by the rules adopted herein.⁵⁰³ The RFA generally defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."⁵⁰⁴ In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act, unless the Commission has developed one or more definitions that are appropriate to its activities.⁵⁰⁵ Under the Small Business Act, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the Small Business Administration (SBA).⁵⁰⁶

169. We have described in detail, *supra*, in the Final Regulatory Flexibility Analysis, the categories of entities that may be directly affected by any rules or proposals adopted in our efforts to reform the universal service contribution system.⁵⁰⁷ For this Initial Regulatory Flexibility Analysis, we hereby incorporate those entity descriptions by reference.

⁵⁰² See *supra* part V.D.

⁵⁰³ 5 U.S.C. § 604(a)(3).

⁵⁰⁴ 5 U.S.C. § 601(6).

⁵⁰⁵ 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition in the Federal Register."

⁵⁰⁶ 15 U.S.C. § 632.

⁵⁰⁷ See *supra* paras. 152-158.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

170. Should the Commission decide that modifications must be made to the rate review and expanded certification process implemented above, the associated rule changes will only modify the reporting requirements of the state commissions. Based on our review of the process, such state reporting requirements have no direct effect on the federal reporting and recordkeeping requirements of telecommunications service providers regulated under the Communications Act, including any small business entities directly affected by the Order. No questions posed in the Further Notice consider any changes to the rules that would directly impose additional reporting, recordkeeping, and other compliance requirements on small business entities.

5. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

171. The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.⁵⁰⁸

172. The Commission does not foresee that any modifications to the rate review and expanded certification process resulting from this Further Notice will have a direct impact on any small business entities. Furthermore, based on the current data, we do not believe that the result in any area of the proposals under consideration will have a differential impact on small entities. In this Further Notice, however, the commenters may present the Commission with various proposals that may have varying impacts on small businesses. We seek comment on whether any proposals, if implemented, may result in an unfair burden. If there is such an unfair burden, we seek comment on how best to mitigate or eliminate it, as appropriate.

6. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rules

173. None.

D. Initial Paperwork Reduction Act of 1995 Analysis

174. The *Further Notice* contains either a proposed or modified information collection from state commissions. As part of a continuing effort to reduce paperwork burdens, we invite the general public and the Office of Management and Budget (OMB) to take this opportunity to comment on the information collections contained in this Further Notice, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. Public and agency comments are due at

⁵⁰⁸ 5 U.S.C. § 603(c).

the same time as other comments on the Further Notice; OMB comments are due 60 days from the date of publication of the Further Notice in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

E. Comment Filing Procedures

175. We invite comment on the issues and questions set forth in the Further Notice and Initial Regulatory Flexibility Analysis contained herein. Pursuant to applicable procedures set forth in sections 1.415 and 1.419 of the Commission's rules,⁵⁰⁹ interested parties may file comments on or before 30 days after Federal Register publication of this Further Notice, and reply comments on or before 60 days after Federal Register publication of this Further Notice. All filings should refer to CC Docket No. 96-45. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.⁵¹⁰

176. Comments filed through the ECFS can be sent as an electronic file via the Internet to <<http://www.fcc.gov/e-file/ecfs.html>>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the following words in the body of the message, "get form <your e-mail address>." A sample form and directions will be sent in reply.

177. Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). The Commission's contractor, Natek, Inc., will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to

⁵⁰⁹ 47 C.F.R. §§ 1.415, 1.419.

⁵¹⁰ See Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24,121 (1998).

9300 East Hampton Drive, Capitol Heights, MD 20743. U.S. Postal Service first-class mail, Express Mail, and Priority Mail should be addressed to 445 12th Street, SW, Washington, D.C. 20554. All filings must be addressed to the Commission's Secretary, Marlene H. Dortch, Office of the Secretary, Federal Communications Commission.

178. Parties also must send three paper copies of their filing to Sheryl Todd, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission, 445 12th Street S.W., Room 5-B540, Washington, D.C. 20554. In addition, commenters must send diskette copies to the Commission's copy contractor, Qualex International, Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20054.

VIII. ORDERING CLAUSES

179. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 1, 4(i), 4(j), 201-205, 214, 218-220, 254, 403 and 405 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 154(j), 201-205, 214, 218-220, 254, 403 and 405, this ORDER ON REMAND is hereby ADOPTED.

180. IT IS FURTHER ORDERED that Part 54 of the Commission's rules, 47 C.F.R. Part 54, IS AMENDED as set forth in Appendix A attached hereto, effective thirty (30) days after their publication in the Federal Register. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

181. IT IS FURTHER ORDERED that, pursuant to the authority contained in sections 1, 4(i), 4(j), 201-205, 214, 218-220, 254, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 154(j), 201-205, 214, 218-220, 254 and 403, this Further Notice of Proposed Rulemaking IS ADOPTED.

182. IT IS FURTHER ORDERED that, pursuant to section 1.106(j) of the Commission's rules, 47 C.F.R. §1.106(j), the Petitions for Reconsideration of the Ninth Report and Order and Eighteenth Order on Reconsideration filed by AT&T Corp., Personal Communications Industry Association, Puerto Rico Telephone Company, and the Wyoming Public Service Commission on January 3, 2000 are DENIED, and the Petition for Reconsideration of the Ninth Report and Order and Eighteenth Order on Reconsideration filed by SBC Communications Inc. on January 3, 2000 is DENIED in part and DISMISSED AS MOOT in part.

183. IT IS FURTHER ORDERED that, pursuant to section 4(i) of the Communications Act of 1934, as amended, 47 U.S.C. §154(i), and section 1.3 of the Commission's rules, 47 C.F.R. §1.3, the Petition for Waiver of Section 36.631 of the Commission's Rules Governing the Universal Service Fund, filed by the Vermont Department of Public Service and the Vermont Public Service Board, September 21, 1993, AAD 93-103, is DISMISSED AS MOOT.

184. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, including the Final Regulatory Flexibility Analysis and Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX A -- FINAL RULES

Part 54 of the Code of Federal Regulations is amended as follows:

PART 54 -- UNIVERSAL SERVICE

1. The authority citations continue to read as follows:

Authority: 47 U.S.C. § 1, 4(i), 201, 205, 214, and 254 unless otherwise noted.

Subpart D -- Universal Service Support in High Cost Areas

2. Section 54.309 (a)(3) is revised to read as follows:

§ 54.309 Calculation and distribution of forward-looking support for non-rural carriers.

(a) * * *

(3) The national cost benchmark shall equal two weighted standard deviations above the national average FLEC per line.

* * *

3. Add section 54.316 as follows:

§ 54.316 Rate comparability review and certification for areas served by non-rural carriers.

(a) *Certification.* Each state will be required annually to review the comparability of residential rates in rural areas of the state served by non-rural incumbent local exchange carriers to urban rates nationwide, and to certify to the Commission and the Administrator as to whether the rates are reasonably comparable, for purposes of section 254(b)(3) of the Telecommunications Act of 1996. If a state does not rely on the safe harbor described in paragraph (b), or certifies that the rates are not reasonably comparable, the state must fully explain its rate comparability analysis and provide data supporting its certification, including but not limited to residential rate data for rural areas within the state served by non-rural incumbent local exchange carriers. If a state certifies that the rates are not reasonably comparable, it must also explain why the rates are not reasonably comparable and explain what action it intends to take to achieve rate comparability.

(b) *Safe Harbor.* For the purposes of its certification, a state may presume that the residential rates in rural areas served by non-rural incumbent local exchange carriers are reasonably comparable to urban rates nationwide if the rates are below the nationwide urban rate benchmark. The nationwide urban rate benchmark shall equal the most recent average urban rate plus two weighted standard deviations. The benchmark shall be calculated using the average urban rate and standard deviation shown in the most recent annual *Reference Book of Rates, Price Indices, and Expenditures for Telephone Service* published by the Wireline Competition Bureau. To the extent that a state relies on the safe harbor, the rates that it compares to the nationwide urban rate benchmark shall include the access charges and other mandatory monthly rates included in the rate survey published in the most recent annual *Reference Book of Rates, Price Indices, and Expenditures for Telephone Service*. The *Reference Book of Rates, Price*

Indices, and Expenditures for Telephone Service is available for public inspection at the Commission's Reference Center at 445 12th Street, S.W., Washington, D.C. 20554 and on the Commission website at www.fcc.gov/wcb/iatd/lec.html.

(c) *Definition of "Rural Area."* For the purposes of this section, a "rural area" is a non-metropolitan county or county equivalent, as defined in the Office of Management and Budget's (OMB) Revised Standards for Defining Metropolitan Areas in the 1990s and identifiable from the most recent Metropolitan Statistical Area (MSA) list released by OMB. At a state's discretion, a "rural area" may also include any wire center designated by the state as rural for the purposes of this section. In the event that a state designates a wire center as rural, it must provide an explanation supporting such designation in its certification pursuant to paragraph (a).

(d) *Schedule for Certification.* Annual certifications are required on the schedule set forth in section 54.313(d)(3), beginning October 1, 2004. Certifications due on October 1 of each year shall pertain to rates as of the prior July 1. Certifications filed during the remainder of the schedule set forth in section 54.313(d)(3) shall pertain to the same date as if they had been filed on October 1.

(e) *Effect of Failure to Certify.* In the event that a state fails to certify, no eligible telecommunications carrier in the state shall receive support pursuant to section 54.309.

APPENDIX B

Residential Monthly Urban Rate Data

**Reference Book Residential Monthly Urban Rate Data
1993-2002**

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Maximum	\$32.68	\$31.63	\$30.62	\$28.65	\$28.78	\$28.27	\$28.75	\$29.72	\$34.75	\$35.19
Minimum	\$12.18	\$12.18	\$13.04	\$13.04	\$13.05	\$13.05	\$13.05	\$13.21	\$15.31	\$15.65
Representative Monthly Charge (Average)	\$19.95	\$19.81	\$20.01	\$19.95	\$19.88	\$19.76	\$19.93	\$20.78	\$22.62	\$23.38
Weighted Standard Deviation (Std Dev)	\$4.23	\$4.28	\$3.41	\$3.28	\$3.35	\$3.24	\$3.46	\$3.57	\$4.20	\$4.45
Average + 2*(Std Dev)	\$28.41	\$28.38	\$26.84	\$26.51	\$26.58	\$26.24	\$26.85	\$27.92	\$31.01	\$32.28
Percentage to Average	142%	143%	134%	133%	134%	133%	135%	134%	137%	138%
Average + 3*(Std Dev)	\$32.65	\$32.66	\$30.25	\$29.78	\$29.93	\$29.47	\$30.31	\$31.49	\$35.21	\$36.72
Percentage to Average	164%	165%	151%	149%	151%	149%	152%	152%	156%	157%

Source:

Industry Analysis and Technology Division, Wireline Competition Bureau, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (July 2003) (*2003 Reference Book*).

APPENDIX C

Adjusted GAO Rate Data

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Alabama	Auburn	CentralCity	BellSouth	\$24.73	\$24.73	
Alabama	Baileyton	Non-MSA	BellSouth	\$24.73		\$24.73
Alabama	Birmingham	CentralCity	BellSouth	\$25.08	\$25.08	
Alabama	Decatur	CentralCity	BellSouth	\$25.08	\$25.08	
Alabama	Goodwater	Non-MSA	BellSouth	\$24.43		\$24.43
Alabama	Hillsboro	Suburb	BellSouth	\$24.73	\$24.73	
Alabama	Morris	Suburb	BellSouth	\$25.08	\$25.08	
Alabama	Notasulga	Suburb	GTE Systems of the South	\$25.16	\$25.16	
Alaska	Anchorage	CentralCity	ATU Telecom	\$18.48	\$18.48	
Arizona	Flagstaff	CentralCity	Qwest	\$21.96	\$21.96	
Arizona	Gila Bend	Suburb	Qwest	\$21.96	\$21.96	
Arizona	Phoenix	CentralCity	Qwest	\$21.96	\$21.96	
Arizona	Sierra Vista	Non-MSA	Qwest	\$21.96		\$21.96
Arizona	South Tucson	Suburb	Qwest	\$21.96	\$21.96	
Arizona	Tucson	CentralCity	Qwest	\$21.96	\$21.96	
Arizona	Williams	Suburb	Qwest	\$21.96	\$21.96	
Arizona	Winslow	Non-MSA	Qwest	\$21.96		\$21.96
Arkansas	Barling	Suburb	Southwestern Bell	\$23.69	\$23.69	
Arkansas	Fort Smith	CentralCity	Southwestern Bell	\$23.69	\$23.69	
Arkansas	Haynes	Non-MSA	Southwestern Bell	\$22.29		\$22.29
Arkansas	Little Rock	CentralCity	Southwestern Bell	\$25.09	\$25.09	
Arkansas	Oil Trough	Non-MSA	Southwestern Bell	\$20.89		\$20.89
Arkansas	Pine Bluff	CentralCity	Southwestern Bell	\$23.69	\$23.69	
Arkansas	Sherrill	Suburb	Southwestern Bell	\$20.89	\$20.89	
Arkansas	Wrightsville	Suburb	Southwestern Bell	\$25.09	\$25.09	

* Rate data from GAO report for areas served by non-rural carriers only, adjusted by adding \$8.78 to each rate to reflect additional charges included in Bureau's Reference Book Residential Monthly Urban Rate Data.

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
California	Dos Palos	Suburb	Contel	\$25.63	\$25.63	
California	El Centro	Non-MSA	Pacific Bell	\$19.90		\$19.90
California	Greenfield	Suburb	Pacific Bell	\$19.47	\$19.47	
California	Hanford	Non-MSA	Pacific Bell	\$19.47		\$19.47
California	Los Angeles	CentralCity	Pacific Bell	\$19.47	\$19.47	
California	Merced	CentralCity	Pacific Bell	\$19.47	\$19.47	
California	Placerville	Suburb	Pacific Bell	\$19.47	\$19.47	
California	Sacramento	CentralCity	Pacific Bell	\$19.47	\$19.47	
California	Salinas	CentralCity	Pacific Bell	\$19.47	\$19.47	
California	San Fernando	Suburb	GTE	\$26.03	\$26.03	
Colorado	Boulder	CentralCity	Qwest	\$23.69	\$23.69	
Colorado	Buena Vista	Non-MSA	Qwest	\$23.69		\$23.69
Colorado	Colorado Springs	CentralCity	Qwest	\$23.69	\$23.69	
Colorado	Lafayette	Suburb	Qwest	\$23.69	\$23.69	
Colorado	Leadville	Non-MSA	Qwest	\$23.69		\$23.69
Colorado	Monument	Suburb	Qwest	\$23.69	\$23.69	
Colorado	Pueblo	CentralCity	Qwest	\$23.69	\$23.69	
Connecticut	Chester Center	Non-MSA	SNET	\$19.31		\$19.31
Connecticut	Essex	Non-MSA	SNET	\$19.31		\$19.31
Connecticut	Groton	Suburb	SNET	\$20.31	\$20.31	
Connecticut	Hartford	CentralCity	SNET	\$23.31	\$23.31	
Connecticut	New Canaan	Suburb	SNET	\$20.31	\$20.31	
Connecticut	Stamford	CentralCity	SNET	\$21.31	\$21.31	
Connecticut	Waterbury	CentralCity	SNET	\$22.31	\$22.31	
Delaware	Dover	CentralCity	Bell Atlantic	\$19.74	\$19.74	
Delaware	Felton	Suburb	Bell Atlantic	\$19.74	\$19.74	
Delaware	Lewes	Non-MSA	Bell Atlantic	\$20.40		\$20.40
Delaware	Millville	Non-MSA	Bell Atlantic	\$20.40		\$20.40
Delaware	Newport	Suburb	Bell Atlantic	\$20.40	\$20.40	
Delaware	Wilmington	CentralCity	Bell Atlantic	\$20.40	\$20.40	
District of Columbia	Washington	CentralCity	Bell Atlantic	\$21.56	\$21.56	

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Florida	Bartow	Suburb	GTE	\$20.33	\$20.33	
Florida	Fanning Springs	Non-MSA	BellSouth	\$19.95		\$19.95
Florida	Fernandina Beach	Suburb	BellSouth	\$17.00	\$17.00	
Florida	Havana	Suburb	BellSouth	\$18.07	\$18.07	
Florida	Jacksonville	CentralCity	BellSouth	\$19.24	\$19.24	
Florida	Lakeland	CentralCity	GTE	\$20.33	\$20.33	
Georgia	Aldora	Non-MSA	BellSouth	\$26.23		\$26.23
Georgia	Augusta	CentralCity	BellSouth	\$23.63	\$23.63	
Georgia	Avera	Non-MSA	BellSouth	\$21.28		\$21.28
Georgia	Columbus	CentralCity	BellSouth	\$23.63	\$23.63	
Georgia	Hamilton	Suburb	BellSouth	\$23.63	\$23.63	
Georgia	Hephzibah	Suburb	BellSouth	\$23.63	\$23.63	
Georgia	Macon	CentralCity	BellSouth	\$23.63	\$23.63	
Georgia	Payne	Suburb	BellSouth	\$23.63	\$23.63	
Hawaii	Hana	Non-MSA	GTE Hawaiian Tel Co	\$21.28		\$21.28
Hawaii	Honolulu	CentralCity	GTE Hawaiian Tel Co	\$23.18	\$23.18	
Hawaii	Kailua	Non-MSA	GTE Hawaiian Tel Co	\$23.18		\$23.18
Idaho	Boise City	CentralCity	Qwest	\$26.24	\$26.24	
Idaho	Caldwell	Suburb	Qwest	\$26.24	\$26.24	
Idaho	Dietrich	Non-MSA	Qwest	\$26.24		\$26.24
Idaho	Inkom	Suburb	Qwest	\$26.24	\$26.24	
Idaho	Pocatello	CentralCity	Qwest	\$26.24	\$26.24	
Idaho	Wendell	Non-MSA	Qwest	\$26.24		\$26.24
Illinois	Arlington Heights	Suburb	Ameritech	\$21.78	\$21.78	
Illinois	Champaign	CentralCity	Ameritech	\$21.78	\$21.78	
Illinois	Chicago	CentralCity	Ameritech	\$18.31	\$18.31	
Illinois	Clayton	Non-MSA	GTE	\$29.55		\$29.55
Illinois	Homer	Suburb	GTE	\$29.55	\$29.55	
Illinois	Minier	Suburb	GTE	\$29.55	\$29.55	
Illinois	Neponset	Non-MSA	GTE	\$29.55		\$29.55
Illinois	Peoria	CentralCity	Ameritech	\$21.78	\$21.78	

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Indiana	Edgewood	Suburb	Ameritech	\$19.26	\$19.26	
Indiana	Fort Wayne	CentralCity	GTE	\$26.34	\$26.34	
Indiana	Indianapolis	CentralCity	Ameritech	\$20.95	\$20.95	
Indiana	Kokomo	CentralCity	Ameritech	\$18.53	\$18.53	
Indiana	Ladoga	Non-MSA	Ameritech	\$18.53		\$18.53
Indiana	Marengo	Non-MSA	GTE	\$26.34		\$26.34
Indiana	Waterloo	Suburb	GTE	\$21.13	\$21.13	
Indiana	Windfall	Suburb	GTE	\$24.72	\$24.72	
Iowa	Atlantic City	Non-MSA	Qwest	\$19.49		\$19.49
Iowa	Davenport	CentralCity	Qwest	\$21.43	\$21.43	
Iowa	Des Moines	CentralCity	Qwest	\$21.43	\$21.43	
Iowa	Dubuque	CentralCity	Qwest	\$20.46	\$20.46	
Iowa	Durango	Suburb	Qwest	\$20.46	\$20.46	
Iowa	Hartford	Suburb	Qwest	\$21.43	\$21.43	
Iowa	Panorama Park	Suburb	Qwest	\$21.43	\$21.43	
Iowa	Renwick	Non-MSA	Qwest	\$19.49		\$19.49
Kansas	Auburn	Suburb	Southwestern Bell	\$23.53	\$23.53	
Kansas	Beloit	Non-MSA	Southwestern Bell	\$22.68		\$22.68
Kansas	El Dorado	Suburb	Southwestern Bell	\$22.68	\$22.68	
Kansas	Eudora	Suburb	Southwestern Bell	\$22.68	\$22.68	
Kansas	Lawrence	CentralCity	Southwestern Bell	\$22.68	\$22.68	
Kansas	Parsons	Non-MSA	Southwestern Bell	\$22.68		\$22.68
Kansas	Topeka	CentralCity	Southwestern Bell	\$22.68	\$22.68	
Kansas	Wichita	CentralCity	Southwestern Bell	\$22.98	\$22.98	
Kentucky	Lexington	CentralCity	GTE	\$27.73	\$27.73	
Kentucky	Louisville	CentralCity	BellSouth	\$27.18	\$27.18	
Kentucky	Owensboro	CentralCity	BellSouth	\$23.15	\$23.15	
Kentucky	Plymouth Village	Suburb	BellSouth	\$27.18	\$27.18	
Kentucky	Scottsville	Non-MSA	GTE	\$21.98		\$21.98
Kentucky	Stamping Ground	Suburb	BellSouth	\$24.00	\$24.00	
Kentucky	Stanford	Non-MSA	BellSouth	\$21.55		\$21.55
Kentucky	Whitesville	Suburb	BellSouth	\$23.15	\$23.15	

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Louisiana	Houma	CentralCity	BellSouth	\$21.21	\$21.21	
Louisiana	Lockport	Suburb	BellSouth	\$19.75	\$19.75	
Louisiana	Monroe	CentralCity	BellSouth	\$21.42	\$21.42	
Louisiana	New Llano	Non-MSA	BellSouth	\$20.59		\$20.59
Louisiana	New Orleans	CentralCity	BellSouth	\$21.42	\$21.42	
Louisiana	Sterlington	Suburb	BellSouth	\$21.42	\$21.42	
Louisiana	Vidalia	Non-MSA	BellSouth	\$20.59		\$20.59
Louisiana	Westwego	Suburb	BellSouth	\$21.42	\$21.42	
Maine	Auburn	Suburb	Verizon – New England	\$25.69	\$25.69	
Maine	Augusta	Non-MSA	Verizon – New England	\$25.69		\$25.69
Maine	Bangor	CentralCity	Verizon – New England	\$25.69	\$25.69	
Maine	Belfast	Suburb	Verizon – New England	\$24.41	\$24.41	
Maine	Lewiston	CentralCity	Verizon – New England	\$25.69	\$25.69	
Maine	Portland	CentralCity	Verizon – New England	\$25.69	\$25.69	
Maine	Waterville	Non-MSA	Verizon – New England	\$24.81		\$24.81
Maine	Westbrook	Suburb	Verizon – New England	\$25.69	\$25.69	
Maryland	Baltimore	CentralCity	Bell Atlantic	\$25.04	\$25.04	
Maryland	Cumberland	CentralCity	Bell Atlantic	\$23.79	\$23.79	
Maryland	Eldorado	Non-MSA	Bell Atlantic	\$23.79		\$23.79
Maryland	Frostburg	Suburb	Bell Atlantic	\$23.79	\$23.79	
Maryland	Hagerstown	CentralCity	Bell Atlantic	\$23.79	\$23.79	
Maryland	Hancock	Suburb	Bell Atlantic	\$24.29	\$24.29	
Maryland	Kitzmilller	Non-MSA	Bell Atlantic	\$23.79		\$23.79
Maryland	Manchester	Suburb	Bell Atlantic	\$24.29	\$24.29	
Massachusetts	Boston	CentralCity	Verizon – New England	\$26.12	\$26.12	
Massachusetts	Bourne	Non-MSA	Verizon – New England	\$26.12		\$26.12
Massachusetts	Chelmsford	Suburb	Verizon – New England	\$26.12	\$26.12	
Massachusetts	Fitchburg	CentralCity	Verizon – New England	\$26.12	\$26.12	
Massachusetts	Lowell	CentralCity	Verizon – New England	\$26.12	\$26.12	
Massachusetts	Taunton	Suburb	Verizon – New England	\$26.12	\$26.12	
Massachusetts	Templeton	Suburb	Verizon – New England	\$26.12	\$26.12	
Massachusetts	Williamstown	Non-MSA	Verizon – New England	\$26.12		\$26.12

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Michigan	Ann Arbor	CentralCity	Ameritech	\$52.73	\$52.73	
Michigan	Benton Harbor	CentralCity	Ameritech	\$52.73	\$52.73	
Michigan	Custer	Non-MSA	Ameritech	\$52.73		\$52.73
Michigan	Detroit	CentralCity	Ameritech	\$52.73	\$52.73	
Michigan	East Grand Rapids	Suburb	Ameritech	\$52.73	\$52.73	
Michigan	Eau Claire	Suburb	Ameritech	\$52.73	\$52.73	
Michigan	Fairgrove	Non-MSA	Ameritech	\$52.73		\$52.73
Michigan	Grand Rapids	CentralCity	Ameritech	\$52.73	\$52.73	
Michigan	Milan	Suburb	Ameritech	\$52.73	\$52.73	
Michigan	Sturgis	Non-MSA	GTE	\$22.44		\$22.44
Michigan	Wayne	Suburb	Ameritech	\$52.73	\$52.73	
Minnesota	Minneapolis	CentralCity	Qwest	\$23.54	\$23.54	
Minnesota	Rochester	CentralCity	Qwest	\$22.74	\$22.74	
Minnesota	Rock Creek	Non-MSA	Qwest	\$22.74		\$22.74
Minnesota	Sauk Rapids	Suburb	Qwest	\$22.74	\$22.74	
Minnesota	St. Cloud	CentralCity	Qwest	\$22.74	\$22.74	
Minnesota	Stewartville	Suburb	Qwest	\$22.74	\$22.74	
Mississippi	Canton	Suburb	BellSouth	\$24.28	\$24.28	
Mississippi	Duck Hill	Non-MSA	BellSouth	\$23.93		\$23.93
Mississippi	Gulfport	CentralCity	BellSouth	\$27.79	\$27.79	
Mississippi	Hattiesburg	CentralCity	BellSouth	\$26.73	\$26.73	
Mississippi	Jackson	CentralCity	BellSouth	\$27.79	\$27.79	
Mississippi	McComb	Non-MSA	BellSouth	\$25.68		\$25.68
Mississippi	Ocean Springs	Suburb	BellSouth	\$27.44	\$27.44	
Mississippi	Purvis	Suburb	BellSouth	\$23.57	\$23.57	
Missouri	Bella Villa	Suburb	Southwestern Bell	\$20.03	\$20.03	
Missouri	Bragg City	Non-MSA	Southwestern Bell	\$16.26		\$16.26
Missouri	Columbia	CentralCity	GTE d/b/a/ Verizon	\$18.69	\$18.69	
Missouri	Duenweg	Suburb	Southwestern Bell	\$17.80	\$17.80	
Missouri	Harrisburg	Suburb	GTE	\$18.69	\$18.69	
Missouri	Joplin	CentralCity	Southwestern Bell	\$17.80	\$17.80	
Missouri	St. Louis	CentralCity	Southwestern Bell	\$20.03	\$20.03	
Missouri	Wyatt	Non-MSA	Southwestern Bell	\$16.26		\$16.26

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Montana	Billings	CentralCity	Qwest	\$25.51	\$25.51	
Montana	Cascade	Suburb	Qwest	\$25.51	\$25.51	
Montana	Dillon	Non-MSA	Qwest	\$25.51		\$25.51
Montana	Great Falls	CentralCity	Qwest	\$25.51	\$25.51	
Montana	Laurel	Suburb	Qwest	\$25.51	\$25.51	
Montana	Whitehall	Non-MSA	Qwest	\$25.51		\$25.51
Nebraska	Avoca	Suburb	Aliant	\$26.28	\$26.28	
Nebraska	Hebron	Non-MSA	Aliant	\$26.28		\$26.28
Nebraska	Humphrey	Non-MSA	Qwest	\$26.93		\$26.93
Nebraska	Lincoln	CentralCity	Aliant	\$26.28	\$26.28	
Nebraska	Omaha	CentralCity	Qwest	\$26.93	\$26.93	
Nebraska	Roca	Suburb	Aliant	\$26.28	\$26.28	
Nevada	Carson City	Non-MSA	Nevada Bell	\$19.53		\$19.53
Nevada	Henderson	Suburb	Central Tel Co of NV Sprint	\$17.83	\$17.83	
Nevada	Las Vegas	CentralCity	Central Tel Co of NV Sprint	\$17.83	\$17.83	
Nevada	Lovelock	Non-MSA	Nevada Bell	\$19.53		\$19.53
Nevada	Reno	CentralCity	Nevada Bell	\$19.53	\$19.53	
Nevada	Sparks	Suburb	Nevada Bell	\$19.53	\$19.53	
New Hampshire	Franklin	Suburb	Verizon – New England	\$23.23	\$23.23	
New Hampshire	Littleton	Non-MSA	Verizon – New England	\$20.92		\$20.92
New Hampshire	Manchester	CentralCity	Verizon – New England	\$24.51	\$24.51	
New Hampshire	Mason	Suburb	Verizon – New England	\$22.07	\$22.07	
New Hampshire	Nashua	CentralCity	Verizon – New England	\$24.51	\$24.51	
New Hampshire	Rochester	CentralCity	Verizon – New England	\$23.23	\$23.23	
New Hampshire	Somersworth	Suburb	Verizon – New England	\$23.23	\$23.23	
New Hampshire	Whitefield	Non-MSA	Verizon – New England	\$20.92		\$20.92
New Jersey	Atlantic City	CentralCity	Bell Atlantic - NJ	\$16.23	\$16.23	
New Jersey	Cap May Point	Suburb	Bell Atlantic - NJ	\$16.23	\$16.23	
New Jersey	Hoboken	Suburb	Bell Atlantic - NJ	\$16.97	\$16.97	
New Jersey	Jersey City	CentralCity	Bell Atlantic - NJ	\$16.97	\$16.97	
New Jersey	Newark	CentralCity	Bell Atlantic - NJ	\$16.97	\$16.97	
New Jersey	Victory Gardens	Suburb	Bell Atlantic – NJ	\$16.23	\$16.23	

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
New Mexico	Albuquerque	CentralCity	Qwest	\$19.44	\$19.44	
New Mexico	Angel Fire	Non-MSA	Qwest	\$19.44		\$19.44
New Mexico	Bernalillo	Suburb	Qwest	\$19.44	\$19.44	
New Mexico	Las Cruces	CentralCity	Qwest	\$19.44	\$19.44	
New Mexico	Las Vegas	Non-MSA	Qwest	\$19.44		\$19.44
New Mexico	Santa Fe	CentralCity	Qwest	\$19.44	\$19.44	
New Mexico	Sunland Park	Suburb	Qwest	\$19.44	\$19.44	
New York	Bronxville	Suburb	Verizon	\$28.94	\$28.94	
New York	Cattaraugus	Non-MSA	Verizon	\$21.92		\$21.92
New York	Cornwall on Hudson	Suburb	Verizon	\$25.43	\$25.43	
New York	Glens Falls	CentralCity	Verizon	\$25.43	\$25.43	
New York	Ithaca	Non-MSA	Verizon	\$24.06		\$24.06
New York	New York	CentralCity	Verizon	\$28.94	\$28.94	
New York	Newburgh	CentralCity	Verizon	\$25.43	\$25.43	
New York	Rochester	CentralCity	Frontier	\$20.49	\$20.49	
New York	Sodus Point	Suburb	Verizon	\$25.43	\$25.43	
New York	Whitehall	Suburb	Verizon	\$24.06	\$24.06	
North Carolina	Asheville	CentralCity	BellSouth	\$20.97	\$20.97	
North Carolina	Biltmore Forest	Suburb	BellSouth	\$20.97	\$20.97	
North Carolina	Charlotte	CentralCity	BellSouth	\$21.31	\$21.31	
North Carolina	Elk Park	Non-MSA	BellSouth	\$19.25		\$19.25
North Carolina	Lake Park	Suburb	BellSouth	\$21.04	\$21.04	
North Dakota	Belfield	Non-MSA	Qwest	\$26.47		\$26.47
North Dakota	Bismarck	CentralCity	Qwest	\$26.47	\$26.47	
North Dakota	Emerado	Suburb	Qwest	\$26.47	\$26.47	
North Dakota	Fargo	CentralCity	Qwest	\$26.47	\$26.47	
North Dakota	Grand Forks	CentralCity	Qwest	\$26.47	\$26.47	
North Dakota	Grandin	Suburb	Qwest	\$26.47	\$26.47	
North Dakota	Mandan	Suburb	Qwest	\$26.47	\$26.47	

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Ohio	Canton	CentralCity	Ameritech	\$23.03	\$23.03	
Ohio	Clarksville	Non-MSA	GTE	\$22.71		\$22.71
Ohio	Dayton	CentralCity	Ameritech	\$23.03	\$23.03	
Ohio	Miamisburg	Suburb	Ameritech	\$23.03	\$23.03	
Ohio	Middleport	Non-MSA	GTE	\$22.71		\$22.71
Ohio	Waynesburg	Suburb	Ameritech	\$23.13	\$23.13	
Oklahoma	Cache	Suburb	Southwestern Bell	\$20.85	\$20.85	
Oklahoma	Claremore	Suburb	Southwestern Bell	\$22.50	\$22.50	
Oklahoma	Lake Aluma	Suburb	Southwestern Bell	\$22.50	\$22.50	
Oklahoma	Lawton	CentralCity	Southwestern Bell	\$20.85	\$20.85	
Oklahoma	Oklahoma City	CentralCity	Southwestern Bell	\$22.50	\$22.50	
Oklahoma	Pawnee	Non-MSA	Southwestern Bell	\$19.00		\$19.00
Oklahoma	Pocola	Non-MSA	Southwestern Bell	\$20.85		\$20.85
Oklahoma	Tulsa	CentralCity	Southwestern Bell	\$22.50	\$22.50	
Oregon	Adams	Non-MSA	Qwest	\$21.58		\$21.58
Oregon	Albany	Suburb	Qwest	\$21.58	\$21.58	
Oregon	Corvallis	CentralCity	Qwest	\$21.58	\$21.58	
Oregon	Eugene	CentralCity	Qwest	\$21.58	\$21.58	
Oregon	Junction City	Suburb	Qwest	\$21.58	\$21.58	
Oregon	Milton-Freewater	Non-MSA	Qwest	\$21.58		\$21.58
Oregon	Portland	CentralCity	Qwest	\$21.58	\$21.58	
Oregon	Yamhill	Suburb	GTE	\$21.37	\$21.37	
Pennsylvania	Exeter	Suburb	Bell Atlantic - PA	\$20.91	\$20.91	
Pennsylvania	Franklin	Suburb	Verizon North	\$21.61	\$21.61	
Pennsylvania	Johnstown	CentralCity	Verizon North	\$22.58	\$22.58	
Pennsylvania	Oxford	Suburb	Bell Atlantic - PA	\$19.66	\$19.66	
Pennsylvania	Philadelphia	CentralCity	Bell Atlantic - PA	\$22.21	\$22.21	
Pennsylvania	Saltsburg	Non-MSA	Verizon North	\$18.65		\$18.65
Pennsylvania	Scranton	CentralCity	Bell Atlantic - PA	\$20.91	\$20.91	
Pennsylvania	South New Castle	Non-MSA	Bell Atlantic - PA	\$17.06		\$17.06
Rhode Island	East Providence	Suburb	Verizon	\$26.04	\$26.04	
Rhode Island	Providence	CentralCity	Verizon	\$26.04	\$26.04	

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
South Carolina	Arcadia Lakes	Suburb	BellSouth	\$24.18	\$24.18	
South Carolina	Calhoun Falls	Non-MSA	GTE	\$24.74		\$24.74
South Carolina	Columbia	CentralCity	BellSouth	\$24.18	\$24.18	
South Carolina	Greenville	CentralCity	BellSouth	\$24.18	\$24.18	
South Carolina	Norris	Suburb	BellSouth	\$22.83	\$22.83	
South Carolina	Springfield	Non-MSA	BellSouth	\$21.48		\$21.48
South Carolina	Sumter	CentralCity	GTE	\$24.74	\$24.74	
South Dakota	Chamberlain	Non-MSA	Qwest	\$24.53		\$24.53
South Dakota	Hill City	Suburb	Qwest	\$26.53	\$26.53	
South Dakota	Kranzburg	Non-MSA	Qwest	\$25.33		\$25.33
South Dakota	Madison	Non-MSA	Qwest	\$25.33		\$25.33
South Dakota	Rapid City	CentralCity	Qwest	\$26.53	\$26.53	
South Dakota	Sioux Falls	CentralCity	Qwest	\$27.03	\$27.03	
South Dakota	Tea	Suburb	Qwest	\$27.03	\$27.03	
Tennessee	Cumberland Gap	Non-MSA	BellSouth	\$18.03		\$18.03
Tennessee	Dover	Non-MSA	BellSouth	\$17.08		\$17.08
Tennessee	Humboldt	Suburb	BellSouth	\$18.03	\$18.03	
Tennessee	Jackson	CentralCity	BellSouth	\$18.58	\$18.58	
Tennessee	Memphis	CentralCity	BellSouth	\$21.68	\$21.68	
Tennessee	Piperton	Suburb	BellSouth	\$21.68	\$21.68	
Texas	Bruceville-Eddy	Suburb	Southwestern Bell	\$17.88	\$17.88	
Texas	El Lago	Suburb	Southwestern Bell	\$19.83	\$19.83	
Texas	Galveston	CentralCity	Southwestern Bell	\$17.88	\$17.88	
Texas	Houston	CentralCity	Southwestern Bell	\$19.83	\$19.83	
Texas	Jamaica Beach	Suburb	Southwestern Bell	\$17.88	\$17.88	
Texas	Victoria	CentralCity	Southwestern Bell	\$17.58	\$17.58	
Texas	Waco	CentralCity	Southwestern Bell	\$17.88	\$17.88	
Texas	Winters	Non-MSA	GTE	\$15.88		\$15.88

Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Utah	Bountiful	Suburb	Qwest	\$19.81	\$19.81	
Utah	Provo	CentralCity	Qwest	\$19.81	\$19.81	
Utah	River Heights	Non-MSA	Qwest	\$19.81		\$19.81
Utah	Salina	Non-MSA	Qwest	\$19.81		\$19.81
Utah	Salt Lake City	CentralCity	Qwest	\$19.81	\$19.81	
Utah	Springville	Suburb	Qwest	\$19.81	\$19.81	
Vermont	Burlington	CentralCity	Verizon	\$33.33	\$33.33	
Vermont	Jeffersonville	Non-MSA	Verizon	\$33.33		\$33.33
Vermont	Newport	Non-MSA	Verizon	\$33.33		\$33.33
Vermont	South Burlington	Suburb	Verizon	\$33.33	\$33.33	
Virginia	Buchanan	Suburb	Bell Atlantic	\$21.42	\$21.42	
Virginia	Hampton	Suburb	Bell Atlantic	\$23.08	\$23.08	
Virginia	Lynchburg	CentralCity	Bell Atlantic	\$21.42	\$21.42	
Virginia	Melfa	Non-MSA	Bell Atlantic	\$20.69		\$20.69
Virginia	Radford	Non-MSA	Bell Atlantic	\$21.42		\$21.42
Virginia	Roanoke	CentralCity	Bell Atlantic	\$22.37	\$22.37	
Virginia	Virginia Beach	CentralCity	Bell Atlantic	\$23.08	\$23.08	
Washington	Bainbridge Island	Suburb	Qwest	\$21.28	\$21.28	
Washington	Bellingham	CentralCity	Qwest	\$21.28	\$21.28	
Washington	Bremerton	CentralCity	Qwest	\$21.28	\$21.28	
Washington	Kenmore	Suburb	GTE	\$22.03	\$22.03	
Washington	Seattle	CentralCity	Qwest	\$21.28	\$21.28	
Washington	Tekoa	Non-MSA	GTE	\$20.62		\$20.62
Washington	Warden	Non-MSA	Qwest	\$21.28		\$21.28
West Virginia	Huntington	CentralCity	Verizon	\$23.78	\$23.78	
West Virginia	Milton	Suburb	Verizon	\$23.78	\$23.78	
West Virginia	Moundsville	Suburb	Verizon	\$23.78	\$23.78	
West Virginia	Parkersburg	CentralCity	Verizon	\$23.78	\$23.78	
West Virginia	Shinnston	Non-MSA	Verizon	\$23.78		\$23.78
West Virginia	Terra Alta	Non-MSA	Verizon	\$23.78		\$23.78
West Virginia	Vienna	Suburb	Verizon	\$23.78	\$23.78	
West Virginia	Wheeling	CentralCity	Verizon	\$23.78	\$23.78	

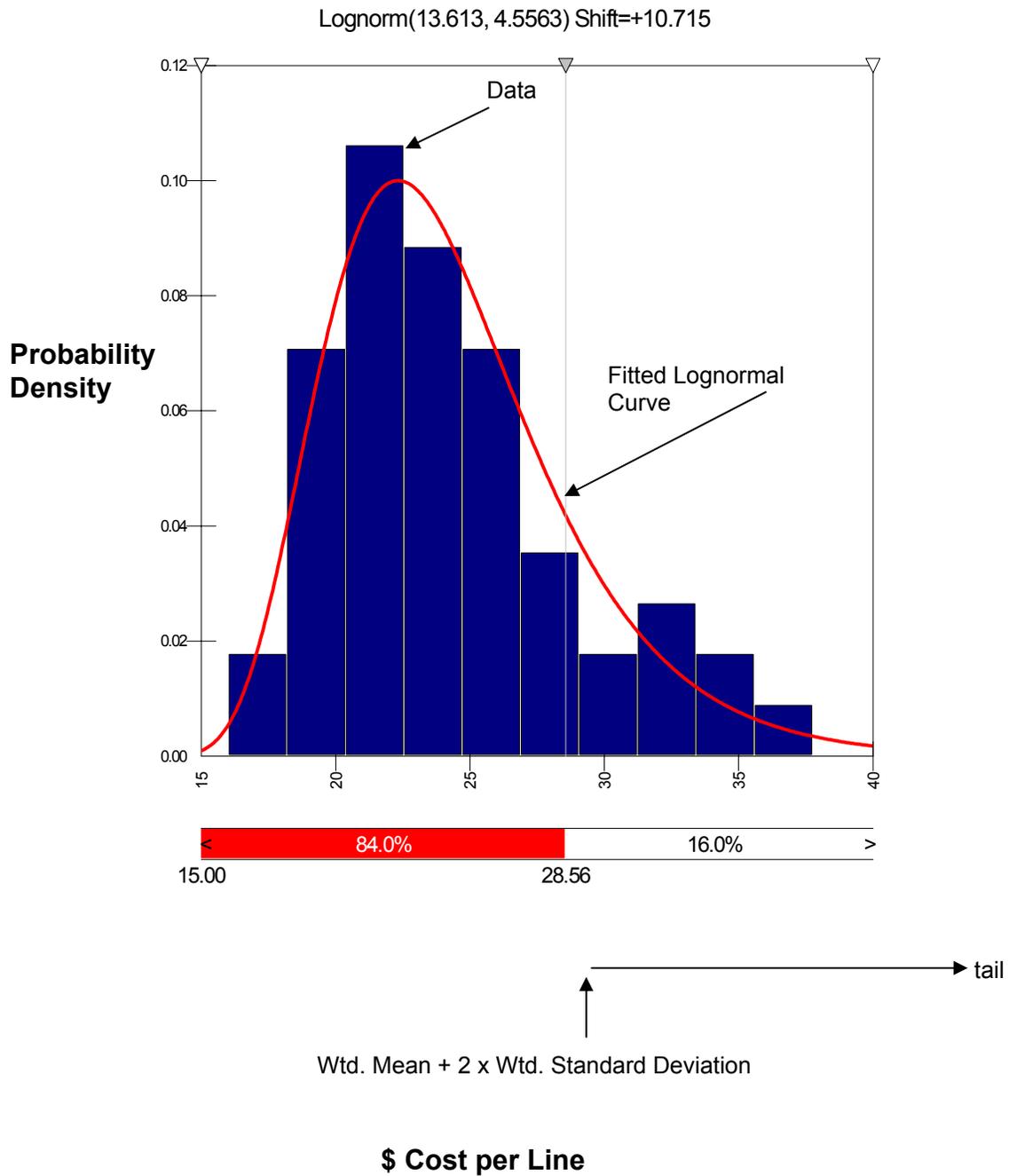
Adjusted GAO Report Data*

State	Place name	Type of place	Non-Rural ILEC	Residential Rate + \$8.78	Urban (Central City / Suburban)	Rural (Non-MSA)
Wisconsin	Brokaw	Suburb	GTE	\$27.03	\$27.03	
Wisconsin	Footville	Suburb	GTE	\$28.26	\$28.26	
Wisconsin	Genoa	Non-MSA	Ameritech	\$19.45		\$19.45
Wisconsin	Janesville	CentralCity	Ameritech	\$19.45	\$19.45	
Wisconsin	Madison	CentralCity	Ameritech	\$19.45	\$19.45	
Wisconsin	Stoughton	Suburb	GTE	\$19.45	\$19.45	
Wisconsin	Wausau	CentralCity	GTE	\$27.03	\$27.03	
Wyoming	Casper	CentralCity	Qwest	\$31.88	\$31.88	
Wyoming	Cheyenne	CentralCity	Qwest	\$31.88	\$31.88	
Wyoming	Evansville	Suburb	Qwest	\$31.88	\$31.88	
Wyoming	Gillette	Non-MSA	Qwest	\$31.88		\$31.88
Wyoming	Hudson	Non-MSA	Qwest	\$57.38		\$57.38

APPENDIX D

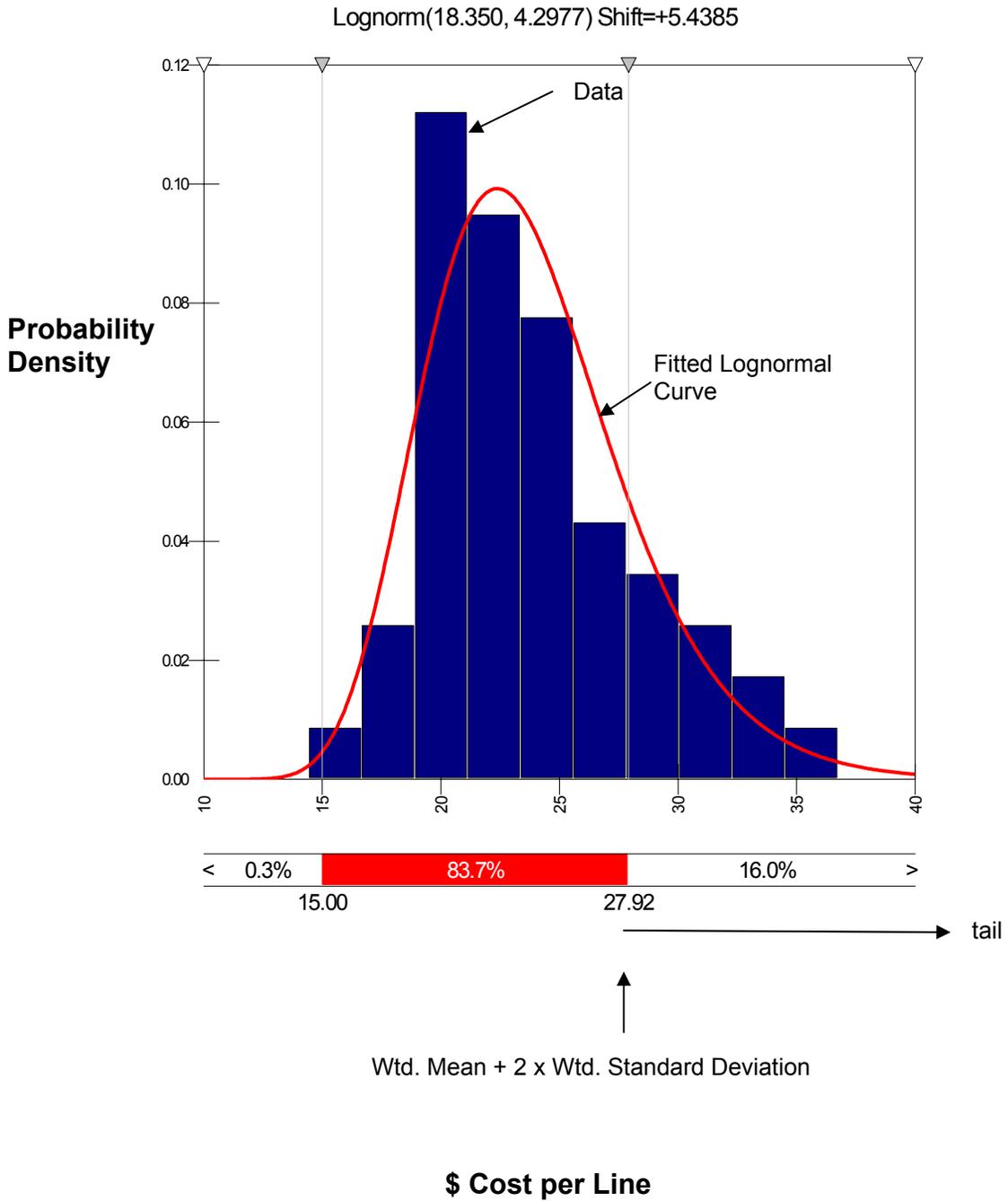
Dispersion of Statewide Average Costs Per Line

Statewide Cost/Line Model Run Data for Year 2001



State cost per line model run data graphed as a histogram with the horizontal axis cost per line and the vertical axis frequency.

Statewide Cost/Line Model Run Data for Year 2002

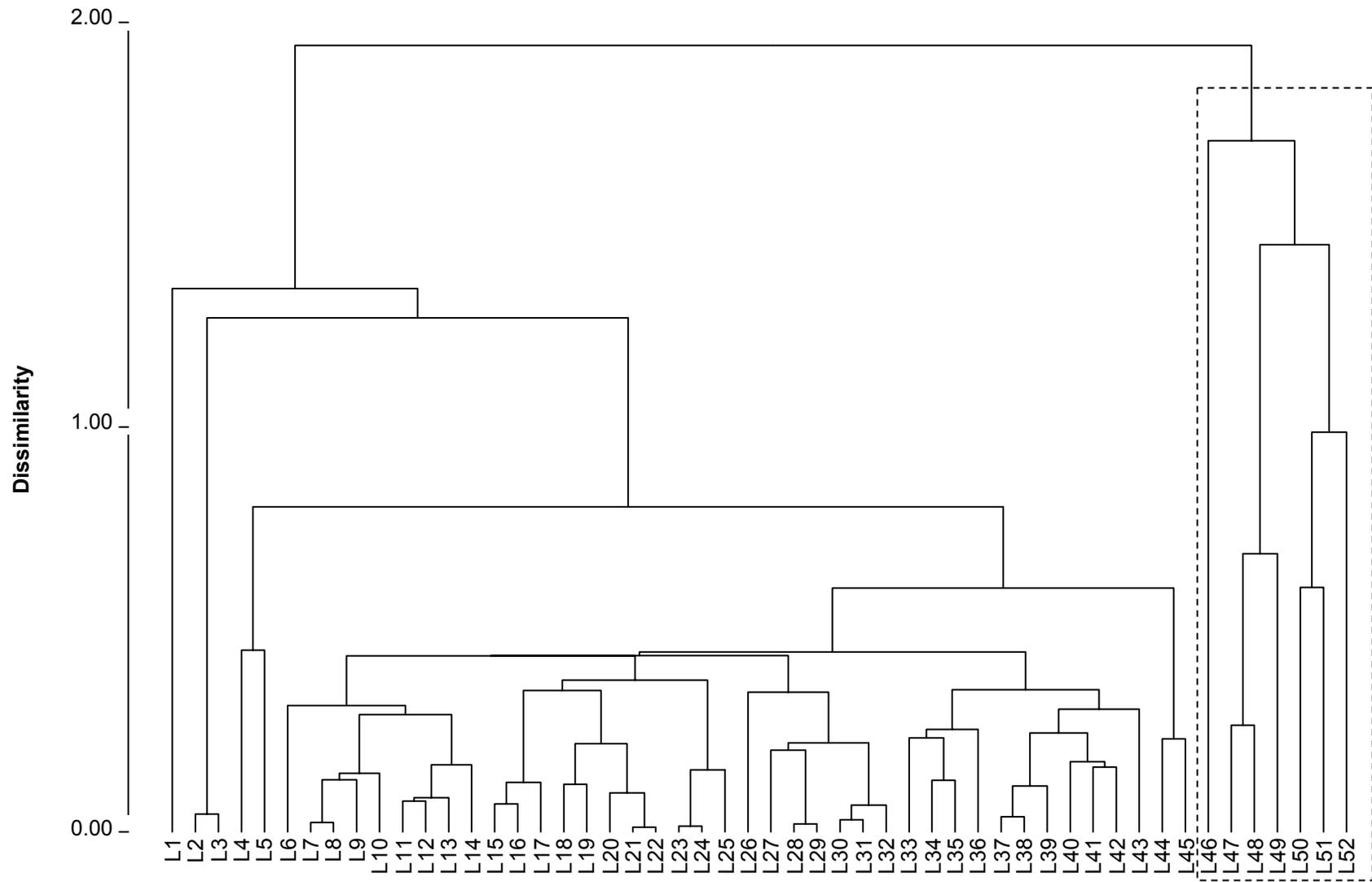


State cost per line model run data graphed as a histogram with the horizontal axis cost per line and the vertical axis frequency.

APPENDIX E

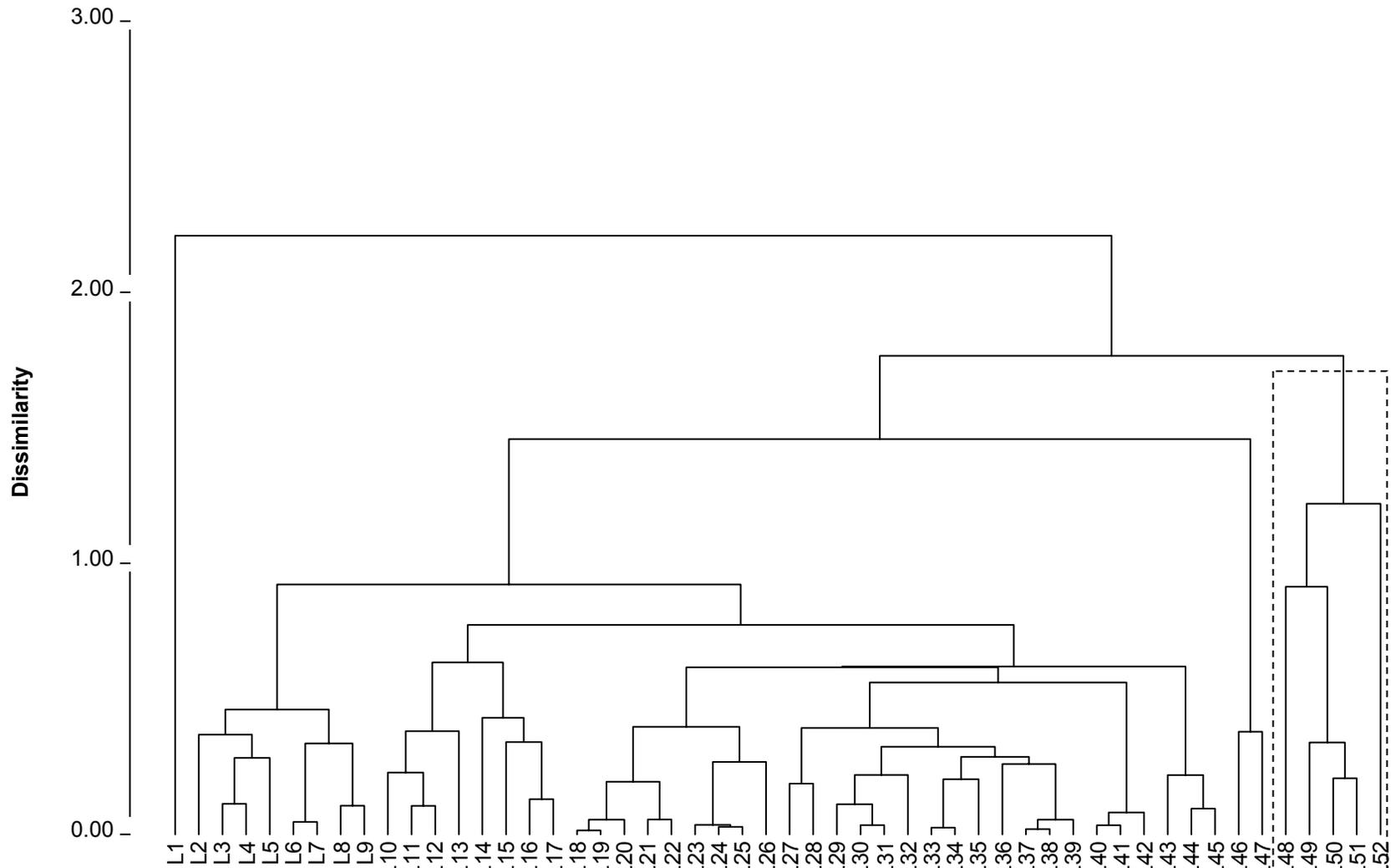
Cluster Analysis Based on Simulated Statewide Average Cost Per Line Data

Dendrogram 1 of Simulated Cluster Analysis*

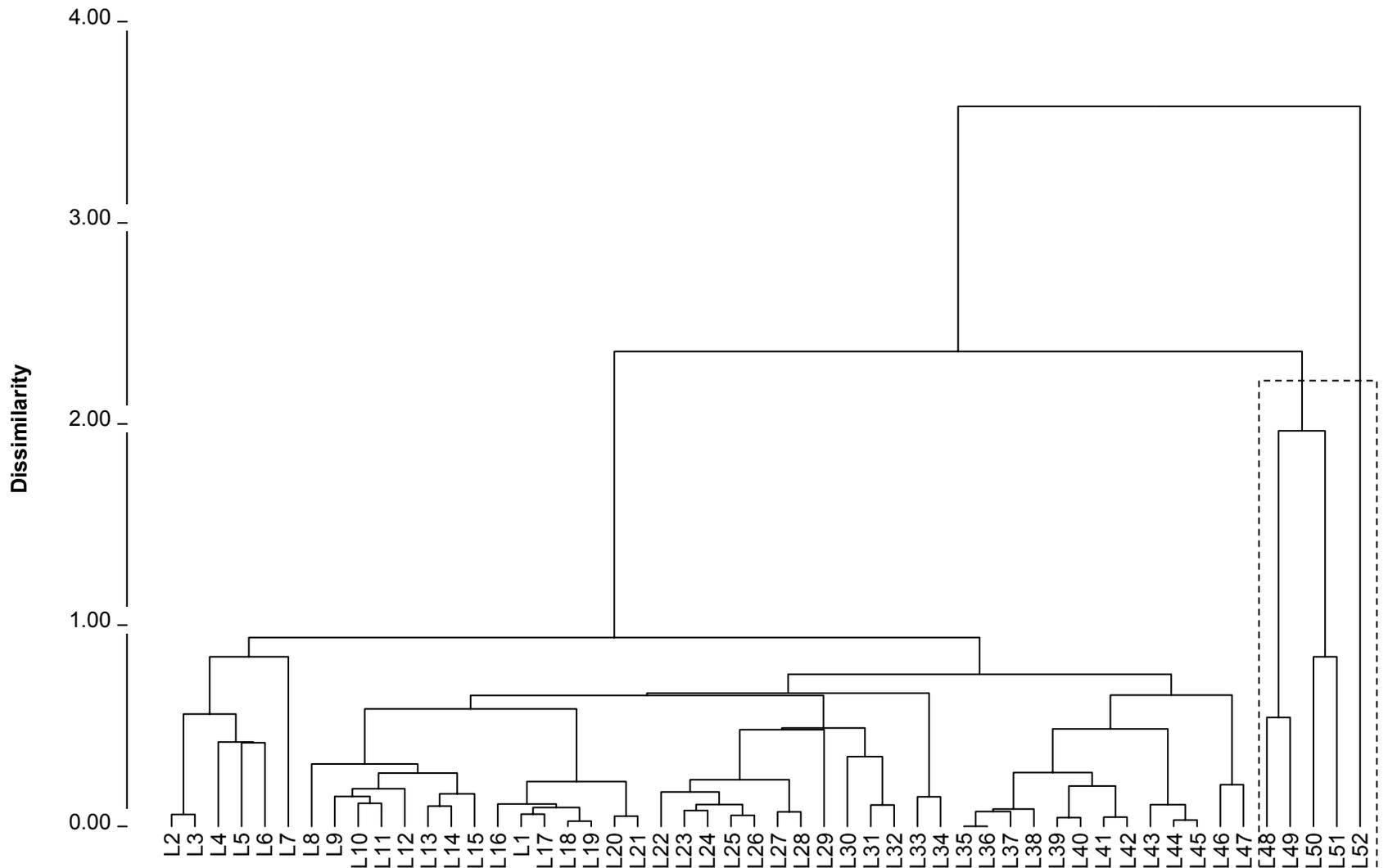


* Each chart reflects a cluster analysis of simulated cost data. A random number generator was applied to the fitted lognormal curve to simulate ten data sets of 52 cost data points (L1 to L52) representing 52 jurisdictions. See *Supra*, note 251 and accompanying text.

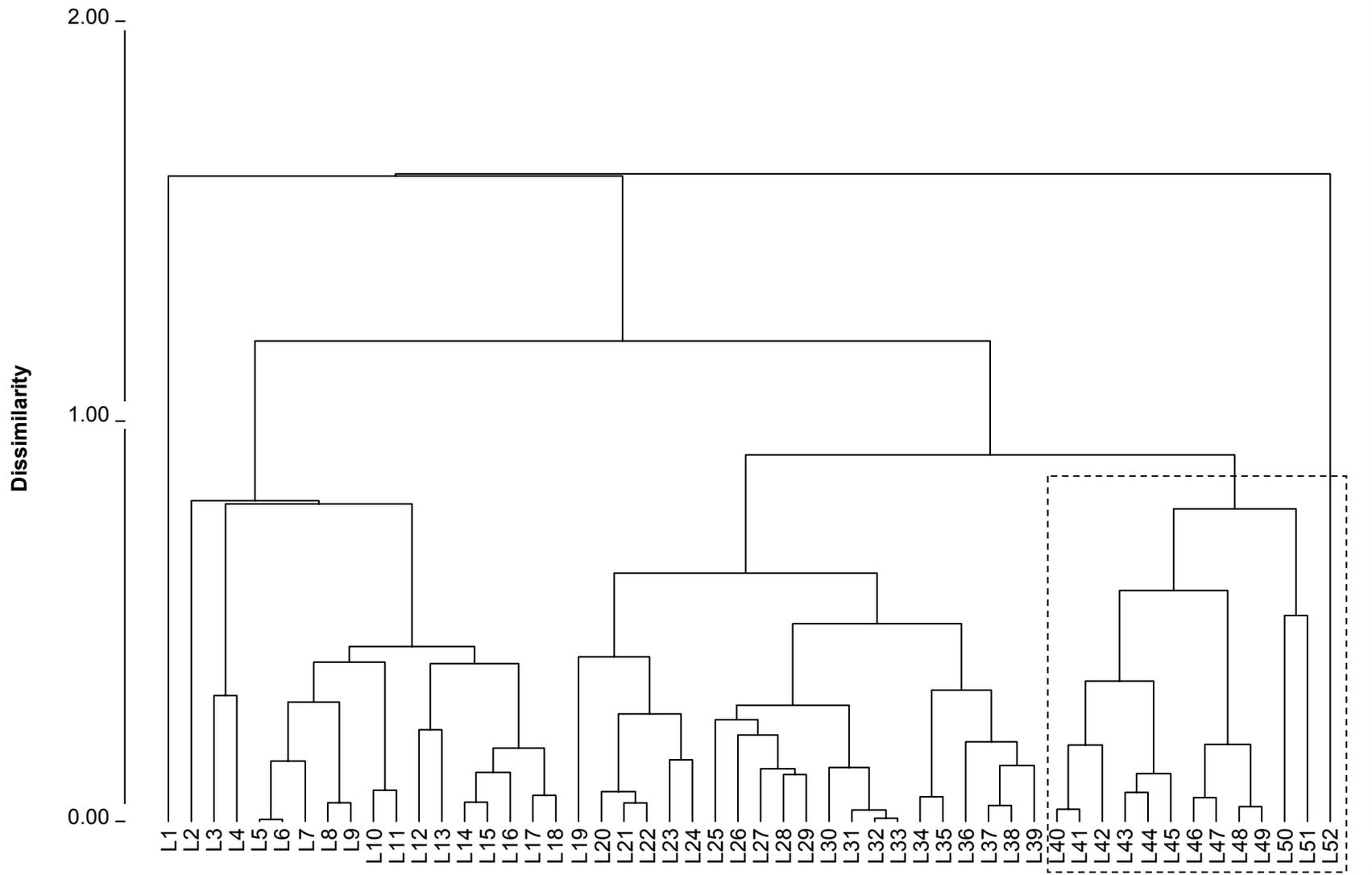
Dendrogram 2 of Simulated Clusters



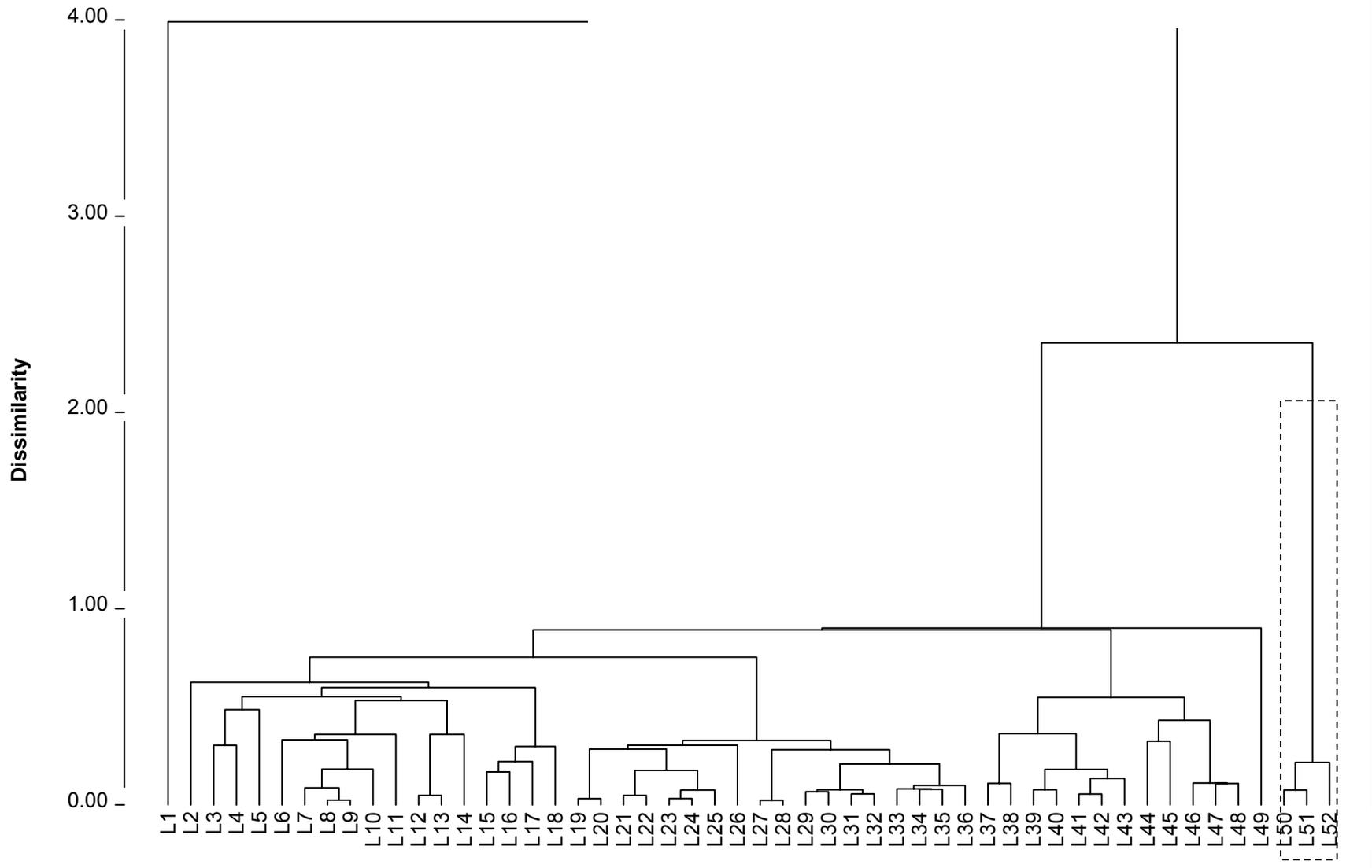
Dendrogram 3 of Simulated Clusters



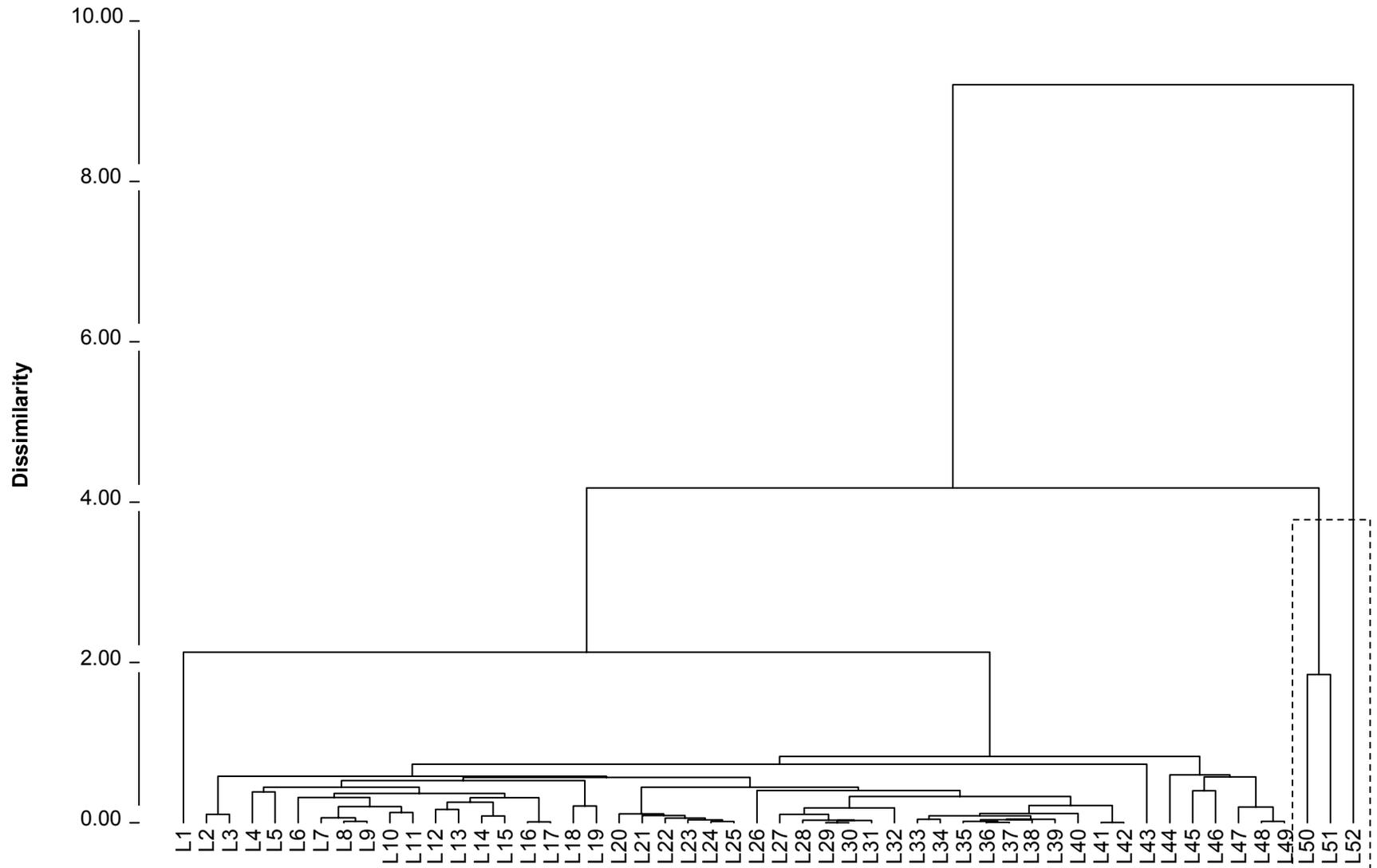
Dendrogram 4 of Simulated Clusters



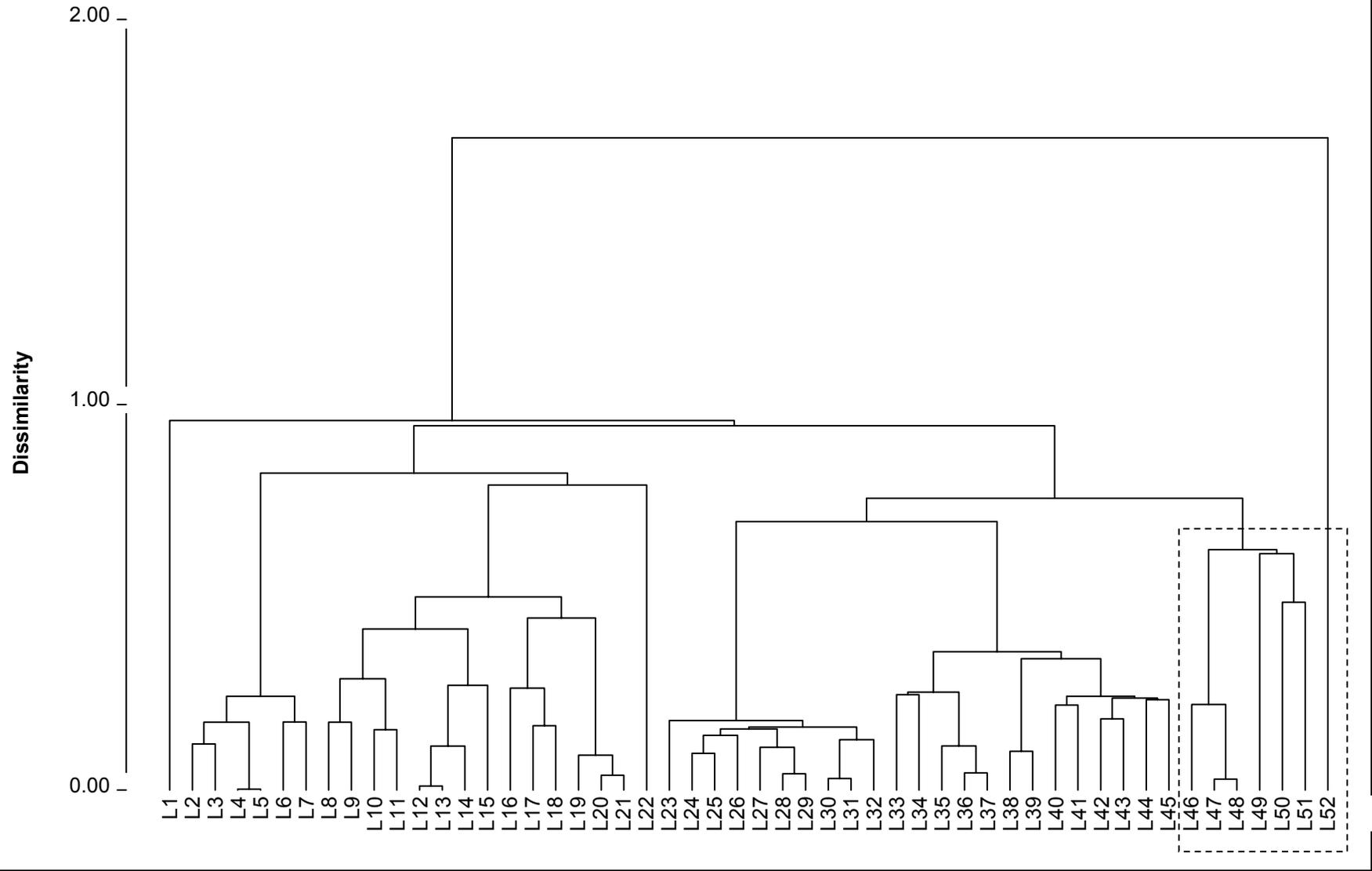
Dendrogram 5 of Simulated Clusters



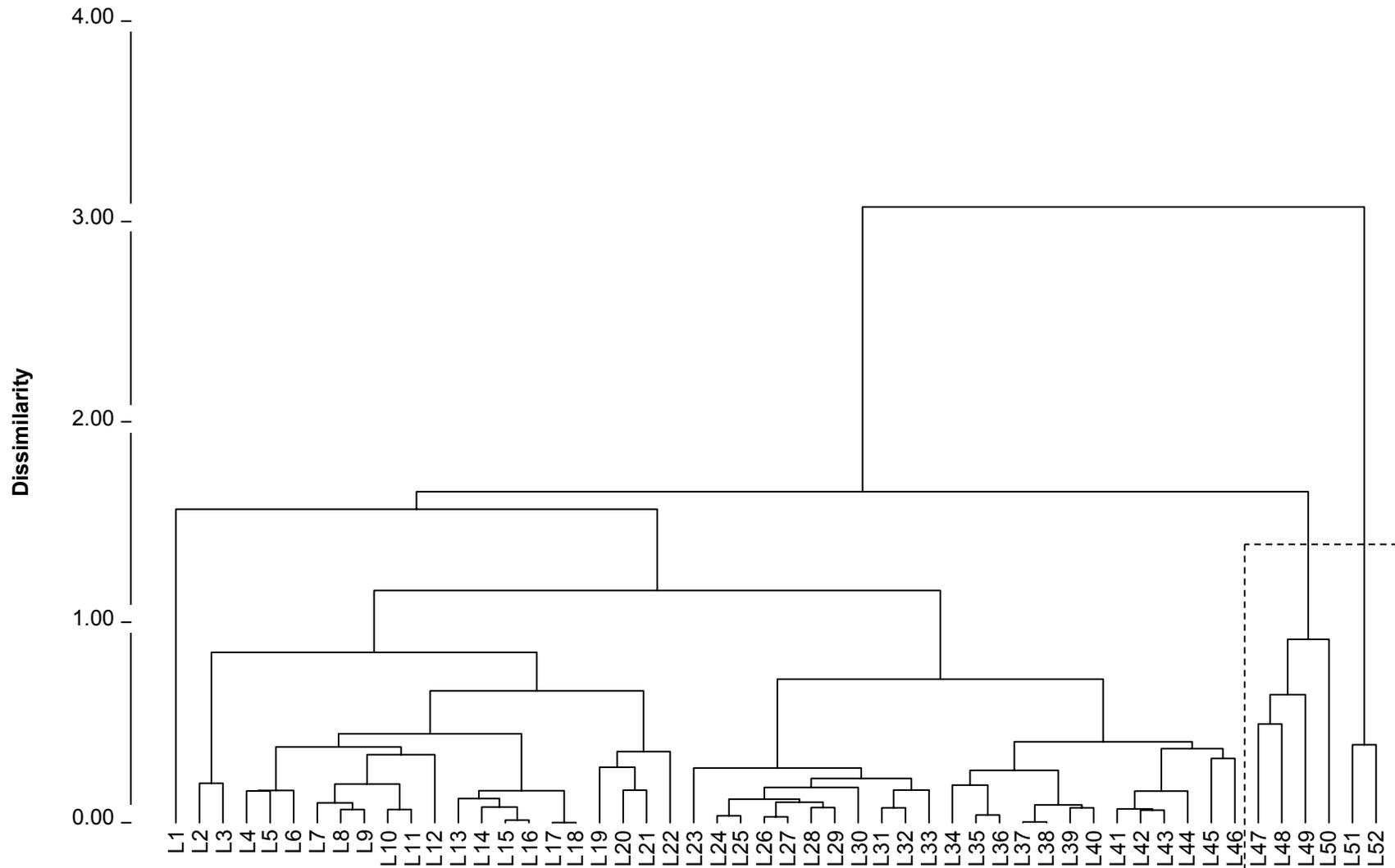
Dendrogram 6 of Simulated Clusters



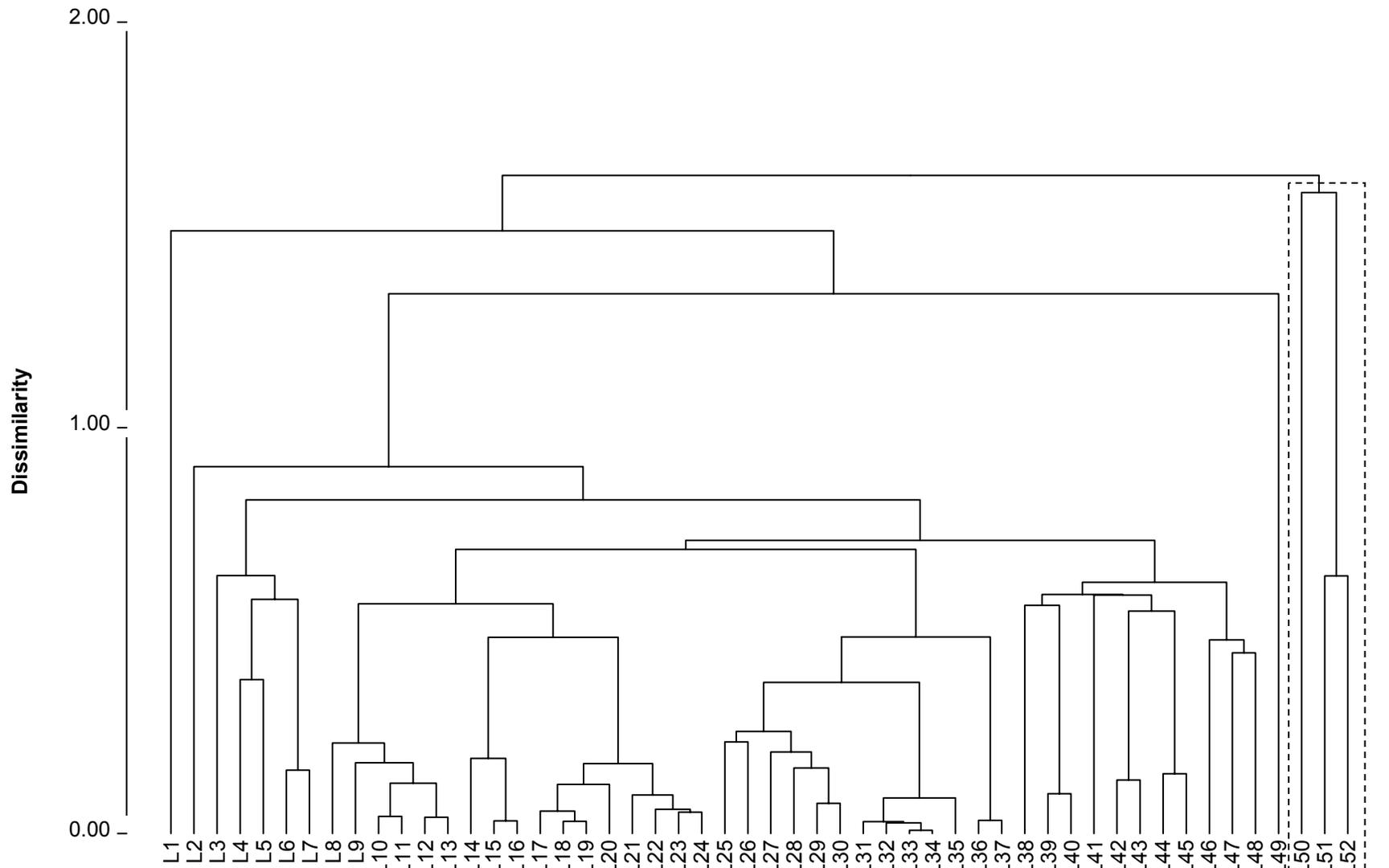
Dendrogram 7 of Simulated Clusters



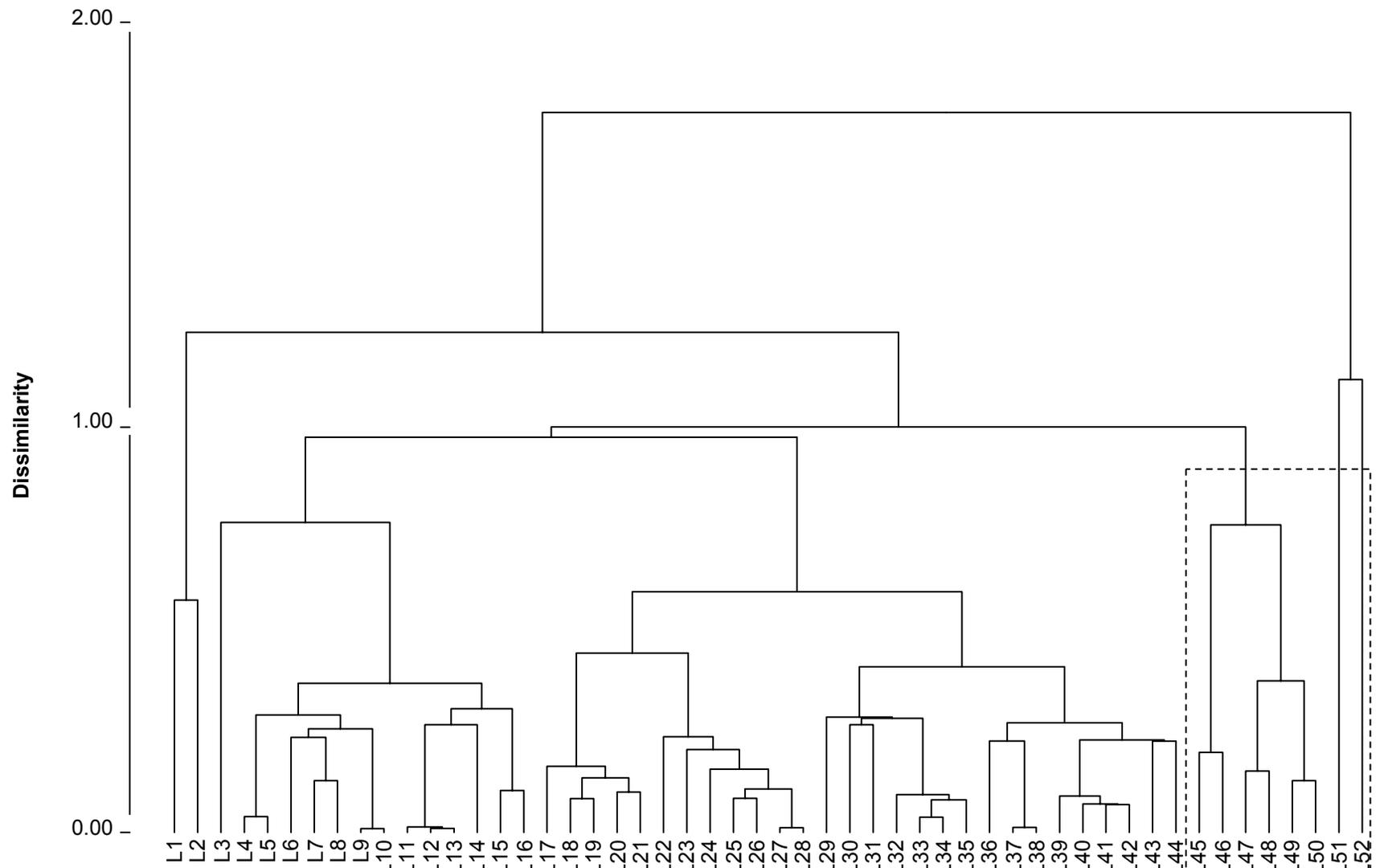
Dendrogram 8 of Simulated Clusters



Dendrogram 9 of Simulated Clusters



Dendrogram 10 of Simulated Clusters



APPENDIX F

Bureau Rate Survey

Residential Rate Review

Please update these data for October 15, 2002

I. Access Rates	Generally Available Service		Subsidized Services Such as Lifeline	
	(#1) Unlimited or Flat-Rate Service	(#2) Measured or Message Service	(#3) Unlimited or Flat-Rate Service	(#4) Measured or Message Service
Monthly Charges per Line a. Recurring service charge b. Federal subscriber line charge c. State subscriber line charge d. Touch-Tone monthly charge e. Lowest monthly inside wiring f. Optional extended area plan				
Charges for calls in the local service area g. The number of voice calls or message units included in the monthly recurring rate if message service h. The dollar calling allowance for voice calls included in the monthly recurring rate if measured service i. The charge for a 5-minute, business day, same-zone voice call				

II. Other Mandatory Monthly Charges Associated with Local Access

- a1. Mandatory percentage surcharge for USF passthrough
- a2. Other mandatory percent surcharges accounted as company revenue
- b1. Mandatory fixed amount surcharge for USF passthrough
- b2. Other mandatory fixed amount surcharges accounted as company revenue
- c. Percentage tax or surcharge for funding 911 service
- d. Fixed amount tax or surcharge for funding 911 service
- e. Federal excise tax rate
- f. Other percentage taxes (sales, excise, gross receipts, etc.) levied on monthly service by state county or local government
- g. Other fixed amount government taxes or surcharges

III. Service Connection Charges

- a. Total connection charge for rotary service if no premises visit is required
- b. Additional charge if company is connecting Touch-Tone service
- c. Minimum additional charge if drop line and terminal block are needed to connect service. Do not include any inside wiring charges.

Normal Service

Subsidized Service
(e.g., Link-Up)

IV. Other Mandatory Charges for Connection

- a. Mandatory percentage surcharges on connection accounted as company revenue
- b. State, county, and local taxes and surcharges on connection [total of % rates]
- c. Other mandatory connection charges

Notes

Form Completed by: _____ Contact Telephone Number: _____

APPENDIX G

Proposed Methods of Targeting Additional Federal Support

Proposed Levels of Additional Targeted Federal Support*

<u>STATE</u>	<u>25%</u>	<u>20%</u>	<u>15%</u>	<u>10%</u>	<u>5%</u>
AK	86,247	68,998	51,748	34,499	17,249
AL	14,089,895	11,271,916	8,453,937	5,635,958	2,817,979
AR	5,393,077	4,314,461	3,235,846	2,157,231	1,078,615
AZ	3,544,761	2,835,809	2,126,856	1,417,904	708,952
CA	15,571,160	12,456,928	9,342,696	6,228,464	3,114,232
CO	4,333,636	3,466,909	2,600,182	1,733,455	866,727
CT	13,622	10,898	8,173	5,449	2,724
DC	-	-	-	-	-
DE	122,737	98,190	73,642	49,095	24,547
FL	1,820,616	1,456,493	1,092,370	728,247	364,123
GA	4,447,137	3,557,710	2,668,282	1,778,855	889,427
HI	744,219	595,375	446,531	297,687	148,844
IA	2,203,372	1,762,698	1,322,023	881,349	440,674
ID	3,013,154	2,410,523	1,807,893	1,205,262	602,631
IL	13,962,653	11,170,122	8,377,592	5,585,061	2,792,531
IN	8,680,321	6,944,257	5,208,192	3,472,128	1,736,064
KS	4,868,330	3,894,664	2,920,998	1,947,332	973,666
KY	12,680,555	10,144,444	7,608,333	5,072,222	2,536,111
LA	9,945,778	7,956,623	5,967,467	3,978,311	1,989,156
MA	437,020	349,616	262,212	174,808	87,404
MD	834,342	667,474	500,605	333,737	166,868
ME	3,732,778	2,986,223	2,239,667	1,493,111	746,556
MI	11,236,163	8,988,930	6,741,698	4,494,465	2,247,233
MN	3,495,280	2,796,224	2,097,168	1,398,112	699,056
MO	15,100,304	12,080,243	9,060,182	6,040,121	3,020,061
MS	20,963,077	16,770,462	12,577,846	8,385,231	4,192,615
MT	5,850,211	4,680,169	3,510,127	2,340,084	1,170,042
NC	3,277,455	2,621,964	1,966,473	1,310,982	655,491
ND	1,301,696	1,041,357	781,017	520,678	260,339
NE	9,563,011	7,650,409	5,737,806	3,825,204	1,912,602
NH	797,075	637,660	478,245	318,830	159,415
NJ	-	-	-	-	-
NM	2,434,405	1,947,524	1,460,643	973,762	486,881
NV	6,168,957	4,935,166	3,701,374	2,467,583	1,233,791
NY	6,873,425	5,498,740	4,124,055	2,749,370	1,374,685
OH	10,496,923	8,397,538	6,298,154	4,198,769	2,099,385
OK	7,643,149	6,114,519	4,585,889	3,057,259	1,528,630
OR	4,847,665	3,878,132	2,908,599	1,939,066	969,533
PA	3,839,360	3,071,488	2,303,616	1,535,744	767,872
PR	195,471	156,377	117,283	78,189	39,094
RI	-	-	-	-	-
SC	2,344,486	1,875,589	1,406,691	937,794	468,897
SD	2,574,503	2,059,603	1,544,702	1,029,801	514,901
TN	5,956,883	4,765,506	3,574,130	2,382,753	1,191,377
TX	23,970,826	19,176,660	14,382,495	9,588,330	4,794,165
UT	826,729	661,383	496,038	330,692	165,346
VA	8,099,831	6,479,865	4,859,898	3,239,932	1,619,966
VT	2,408,155	1,926,524	1,444,893	963,262	481,631
WA	6,204,584	4,963,668	3,722,751	2,481,834	1,240,917
WI	3,559,407	2,847,526	2,135,644	1,423,763	711,881
WV	7,017,028	5,613,623	4,210,217	2,806,811	1,403,406
WY	2,731,463	2,185,170	1,638,878	1,092,585	546,293
Total	290,302,932	232,242,346	174,181,759	116,121,173	58,060,586

* This table shows the amount of additional targeted federal support that each state would receive at a given percentage of wire center costs exceeding a threshold of 2 standard deviations above the national average cost. See *supra* paras. 123-26, 132-33. These numbers are calculated by summing the individual wire center costs that exceed the average plus 2 standard deviations in each state, and multiplying by the given percentage. The District of Columbia, New Jersey and Rhode Island had no wire centers with costs that exceeded the average plus 2 standard deviations.

APPENDIX H

Parties Filing Comments and Reply Comments

CC Docket No. 96-45

Comments:

<u>Commenter</u>	<u>Abbreviation</u>
AT&T Corp.	AT&T
California Public Utilities Commission and of the People of the State of California	California
Competitive Universal Service Coalition	CUSC
Maine Public Utilities Commission	Maine
Missouri Office of the Public Counsel	Missouri
Montana Public Service Commission, Montana Consumer Counsel, Vermont Public Service Board, Vermont Department of Public Service	Montana and Vermont
National Association of State Utility Consumer Advocates	NASUCA
National Rural Telecom Association	NRTA
New York State Department of Public Service	New York
Qwest Communications International Inc.	Qwest
Rural Independent Competitive Alliance	RICA
SBC Communications	SBC
Sprint Corporation	Sprint
SureWest Communications	SureWest
Texas Public Utility Commission	Texas
United States Telecom Association	USTA
Verizon Telephone Companies	Verizon
Public Service Commission of Wisconsin	Wisconsin
Wyoming Public Service Commission	Wyoming

Reply Comments:

<u>Commenter</u>	<u>Abbreviation</u>
AT&T Corporation	AT&T
GVNW Consulting, Inc.	GVNW
Maine Public Utilities Commission	Maine
National Association of State Utility Consumer Advocates	NASUCA
Qwest Communications International Inc.	Qwest
SBC Communications Inc.	SBC
Sprint Corporation	Sprint

Surewest Communications
Verizon
WorldCom, Inc.

Surewest
Verizon
WorldCom

**SEPARATE STATEMENT OF
CHAIRMAN MICHAEL K. POWELL**

In many ways, our action today is the ultimate truth-in-billing measure. In 1996, Congress recognized that the amalgam of implicit support mechanisms that had creaked along in a monopoly environment would no longer function in a competitive market for the simple reason that companies would abandon the artificially unprofitable markets and swarm the artificially profitable ones. In adopting the 1996 Act, Congress directed the Commission and the states to stop doing what they had done for sixty years. Rather than require companies to artificially lower prices on high-cost residential lines, Congress directed this Commission to meet the goals of affordability and ubiquity by providing consumers with explicit discounts for supported telecommunications services. And rather than permitting companies to recoup costs for unprofitable lines through higher prices for business services Congress directed us to take steps in furtherance of a regulatory regime where retail rate structures reflect the cost of providing service.

In the face of years of hidden costs, uneconomic pricing and cross-subsidies, Congress gave the Commission the difficult task of determining the “real” cost of service in all parts of the country, maintaining a fund sufficient to provide reasonably comparable rates and distributing money in an equitable manner. Today’s *Order and Further Notice* moves the nation one step closer to dismantling the system of false pricing information that regulators have imposed on the public. Admittedly, our action today does not eliminate all implicit support in local rate structures. However, I remain convinced that in a competitive market, we can only achieve Congress’ universal service goals by creating an explicit support fund to benefit consumers who need it and by eliminating the vestiges of implicit support that misallocate resources and distort competition.

Over the last seven years, the Commission has adopted several measures to establish explicit universal support mechanisms that remain resilient to intense competition, including a federal high-cost universal service support mechanism for non-rural carriers based on forward-looking economic cost. Consistent with the Act, the Commission’s 1999 *Ninth Report and Order* chose to determine the amount of federal support given to non-rural carriers in each state by comparing the statewide average cost per line, as estimated by the Commission’s forward-looking cost model, to a nationwide cost benchmark of the national average cost. Non-rural carriers whose costs exceed the benchmark would receive universal-service support.

I voted in favor of the *Ninth Report and Order*, because I believed it is “imperative that we introduce some notion of economic cost into universal service support.”¹ While I questioned the adequacy of the Commission’s rationale, I said then that, without some type of a forward-

¹ Separate Statement of Commissioner Michael K. Powell, Concurring in Part, *Federal-State Joint Board on Universal Service*, Ninth Report and Order and Eighteenth Order on Reconsideration, CC Docket No. 99-45, 14 FCC Rcd. 20432 (1999).

looking economic cost model, states and carriers would have had no objective way of knowing how much money they needed, much less where they should spend the money they got.²

In the appellate litigation that followed the *Ninth Report and Order*, the Tenth Circuit largely agreed with the Commission's ruling. It upheld the Commission's cost model, though it remanded the methodology for determining the precise level of non-rural support for further analysis. Specifically, the Tenth Circuit directed us to define the statutory terms "reasonably comparable" and "sufficient" more precisely and then to assess whether and how the non-rural mechanism we choose would prove sufficient to achieve the statutory principle of making rural and urban rates reasonable comparable. The Tenth Circuit also told us to do more to induce states to ensure local rate comparability and to create positive incentives for them to abandon their long-standing practice of permitting implicit cost subsidies based on little more than back-of-the-envelope perceptions of need.

Today's order fulfills the Tenth Circuit's directives. We have taken this opportunity to define our goals more precisely and we have done a better job in determining that support which is "sufficient" to achieve "reasonably comparable" rates. We have also adopted a rational threshold to determine when non-rural, high-cost support should become available by balancing legitimate state need against the risk of excessive support. And we have reviewed our comprehensive plan for supporting universal service in high cost areas and sought comment on how to adapt the overall plan to meet changing conditions. I support fine-tuning our forward-looking cost model by comparing statewide average costs to a nationwide cost benchmark closely tied to relevant market data. I also support measures such as the expanded rate-review and certification processes that should induce states to achieve reasonably comparable rates in response to the court's remand. I look forward to working with my colleagues in the states to achieve the long-term goal of dismantling the system of cross-subsidies that persists in many of the nation's telephone rates.

The creation of a rational, economically sound support mechanism, of course, is only one half of the solution to the problem of cross subsidies in the telecommunications market. The other half of the solution lies in the *Triennial Review Order*. No matter how rational and well reasoned, an economic support mechanism will prove meaningless if states remain able to avoid its strictures simply by offering suppliers the option of buying essential telecommunications inputs at super-efficient prices – untethered from the realities of providing that wholesale service. While I therefore support today's decision, true reform will prove elusive as long as the other half of the problem – the pricing of wholesale inputs – goes unaddressed. For this reason, we should redouble our efforts along a number of different regulatory vectors. We should seek out new ways for federal and state regulators to work together and rationalize state support mechanism to achieve Congress' twin goals of universal service and sustainable local competition. At the same time, the Commission's universal service focus will turn to the Joint Board's recommendation in the *Portability* proceeding and the Commission's efforts to ensure that wholesale rate structures more accurately reflect the forward-looking economic costs of providing service to competitors.

² *Id.*

**SEPARATE STATEMENT OF
COMMISSIONER KATHLEEN Q. ABERNATHY**

Today we bring closure to the complex set of rules that allocate universal service funds to non-rural carriers. These companies are the largest carriers providing telecommunications service across the United States. Although most of the high cost loop support is directed to smaller rural carriers (well-over 90%), the non-rural carriers are also a critical component of the success of USF in America. In some states, for example, the non-rural carrier may be the primary provider of communications service for rural Americans. Given this critical position, the USF Joint Board and the FCC were dedicated to crafting high-cost support rules that would ensure comparable rural and urban rates for areas served by the non-rural carriers.

Today's order reflects that effort. First, we adopt a more precise definition of the statutory terms "sufficient" and "reasonably comparable" for purposes of the non-rural support mechanism. Second, we adopt a methodology for setting a national average cost per line benchmark. Third, we have created an expanded annual certification process, which provides an inducement to states to achieve reasonably comparable rates. This mandatory review process encourages each state to examine whether its policies are achieving rate comparability and if not, to take such action as necessary to do so. It also enables the Commission to evaluate whether the non-rural mechanism is achieving the goal of reasonable comparability among states, while placing primary responsibility on the states and giving each state the flexibility to regulate basic rates and services.

I believe the modifications we are making to our Universal Service requirements address the concerns outlined by the Tenth Circuit. The order also furthers the goals of the Communications Act by ensuring that there are reasonably comparable urban and rural rates for all customers served by non-rural carriers.

**SEPARATE STATEMENT OF
COMMISSIONER MICHAEL J. COPPS**

Universal service policy is built on the principle that all of us benefit when more of us are connected. This principle resides at the core of the Telecommunications Act. And Congress made clear that the Commission must be working to ensure that all Americans—rural, urban and everything in between—have access to reasonably comparable services at reasonably comparable rates.

Today, we bring needed clarity to this concept by retooling our mechanism for non-rural carrier high-cost support. I am pleased that in this item we define key statutory terms and adopt further measures to induce States to ensure reasonable comparability of rural and urban rates. At last, we can remove the non-rural high-cost mechanism out from under the cloud of judicial remand that has hovered over it for more than two years. Our action today represents a measured step in the right direction and I support it.

I still have, however, a reservation or two with respect to where we are headed. Today's decision adopts the use of statewide average costs as part of the mechanism to direct support to non-rural carriers serving high-cost States. I support this approach, but recognize that some have argued that the selection of statewide average costs disadvantages non-rural carriers providing service in States with significant rural and urban areas. I think the best course going forward is to monitor carefully the methodology we have chosen here. If the statewide average approach provides insufficient support, resulting in rates that are not reasonably comparable, we will have no choice under the statute but to reconsider.

I also am concerned that rates for basic service that are two standard deviations higher than the average urban rate may not always be the right metric for determining reasonably comparable rates. However, I believe we provide States with ample opportunity through the rate review and certification process to demonstrate that factors other than basic service rates affect the comparability of their rates.

Finally, I wish to note that today's item applies only to non-rural carriers. The assumptions that buttress our analysis here—like using statewide average costs—may not prove appropriate when we consider sufficient support for rural carriers.

As technical as this decision is, the goal that undergirds it is simple. Congress charged us to ensure that comparable technologies are available all across the country at affordable and roughly equivalent rates. Our actions here endeavor to advance that goal. This is what the statute mandates, what the public interest requires and what this item sets us on the road to accomplish.

**SEPARATE STATEMENT OF
COMMISSIONER JONATHAN S. ADELSTEIN**

With the passage of the Telecommunications Act, Congress affirmed the broad principle that “consumers in all regions of the nation ... should have access to telecommunications and information services that are reasonably comparable to those available in urban areas and at rates that are reasonably comparable to rates charged for similar services in urban areas.” This simple, elegantly-stated principle is at the heart of our universal service policy and is the focus of our attention today.

Through this Order, we modify our universal service funding mechanisms for non-rural telephone companies. By “non-rural telephone companies,” we refer to some of the largest local exchange carriers in the nation. These companies serve rural areas in numerous states, but also serve non-rural areas including most of the urban, low-cost areas in any given state. I emphasize that this order applies only to the non-rural universal service funding mechanisms and I am pleased that this Order continues to recognize the fundamental geographic, economic, and demographic differences between rural and non-rural carriers.¹

This Order responds to a decision of the United States Court of Appeals for the Tenth Circuit, which had remanded our prior rules to us for further consideration and explanation. I believe that this Order speaks to the concerns raised by the Tenth Circuit Court of Appeals by providing meaningful definitions for key terms in the Act and by adopting a two part mechanism for federal universal service funding to non-rural carriers. The Order is based largely on the helpful recommendations of the Federal-State Board for Universal Service. When this Recommended Decision was adopted, I had not yet had the pleasure of joining this Commission or the Joint Board, so I would like to take this opportunity to thank my colleagues on the Joint Board, both present and past, for their hard work on this proceeding.

The Order affirms our practice of comparing statewide average costs to a nationwide cost benchmark to determine federal non-rural high cost support. In addition, we take an important step toward ensuring the reasonable comparability of rates by adopting a supplementary rate review that can form the basis for additional federal support. Some have found fault with our reliance on cost as the primary basis for non-rural support, while others have criticized our two part approach – looking both at cost and at rates. In the end, I believe that ensuring that

¹ Rural carriers continue to be governed by the Rural Task Force Order, which runs through 2006. *See Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11249, para. 11 (2001) (Rural Task Force Order).

consumers in rural areas have access to comparable service at comparable rates is one of our top priorities and I believe that we take a reasonable approach in this item.

We leave for tomorrow several key details of the supplemental rate review, including judgments about what specific showings will be required for additional federal support. I am pleased the item permits states to consider the calling scopes available in rural areas served by non-rural carriers when reviewing whether rates in those areas are comparable to urban rates nationwide and that the item seeks comment on whether and how consideration of calling scopes might be incorporated into the basic template. I look forward to working on these issues with my colleagues and hope that we can provide necessary clarification as soon as possible.

Finally, I note that this Order relies on recent data from the General Accounting Office showing that most rural and urban rates are currently reasonably comparable; this finding supports our conclusion that federal universal service support is set at a reasonable level. That said, it is important that we continue to monitor the effectiveness of the actions we take here. I believe that the new rate data that we will obtain through the expanded certification process will be essential for that purpose and can only help us in our efforts to “preserve and advance” universal service. We can all take pride in the success of our universal service programs and I am pleased to support this item.

STATEMENT OF COMMISSIONER KEVIN J. MARTIN
Approving in Part, Dissenting in Part

I appreciate the efforts of my colleagues to address some of the concerns I raised with the Joint Board recommendation. For the reasons set forth in my attached statement¹, I believe that today's decision continues to fall short in its response to the court mandate and our obligation to ensure that consumers living in rural and high cost areas have access to similar telecommunications services at rates that are reasonably comparable to rates paid by urban consumers.

¹ Statement of Commissioner Kevin J. Martin, Approving in Part, Dissenting in Part, *Federal-State Joint Board on Universal Service, Joint Board Recommended Decision* (Oct. 16, 2002).

**STATEMENT OF
COMMISSIONER KEVIN J. MARTIN
Approving in Part, Dissenting in Part**

Joint Board Recommended Decision

I wish to thank all my colleagues on the Federal-State Joint Board for their hard work and contributions in the effort to reach consensus on the important issue of establishing a universal service support system for non-rural carriers. I believe that today's effort, however, falls short in meeting our obligation to ensure that consumers living in rural and high cost areas have access to similar telecommunications services at rates that are reasonably comparable to rates paid by urban consumers.

Congress gave the Commission a clear mandate: to ensure that consumers in all regions of the nation have access to services that "...are reasonably comparable to those services provided in urban areas and that are available *at rates that are reasonably comparable to rates charged for similar services in urban areas* (emphasis added)."¹ Congress' direction is also clear regarding the obligation to establish mechanisms that are "...specific, predictable and sufficient...to preserve and advance universal service."² In remanding the Commission's previous attempt to establish a federal-high cost universal service support mechanism for non-rural carriers, the United States Court of Appeals for the Tenth Circuit agreed that these fundamental guiding principles govern Commission action on any policies regarding universal service support mechanisms.³

Despite this remand, the majority's recommendation essentially reaffirms the Commission's existing universal service support mechanism for non-rural carriers. The decision continues to base support on forward looking costs and creates a sparsely defined second supplemental support system based on rate comparisons. Today's recommendation falls short in its response to the court mandate that we define the statutory term "reasonably comparable" for purposes of the cost-based support mechanism and fails to demonstrate, with any degree of specificity, how the proposed secondary mechanism will satisfy the statutory requirement that universal service support be "specific, predictable and sufficient."

¹ See 47 U.S.C. 254(b)(3).

² See 47 U.S.C. 254(b)(5).

³ *Federal-State Join Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432(1999)(*Ninth Report and Order*) remanded, *Qwest Corp. v. FCC*, 258 F.3d 1191, 1199 (10th Cir. 2001).

For these and the reasons explained below, I respectfully dissent from portions of the majority opinion today.⁴

Use of Costs as a Surrogate for Rates to Determine Non-Rural High Cost Support

Section 254(b)(3) of the Communications Act requires that universal service support mechanism ensure that telecommunications services in all regions of the nation be provided at reasonably comparable “rates.” The majority, however, recommends continuing the practice of using costs rather than rates to determine federal support. I am not convinced that a mechanism based solely on costs would meet the statutory mandate requiring a comparison of rates.

Moreover, I fear that the recommended decision may be either arbitrary or not fully thought through. If the Joint Board is confident that a cost-based support system satisfies our statutory obligation to produce reasonably comparable rates, then why does it propose establishing an entirely new support mechanism based on rate comparisons? Similarly, if the Commission were to adopt the Joint Board’s recommended “supplemental rate comparability review,” why should it not abandon the cost-based support mechanism and instead rely solely on the rate-based support mechanism? If we need the supplemental rate comparison to meet our statutory obligation, would it not be simpler to have only one mechanism rather than two? These questions seem to remain unanswered by the majority.

The majority’s rejection of rate-based distribution and support for a cost-based mechanism is based on two arguments: (i) an analysis of disparate local rate design practices throughout the nation remains too difficult a task; and (ii) the use of costs reflects the federal government’s primary obligation to support only those states that “do not have the resources within their borders to support all of their high cost lines.”⁵ In my view, both of these arguments fail to support the Joint Board’s position.

First, in response to the argument that such an analysis is too difficult, the majority appears to create just such an analysis in its “supplemental rate comparability review.” The majority also fails to note or even address the fact that many of the issues and data necessary to perform a rate-based comparison will be needed in the context of initiating the proposed catch all “supplemental rate comparability review.” On its face, one well-defined support mechanism based on rate comparisons would appear to present an equal or lesser administrative burden for the Commission, the states and carriers compared to the dual cost-based and rate-based mechanisms recommended by the majority today.

The majority’s recommendation also contains an inherent presumption that the federal government’s role in establishing a support mechanism is apparently limited to equalizing cost discrepancies between states but not equalizing rate discrepancies between rural and urban

⁴ In addition to the reasons discussed below, I also agree with and join in many of the concerns raised in Commissioner Bob Rowe’s thorough and thoughtful analysis in his dissent.

⁵ Recommended Decision at paras. 19-21, 24.

areas.⁶ I disagree. The statute is clear. Our job is to ensure that services in rural and high cost areas are “available at rates that are reasonably comparable to rates charged for similar services in urban areas.”⁷ The 10th Circuit explicitly rejected the FCC’s contention that it had no duty to ensure the reasonable comparability of rural and urban rates and stated that we are “obligated to formulate policies so as to achieve the goal of reasonable comparability...”⁸

In my view, if the Commission is only going to address discrepancies between and among states, then there must be a requirement that states address such discrepancies within their borders. Whether such a requirement compels rate averaging within states or requires that a state universal service mechanism be in place, such action must address differences in cost between rural and urban areas. Yet this decision fails to require that such inequities between urban and rural rates be addressed.⁹

The proposed expanded rate certification mechanism is insufficient. Under the proposed certification process, states would be permitted to report rates that are not “reasonably comparable” according to the benchmark. Such rates could eventually be allowed to meet the “reasonably comparable” standard if a state demonstrates “additional services included in the basic service rate” or by outlining “the method in which the state has targeted existing universal service support.”¹⁰ In my view, such a certification process is insufficient without a standard enunciating the allowable discrepancy for intrastate rates.

Sufficiency of High-Cost Support under the National Average Cost Benchmark

Even if costs can be used as a surrogate, I question the majority’s recommendation to use the 135% benchmark to ensure that rural rates are “reasonably comparable.”

⁶ Recommended Decision at paras. 25-26. “The Commission’s primary role is to identify those states that do not have the resources within their borders to support all of their high-cost lines.... The Commission explained in the *Ninth Report and Order* that the non-rural high cost support mechanism “has the effect of shifting money from relatively low-cost states to relatively high-cost states. The Commission believed that its non-rural support mechanism ensured that no state with costs greater than the national benchmark would be forced to keep rates reasonably comparable without the benefit of federal support.... We continue to support these policies.”

⁷ 47 U.S.C. 254(3).

⁸ 258 F.3d at 1200.

⁹ See *Ninth Report and Order* at 20482-3, para. 95 (The Commission found it most appropriate to allow states to determine how non-rural cost support is used, “[b]ecause the support...is intended to enable the reasonable comparability of intrastate rates, and states have primary jurisdiction over intrastate rates.”; see *id.* At 20483, para. 96 (“As long as the uses prescribed by the state are consistent with 254(e), we believe that states should have the flexibility to decide how carriers use support provided by the federal mechanism.”). See Recommended Decision at paras. 43-56. Even in light of the 10th Circuit remand requiring the Commission to consider appropriate state inducements to address reasonably comparable rates, the Joint Board fails to consider recommending either a state averaging mandate or mandatory state universal service mechanism requirement to address discrepancies between costs in rural and urban areas.

¹⁰ Recommended Decision at para. 55.

In deciding to proceed with a cost-based methodology to ensure reasonably comparable “rural” and “urban” rates, we should compare “rural” costs to average “urban” costs. The Commission certainly has data readily available to perform this comparison. Under the Synthesis Cost model, cost data can be produced by density zone or at the wire center level. Yet, the majority summarily rejects the concept of an “urban benchmark,” setting a benchmark at 135 percent of national average cost. In the process, the decision sidesteps the question of whether the benchmark produces sufficient support in light of the existing disparity between national average cost and the lower average urban cost.

As Commissioner Rowe notes, the majority’s rejection of the urban benchmark is “confusing and unpersuasive.”¹¹ The majority never tackles the uncomfortable fact that the 135 percent benchmark is too high because national average costs are already higher than urban costs because they include in the national average the very rural areas at issue. In other words, the high costs associated with serving rural areas are used twice: once to raise the national average and again in comparison.

Let me illustrate my concern with a simple example. If half of the country lived in an urban area with costs of \$10 and the other half of the country lived in a rural area with costs of \$30, the difference between the costs of the average urban area and average rural area would be \$20. But if a national average were taken, including the costs of the rural areas, the national average cost would be \$20. If support were then based on the difference between the rural cost (\$30) and 135% of the national average ($1.35 \times \$20 = \27), each rural resident would have costs of \$27 (\$30-\$3 of support) and each urban resident would have costs of \$13 (\$10 + \$3 of support). I do not believe that such a methodology sufficiently addresses the reasonable comparability of rural and urban costs. The inclusion of rural costs in the average along with the adoption of a 135% benchmark systematically underestimates the costs of rural areas.¹²

Instead, the majority finds fault with the use of an urban benchmark based on the fact that it “substitutes costs for rates” and “compares statewide average costs to nationwide urban costs.”¹³ The majority’s criticism appears strangely out of place given that its own recommendation is also based on a cost-based support system. I find it ironic that the majority can justify its “existing system on the ground that costs equal rates, and at the same time rejects all changes on the ground that costs do not equal rates.”¹⁴

¹¹ See Commissioner Bob Rowe’s Separate Statement at 8.

¹² National averages could be used without a benchmark or urban averages could be used with a benchmark but the combination of the two mechanisms is arbitrary.

¹³ Recommended Decision at para. 39.

¹⁴ See Commissioner Bob Rowe’s Separate Statement at 8.

It also rejects the urban benchmark because it would “require more funding or a higher benchmark level because urban average costs are lower than national average costs.”¹⁵ I fail to see how the potential for greater funding levels should prevent us from adopting a support system that meets our statutory obligation.¹⁶ Indeed, I fear that this reasoning reflects an analysis that concluded first that there would be no additional funding for rural areas and second adopted a mechanism to assess “reasonable comparability” that achieved that result. I believe our statutory obligation was to achieve reasonably comparable urban and rural rates even if that “requires more funding” than the current system provides.

Nor do I understand how the majority reaches the conclusion that the urban cost benchmark fails to “better satisfy the statutory comparison of urban and rural rates.”¹⁷ I join Commissioner Rowe in questioning how the majority finds that additional “incremental support would be ineffective at producing comparable rates, but existing support passes the test.”

In addition, I question the use of forward-looking costs as the basis for distributing universal service support. Today, rates are set in most states through the use of actual costs not hypothetical replacement costs. Forward-looking costs have little, if any, nexus to the establishment of end user retail rates. Use of these costs for calculating universal service support results in support being provided to some areas with low end user rates while certain areas that have high rates receive insufficient support. In my view, we could better achieve comparability of rates if we based our universal service support system on actual rather than forward looking costs.

Finally, the majority cites three studies/analyses in support of its decision to continue using the 135 percent benchmark. I disagree with the majority’s conclusion that these studies support its decision to retain the benchmark. First, the majority points to the General Accounting Office (GAO) study to show that national averages of rural, suburban and urban rates are affordable and reasonably comparable. The majority, however, fails to acknowledge serious deficiencies in the GAO study that fail to support the use of the benchmark for non-rural carriers.¹⁸ For example, the GAO study includes data from areas served by rural carriers, areas that are not relevant to the establishment of non-rural carrier support system. In addition, GAO’s rate comparison ignores whether rates in different service areas apply to comparable services. Moreover, national averages cited by GAO do not assist the Commission in addressing our core responsibility of whether rates in certain rural or high cost areas are comparable to rates in urban areas, or even whether rates vary significantly from state-to-state. To the contrary, as Commissioner Rowe

¹⁵ Id. at 40.

¹⁶ The United States Department of Agriculture’s Rural Utilities Service (RUS) recommended adoption of a benchmark tied to the national average urban loop cost or another statistical indicator more representative of urban costs, not the national average costs. RUS notes that 135% of the national average (urban and rural) “loop cost” exceed its estimate of urban “loop costs” by 233%.

¹⁷ Recommended Decision at 39. (emphasis in original).

¹⁸ See also Commissioner Rowe’s Separate Statement at 2-3.

points out, GAO's data demonstrates a vast disparity on state rates (e.g., residential rates at two Wyoming locations exceeding \$40 versus residential rates in Roaring Springs, Texas of \$7.10).¹⁹

I also join Commissioner Rowe's dissent asserting that a standard deviation analysis fails to justify the current benchmark.²⁰ I find it particularly troubling that the majority arbitrarily raises the benchmark to 135 percent even in light of its own analysis demonstrating that 2.0 standard deviation above the national mean results in a 132 percent benchmark. The majority offers no reasoned basis why states should be denied the additional \$.50 per customer per month of support that would result by applying the results of the majority's own standard deviation analysis.

Supplementary Rate Review

The majority, in today's recommendation, sets forth an additional supplemental process for rate comparison. It recommends adopting a new and vaguely defined supplemental mechanism. Rather than provide a clearly defined mechanism the majority instead offers an ad hoc process where the specific mechanisms will apparently develop on a case-by-case basis.²¹ The majority envisions a process where States seeking additional federal support will be required to provide a "rate analysis," and will have "great flexibility" in demonstrating that rates are not reasonably comparable.²²

In my view, the majority's "supplementary rate review" is striking similar to the state-by-state cost study approach the Commission had originally rejected in order to pursue its flawed nationwide universal service cost model approach. Under the recommended state-by-state approach, each state would have significant latitude to suggest its own procedures for adjusting rates. Without specific guidelines or a clearly defined standard, this approach appears to invite the potential for uneven and potentially discriminatory results.

I am troubled that majority fails to offer any specific guidance on critical areas of its newly proposed process. The item is silent, for example, on whether states should alter rates to take into account the scope of certain local calling areas or differing calling plans. In my view, without an established standard or guidance for states in this area, the poorly defined "supplementary rate review" will most likely provide results, if any, that are highly susceptible to legal challenge.

Finally, Commissioner Rowe is correct in questioning whether the proposed "supplementary rate review" would "create perverse incentives for carriers."²³ One of the reasons the Commission

¹⁹ *Id.* at 3.

²⁰ *Id.* at 5-7.

²¹ *Id.* at 16.

²² Recommended Decision at para. 56.

²³ *See* Commissioner Bob Rowe's Separate Statement at 18.

adopted the forward-looking cost model was because it believed that an embedded-cost support system promotes inefficient investment that would inhibit competitive entry. I find it ironic that the majority now seeks to adopt a rate-based mechanism that inherently relies on local rates which are typically based on embedded costs.