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

Federal Universal Service Programs

Fund Size Projections & Contribution Base

For the First Quarter 1999

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I. Introduction

The Universal Service Administrative Company (USAC) submits the Federal Universal Service Program fund size and administrative cost projections for the first quarter of calendar year 1999 and contribution base amounts for the first six months of 1999, in accordance with section 54.709 of the Federal Communications Commission's (FCC or Commission) rules.[1] **USAC is a not-for-profit corporation created consistent with Subpart H of the Commission's Part 54 rules for interim administration of the federal High Cost and Low Income Universal Service programs and for performance of billing, collection and distribution of funding for the Schools and Libraries and Rural Health Care Universal Service programs.**[2]

Upon approval of the quarterly funding requirements for the High Cost and Low Income programs, the projected administrative expenses and once the Commission established the quarterly contribution factors for the programs, USAC will bill contributors on a monthly basis for their individual requirements, collect the funds,[3] **and distribute funds**

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[1] **47 C.F.R. § 54.709(a)(3).**

[2] **47 C.F.R. §§ 54.5 and 54.701.**

[3] **47 C.F.R. § 54.709(a)(4).**

to eligible recipients[4] **based on the schedules filed herein.**[5]

II. High Cost Programs

Subpart F of Commission's Part 36 rules and Subpart D of the Commission's Part 54 rules describe the universal service programs that are available for eligible telecommunications carriers serving high cost areas.[6] **These programs include the loop cost expense adjustment (USF), local switching support (LSS) and long term support (LTS). Together, the projected requirements for these three programs and the USAC administrative expenses, discussed *infra*, constitute the funding requirement for the High Cost programs. Appendix 4 contains individual company loop data as well as per-month high cost support for each program that each incumbent local exchange carrier will be eligible to receive and the combined total support per-month for all of the High Cost programs.**[7]

USF Loop Cost Expense Adjustment

The National Exchange Carrier Association, Inc. (NECA), in accordance with Section 36.613 of the Commission's rules, [8] **submitted the results of its annual collection of loop cost data to the Commission and to the universal service program administrator on**

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4 **47 C.F.R. §§ 54.201 and 54.203.**

5 **47 C.F.R. §§ 54.301-54.307, 54.407, 54.413, 54.515 and 54.611.**

6 **47 C.F.R. § 36.631 and 47 C.F.R. §§ 54.301-54.303.**

7 **Appendices 1 through 4 are also being provided electronically in Excel 4.0 format.**

8 **47 C.F.R. § 36.613.**

October 1, 1998.[9]

NECA provided USAC with loop cost and expense adjustment data based on calendar year 1997 data submitted to NECA by the incumbent local exchange carriers on July 31, 1998. Section 36.601(c) limits the growth in total USF expense adjustments to the current level of funding grown by the year-over-year growth in USF loops. The USF expense adjustment for calendar year 1999, in aggregate, exceeded the level of payments for 1998 by more than the rate of growth in USF loops from 1996 to 1997 of 4.54 percent. Therefore, the USF expense adjustment payments for calendar year 1999 are capped at a 4.54 percent increase over 1998 payments and are projected to be $864.2 million.[10]

As a result of the July 31, 1998 annual update submitted and the fact that total expense adjustment funding requirements for 1999 are projected to exceed the cap, payments to each high cost exchange carrier will be adjusted to accommodate the annual update. Payments will also be adjusted for limitations resulting from Commission Waiver Orders and to insure that, in total, the funding does not exceed the cap.[11]

For the first three months of 1999, the projected USF expense adjustment

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9 NECA, Universal Service Fund (USF) 1998 Submission of 1997 Study Results, filed October 1, 1998 (USF Data Submission).

10 The USF cap methodology requires periodic updates to account for increases or decreases in prior calendar year payment amounts.

11 Although the rules governing future quarterly updates are silent on the transfer of quarterly update results from NECA to the administrator, it is assumed the Commission intends USAC to include any updates provided by NECA in the monthly support distribution process.

requirement is $216.1 million. Appendix 1 contains projected monthly and quarterly payment levels by local exchange carrier study area for the first quarter of 1999, based on NECA's October 1, 1998 USF Data Submission, which included the aforementioned cap on total funding.

Local Switching Support

Telephone company study areas having 50,000 or fewer access lines are eligible to receive support for local switching costs[12] in lieu of Dial Equipment Minute (DEM) Weighting formerly included in interstate traffic sensitive switched access rates.

Local Switching Support (LSS) is the product of a carrier's annual unseparated local switching revenue requirement multiplied by its local switching support factor. The local switching support factor is defined as the difference between the 1996 weighted interstate DEM factor and the 1996 unweighted DEM factor.

In its Fourth Reconsideration Order, the Commission clarified the definition of Unseparated Local Switching Revenue Requirement, and provided the methodology to be

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[12] In addition to the eligibility criteria set forth in 47 C.F.R. § 54.201, exchange carrier study areas must also serve fewer than 50,000 lines to receive local switching support. 47 C.F.R §54.301.

used in its computation.[13] **The Fourth Reconsideration Order also adopted the methodology NECA used to estimate the funding requirement for its Traffic Sensitive pool member companies.**[14] **NECA utilized 1999 cost projections underlying its June 16, 1998 access tariff filing as the basis for developing its pool members' local switching support requirements. In the instant filing, USAC relied on these data provided by NECA in establishing first quarter 1999 LSS funding requirements. There are 1,247 study areas in the NECA Traffic Sensitive pool that are eligible to receive local switching support (*i.e.*, have fewer than 50,000 lines in their study areas). NECA calculated the unseparated local switching revenue requirement for its cost and average schedule traffic sensitive pool participants separately. In each case, the unseparated local switching revenue requirement was developed using the algorithm approach that assigns overheads to the switching category. Exhibits 1 and 2 display the algorithms that were used to develop the local switching revenue requirements for NECA's average schedule and cost company pool participants respectively.** [15]

USAC collects local switching support information directly from the exchange carrier study areas that have fewer than 50,000 lines and do not participate in the NECA

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[13] **Federal-State Joint Board on Universal Service, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge, CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, *Fourth Order on Reconsideration,* 13 FCC Rcd 5318 (1997) as corrected by Federal-State Joint Board on Universal Service, *Errata,* CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, DA 98-158 (rel. Jan. 29, 1998), appeal pending in Alenco Communications, Inc., et al. v FCC and USA, No. 98-60213 (5th Cir. 1998) (*Fourth Order on Reconsideration),* para. 49.**

[14] ***Id.***

[15] **47 C.F.R. § 54.301(b).**

traffic sensitive pool.[16] **The instant filing includes local switching support requirements for companies with fewer than 50,000 access lines that do not participate in the NECA Traffic Sensitive pool, based on the results of the collection of individual company data. These companies were required to provide 1999 LSS projections to USAC by October 1, 1998.**[17]

NECA's projection of local switching support amounts being removed from its traffic sensitive pool participants' access rates are $200.7 million for cost study areas and $85.8 million for average schedule study areas. Local switching support amounts of the non-NECA traffic sensitive pool study areas' are $97.8 million for cost study areas and $6.7 million for average schedule study areas.[18] **Based on these estimates, total 1999 local switching support is estimated to be** $390.8 million. USAC projects that one-quarter of this amount, or $97.7 million will be required for 1Q99. Individual study area local switching support projections per month are displayed in Appendix 3.

Because the local switching support is based on projections of 1999 switching costs, actual individual study area requirements will not be known until the 1999 cost studies are completed for those carriers, sometime in late 2000. The Commission's rules specify that true-ups to the local switching support will be made to reflect actual 1999 switching costs.[19]

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[16] ***Id* at ¶ 49.**

[17] ***Id.***

[18] **Of these amounts $1.6 million for cost companies and $0.7 million for average schedule companies are attributable to companies that have elected to exit NECA's traffic sensitive tariff as of July 1, 1998.**

[19] **47 C.F.R. § 54.301(e)(2)(iv).**

Long Term Support

Telephone company study areas that participate in NECA's Common Line pool are eligible to receive long term support (LTS) from the federal high cost support programs.[20] **The amount of long term support that an incumbent local exchange carrier that participates in NECA's Common Line pool is eligible to receive is equal to the difference between the 1997 projected common line revenue requirement of that carrier and the 1997 projected revenue to be recovered by the application of the NECA Carrier Common Line charge to that carrier's common line minutes of use, adjusted to reflect the annual change in the national average USF loop cost. For 1998, the 1997 LTS amounts decreased .44** percent to reflect the decrease in the national average loop cost. For 1999 long term support, each NECA Common Line pool participant's 1998 level of LTS is multiplied by the rate of growth in the national average cost per loop filed by NECA on October 1, 1998.[21]

For the instant filing, NECA provided USAC with individual exchange carrier study area projected Long Term Support requirements for its common line pool participants for 1999, based the projection of 1997 common line cost data it had utilized in support of its June 16, 1998 Common Line rate filing.[22] **Total 1999** Long Term Support is estimated to be $469.6 million. USAC projects that one-quarter of this amount, or $117.4 million, will be

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[20] **47 C.F.R. § 54.303.**

[21] **The national average cost per loop for 1998 decreased by .76 percent from the 1997 level. *See* NECA USF Data Submission at 6.**

[22] **The 1999 long term support amounts are predicated on projections of 1998 requirements, with actual costs and revenues not being known until the final 1997 cost studies are complete, late in 1998.**

required for first quarter 1999. Using year-end 1997 USF loop counts, USAC developed individual study area per-line per-month Long Term Support amounts. Monthly and first quarter study area specific Long Term Support levels are displayed in Appendix 2.

III. Low Income Programs

As a requirement for eligibility for receipt of support, carriers must offer Lifeline programs to qualified low-income consumers. Carriers that provide such programs in accordance with section 54 Subpart E of the Commission's rules and have met the other conditions of eligible carrier status (*i.e.*, have been designated as an eligible telecommunications service provider and have provided a copy of the state public utilities commission document making that designation) are entitled to receive funding from the federal Universal Service programs for waiver of charges and reduced rates provided to qualified low-income subscribers.[23]

Specifically, the federal Lifeline program provides funding from the interstate jurisdiction of up to $7.00 per low-income subscriber per month consisting of a baseline amount of $3.50, an additional $1.75 per subscriber per month if the state commission authorizes a reduction in local rates equal to that amount, and up to an additional $1.75 from the federal program if the state provides support for the low-income subscriber as well (the portion of the final $1.75 that can be recovered is equal to one-half of a state funded amount up to $3.50, if the state approves a reduction in local rates that is one and one-half

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[23] 47 C.F.R. §§ 54.401-54.417. Exhibit 4 lists the carriers (by state) that have received Eligible Telecommunications Carrier status.

times the level of matching state support).[24]

The federal Link Up program compensates eligible telecommunications service providers for revenue foregone in offering a Link Up program that provides for service commencement charges for qualified low-income individuals that are discounted by one-half (up to $30.00 in funding) or for interest forgone from a deferred schedule of payment of the charges assessed for commencing service (up to $200.00) for which the low income consumer pays no interest. Additionally, the federal program compensates eligible telecommunications service providers for providing voluntary toll-limitation based on the carrier's incremental cost of providing toll-limitation services. The Commission defined these costs as the costs that carriers otherwise would not incur if they did not provide toll-limitation service to a given customer.[25]

In the Fourth Reconsideration Order, the Commission established that eligible carriers, required to assess Presubscribed Interexchange Carrier Charges (PICCs) in their access charges, may also receive compensation for the PICCs associated with low-income subscribers that voluntarily opted for toll blocking service.[26]

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[24] For example, if a carrier operating in a state that has a matching program that provides $3.50 in support through a matching program, reduces its intrastate rates by $7.00 for low-income customers, the customer would experience a total monthly rate reduction of $10.50 ($3.50 in interstate charges and $7.00 in intrastate charges) of which $7.00 would be funded from the federal jurisdiction and $3.50 from the state matching program.

[25] Federal-State Joint Board on Universal Service, *Report and Order,* 12 FCC Rcd 8776 (1997) at ¶ 386 (Universal Service Order).

[26] *See Fourth Reconsideration Order* at ¶¶ 123-125. Competitive Local Exchange Carriers designated ETCs to serve customers in these carriers' serving areas are also eligible to receive this compensation for their low income customers that opt for toll blocking. *Id.* at ¶ 125.

The Commission's Second Order on Reconsideration requires USAC's High Cost and Low Income Committee to determine its quarterly demand projections for the Low Income programs based on historic demand.[27] **Low income support is reimbursed two months in arrears of the time discounts are provided to low income subscribers. Thus, support distributions made in August 1998 were for subscriber discounts provided in June 1998. Detailed below are the eligible telecommunications carriers' submitted claims for low income program reimbursement for the months of January 1998 through August 1998:**

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[27] **Changes to the Board of Directors of the National Exchange Carrier Association, Inc., and Federal-State Board on Universal Service,** ***Report and Order and Second Order on Reconsideration*****, 12 FCC Rcd 18400, ¶ 46 (1997) (*****Second Reconsideration Order*****).**

Eligible Telecommunication Carriers
Submitted Claims
(stated in thousands)

Month 1998	Total	Monthly Percent Change
7.5021		
-2.2850	April	36,943
2.4377	May	36,759
-.4971		
2.9852		
2.2520		
.5996		
	Total	$296,511
Avg. Monthly Percent Change		1.856

All eligible telecommunications carriers are required to provide the low income programs to qualified low income customers. The process for reimbursement of low income credits provides the carriers the option of submitting the claims on a monthly, quarterly, or semi-annual basis. USAC anticipates that the claims for January through August 1998 will continue to increase.[28]

The eight month trend of the industry reported data indicates an average growth in

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[28] **Carriers have six months to finalize their most recent submission of data under the USAC reimbursement procedures.**

funding requirement at a rate of 1.856 percent per month. Extrapolating the historical results through March of 1999 and adjusting for full participation results in an estimate of approximately $143.2 million being required to fund the Low Income programs in the first quarter of 1999.

Appendix 5 provides detail on the low-income programs available in each of the states and U.S. territories. Appendix 6 provides detail on company specific claims for reimbursement from the low income programs for January through August 1998, and the amounts that were reimbursed during the June through August 1998 time frame.[29]

IV. Administrative Expenses

Section 69.620 (b) of the Commission's rules require the administrator to submit to the Commission its projected quarterly budget at least 60 days prior to the start of the quarter.[30] **In its Second Reconsideration Order, the Commission determined that USAC should not allocate all of its administrative costs to the high cost and low-income programs' quarterly cost projections.**[31] **The Commission directed USAC to include any costs that can be directly**

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[29] The numbers in Appendix 6 may not be identical to the above table showing submitted claims for reimbursement due to the fact that the referenced table shows an accumulated dollar amount submitted to date for each month. Appendix 6 details actual dollars paid to each company during a monthly accounting cycle. For example, in the month of July an eligible telecommunications carrier submits a claim for reimbursement of Low Income credits provided for the month of April. The preceding table would present these credits in April, when the credits were rendered by the service provider. Appendix 6 would depict these credits in July, when reimbursement was disbursed to the service provider.

[30] 47 C.F.R. § 69.620(b).

[31] *Second Reconsideration Order* at ¶ 47.

attributed to the schools and libraries or rural health care programs in the projected administrative expenses of the relevant programs.[32] **USAC's joint and common costs associated with billing and collection of contributions or disbursement of funds are also to be identified. One-fourth of USAC's joint and common costs are to be included in the projected administrative expenses of the high cost, low-income, schools and libraries, and rural health care programs, respectively.**[33]

USAC projects a First Quarter 1999 budget of $1.7 million. USAC projects that it will incur expenses of $0.5 million to administer the high cost programs during the first quarter of 1999.[34] **Additionally, USAC anticipates costs of $0.2 million to administer the low income programs during the first quarter. The joint and common costs for the first quarter of 1999 total $1.01 million, of which $252 thousand is to be assigned to each of the programs (*i.e.*, high cost, low income, schools and libraries, and rural health care).**

FCC rules direct NECA to continue performing certain functions relative to the Universal Service Fund (USF), *i.e.*, the collection and processing of annual USF data as well as the optional quarterly updates to that data.[35] **The Part 69 rules governing recovery of NECA expenses no longer permit it to recover its expenses related to Universal Service in**

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[32] ***Id.***

[33] ***Id.***

[34] **The projected costs to administer the High Cost program during the first quarter of 1999 include $0.3 million for work related to the implementation of the High Cost Support Model, in the event that USAC is selected as a contingency model administrator. If USAC is not selected, the amount will be refunded in a future filing.**

[35] **47 C.F.R. §§ 36.611-36.613.**

that NECA has no associated revenues.[36] **NECA's projected first quarter expenses to perform these universal service programs-related functions are $1.5 million. These expenses have been included in the first quarter 1999 requirement.** NECA indicates that its expense projection includes system upgrades to ensure that the USF High Cost data processing system will be Year 2000 compliant and to provide for the conversion from mainframe processing to client server technology.

For the first quarter of 1999, USAC projects interest income of approximately $0.9 million for the high cost program and $0.7 million for the low-income program. The projected interest income is being included as an offset to expenses for each of the programs.

Appendix 7 provides the detail of the expense projections for the high cost and low income programs. In total, first quarter 1999 projected expenses attributable to the high cost programs are $2.2 million, offset by projected interest income of $0.9 million, providing a net addition to the funding requirement of $1.3 million. First quarter 1999 projected expenses for the low income programs are $0.5 million offset by interest income of $0.7 million, providing a net decrease to the low income funding requirement of $0.2 million.

V. Funding Requirements

High Cost Programs

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[36] **47 C.F.R. § 69.603.**

Sections 36.631(e) and 36.741(b) of the Commission's rules require NECA to make changes in the size of the projected USF and low income requirements to reflect adjustments based on actual dollar amounts compared to the projection included in prior period.[37] **Increases in the size of the funding requirement for the previous period are added to the projected requirements; decreases from the prior period are subtracted from the projected revenue requirements.**

Third quarter 1998 results contribute to an under-funded condition, for which the instant filing proposes to adjust the first quarter 1999 requirements. The authorized funding requirement for the third quarter for the high cost program was $423.7 million. As a result of changes to the funding base of interstate and international revenues, and the prior quarter's adjustment of the authorized funding requirement, application of the authorized contribution factor of .0314 produced billing for the high cost program totaling $421.1 million, $2.6 million less than the authorized funding level. This deficit in funding is in addition to the billing of five companies that are in bankruptcy proceedings totaling $0.5 million, resulting in a net billing deficit of $3.1 million. In addition to the billing deficit, distributions for the high cost program were $3.7 million more than originally anticipated as a result of changes to the Local Switching Support requirement for non-NECA Traffic Sensitive pool participants. This increase in the funding requirement when added to the net billing deficit results in a proposed increase to the first quarter 1999 funding requirement of $6.8 million. USAC also anticipates that

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[37] **Section 36.631(e) of the Commission's rules defines the resizing procedure for USF. Section 36.741(b) of the Commission's rules defines the resizing procedures for lifeline connection assistance and subscriber line charge waiver. *See* 47 C.F.R. §§ 36.631(e) and 36.741(b).**

approximately 300 companies who had remitted contributions for the first six months of 1998 will, in fact, be ***de minimis*** for calendar year 1998. These companies are eligible for refunds totaling approximately $1.1 million from the high cost program. This increase in the funding requirement, when added to the net-billing deficit, results in a proposed increase to the first quarter funding requirement of $7.9 million. The total projected funding requirement for the high cost programs for the first quarter 1999 is $440.4 million. Exhibit 5 details the individual components of the funding requirement for the first quarter of 1999.

Low-Income Programs

The authorized funding requirement for the third quarter for the low income programs was $124.7 million. As a result of changes to the funding base of interstate and international revenues, and the prior quarter's adjustment of the authorized funding requirement, USAC billed telecommunications service providers $123.2 million for these programs. Based on the revised interstate and international revenue base, $1.5 million less than the authorized level was billed. Adjusting the under-billing amount to account for the five bankrupt entities ($0.2 million) results in an under-funding of $1.7 million. In anticipation of reimbursement requests being lower than projected for May through June 1998, USAC proposes a reduction in funding of $1.0 million. USAC also anticipates that approximately 300 companies who had remitted contributions for the first six months of 1998 will, in fact, be *de minimis* for calendar year 1998. These companies are eligible for refunds of $0.1 million from the low income program. The net result of the proposed adjustments, (i.e., under-billing, bankruptcies, lower reimbursements in the first quarter and required *de minimis* reimbursements) results in a proposed increase for the first quarter 1999 funding requirement of $0.8 million. The total projected funding requirement for the low-income programs for the first quarter 1999 is $143.8 million. Exhibit 5 details the individual components of the funding requirement for the quarter.

VI. Contribution Bases

USAC distributed over 4,800 forms (FCC Form 457) in August of 1998. Interstate telecommunications service providers were required to complete this form with revenue information for the first six months of calendar year 1998 and return the forms to USAC by September 1, 1998. To date, USAC has received approximately 4,000 completed forms.[38]

Funding bases for the first and second quarters are developed from the revenues reported for January through June 1998 (reported in September 1998).[39] **USAC has yet to receive Forms 457 from 379 telecommunications service providers that submitted forms in March, 1998. For those carriers that failed to submit a six month Form 457, USAC has included estimated revenues based on their prior submission in establishing the preliminary first quarter 1999 funding bases for the support programs.**[40]

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[38] **USAC received certifications of *de minimis* status from 1,984** carriers, which are included in the 4,000 completed forms received to date . The USAC Board adopted a late filing penalty, consistent with 47 C.F.R. § 54.713, at its October 1998 meeting. Companies not submitting their FCC Form 457 by the due date are subject to a late filing penalty calculated at a rate of .005 percent applied to their total end-user billed revenue with a minimum penalty of $100 and a maximum penalty of $5,000. This penalty will be effective beginning in March 1999.

[39] **Second Order on Reconsideration, Appendix C (FCC Form 457 - Universal Service Worksheet Instructions, II.B.), 12 FCC Rcd at 18502.**

[40] **January through June 1998 estimated Revenues for carriers not yet filing a Form 457 total approximately $871.1 million in total revenues or** .88 percent of the total funding base projection for the first quarter 1999 . Carriers that have not provided their 6 month data have been contacted; however, as of the filing date have not provided the required submission.

For the first quarter 1999 funding period the preliminary total intrastate, interstate and international end-user revenue base to be used in determining the contribution factor for the schools and libraries and rural health care programs is $98.510 billion. The interstate and international end-user revenue base to be used in determining the contribution factor for the high cost and low-income programs is $37.062 billion.

VII. Operations

At its October 19, 1998 meeting, the High-Cost Low-Income Committee passed a resolution authorizing the First Quarter 1999 High Cost and Low Income program funding requirements described herein. The full USAC Board of Directors, at its October 20, 1998 meeting; by resolution, authorized the inclusion of the first quarter 1999 administrative expenses and funding base.

Respectfully submitted,

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