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THE FUTURE OF UNIVERSAL SERVICE: ENSURING THE SUFFICIENCY AND STABILITY OF THE FUND

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

JUNE 19, 2002

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ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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THE FUTURE OF UNIVERSAL SERVICE: ENSURING THE SUFFICIENCY AND STABILITY OF THE FUND

WEDNESDAY, JUNE 19, 2002

U.S. SENATE,
SUBCOMMITTEE ON COMMUNICATIONS,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:10 a.m. in room SR–253, Russell Senate Office Building, Hon. Daniel K. Inouye, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. DANIEL K. INOUYE, U.S. SENATOR FROM HAWAII

Senator INOUYE. My apologies for being late. Believe it or not, I got stuck in an elevator.

[Laughter.]

Senator INOUYE. This morning's hearing focuses on one of the oldest and most revered principles of U.S. telecommunication policy, universal service. The Federal Government's commitment to universal service is grounded in our belief that basic telecommunications services should be available to all Americans at rates that are affordable and relatively uniform.

As each of us can attest, access to adequate telecommunications services is essential to modern-day social and economic commerce. These challenges are acutely felt by millions of Americans in remote areas who rely on telephone and Internet connections to contact families and friends, to benefit from expanded job opportunities offered by telecommuting, to access educational information from remote libraries, and to maintain critical contacts with health and emergency service personnel.

Yet beyond these specific uses, as telecommunications services reach more and more individuals, all Americans benefit from the network effects of a ubiquitous communications network.

In 1934, when only 40 percent of U.S. households had access to telephone service, Congress passed the Communications Act clearly expressing its intention to make available, so far as possible, to all of the people of the United States, a rapid, efficient, nationwide and worldwide wire and radio communications service with adequate facilities at reasonable charges. And in response to that mandate, Federal and state regulators developed a system of pricing and cost recovery designed to promote expansion of telecommuni-

cations networks and to provide all Americans with access to telecommunications services at affordable prices.

By enacting the 1996 Telecommunications Act, Congress ensured that its longstanding commitment to universal service would survive in a competitive telecommunication marketplace. As a result, Members of this Committee worked diligently to explicitly define the term "universal service" in Section 254 of the act. In so doing, Congress made sure that this definition was sufficiently flexible to capture an evolving level of telecommunications services and that contributions to the fund would be equitably imposed on telecommunications carriers.

As implemented by the Federal Communications Commission, the current mechanism for funding universal service relies on assessments to telecommunications carriers interstate and international revenues. For many years, this system adequately and effectively fulfilled a mission of universal service.

Of late, however, an increasing chorus of carriers have begun to express their dissatisfaction with the current revenue-based assessment mechanism. New technology, such as Internet telephony, the emergence of bundled-service offerings, and the introduction of new competitive providers of interstate services have led some to question the long-term viability of current contribution mechanism and to advocate an assessment based on the number and capacity of carrier connections.

Other parties, however, argue that such wholesale changes are unneeded, unlawful, and unwise in light of less radical reforms that may stabilize the current system during the current economic downturn.

In light of these competing claims, it is my hope that today's hearing will allow the Committee to examine, first, the nature and extent of the problems facing the current contribution mechanism, and, second, the impact that proposed changes will have on consumers and the future of the universal-service fund.

To assist us, we are fortunate today to hear from two distinguished panels of government and industry experts. And I look forward to their testimony. But, before I do, may I call upon my colleagues? Senator Burns?

STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. Thank you, Mr. Chairman. I'm very pleased you're having this hearing today to address the vital topic of universal service.

I am a strong supporter of universal-service programs. During my time here in the Senate, in particular, I have worked to ensure that the rural, commercial, and cooperative companies of Montana continue to recover their costs of providing voice-grade service from the high-cost universal-service system through my introduction of the Universal Service Support Act and other acts that we've sponsored in the past.

I firmly believe that a solvent and stable universal-service fund benefits consumers throughout Montana and this country through the availability of high-quality and affordable service. The topic of this hearing is particularly timely, given the FCC is currently

reaching a conclusion on its proceeding to reform the manner in which the universal-service programs are funded. In fact, within the order released by the Commission this past Friday, the FCC expressed its desire to complete this proceeding and implement its changes by early next year.

Clearly, some significant reforms to the universal-service contribution system need to be made. Market forces, such as competition in the long distance market, alone, warrant such changes.

I'm going to carefully review the Commission's work to ensure that it adheres to the stated core principles which include: to ensure stability and sustainability of the universal-service fund, to ensure that contributors are assessed in an equitable and nondiscriminatory manner, to minimize the regulatory costs associated with complying with universal-service obligations, and to develop a contribution recovery process that is fair and readily—and understood by the consumers.

This universal-service contribution proceedings impacts all providers of interstate telecommunications services. The proceeding also impacts consumers because of the uncertainty of how carriers will ultimately be allowed to recover their contributions from end users.

My thinking on universal service has been greatly informed by the experience that Montanans have had with their small, rural operators. I want to specifically point out the tremendous job that these independent companies and rural cooperatives have done in providing quality service to Montana for decades. In particular, the smaller operators have been incredibly productive in the area of providing advanced services. There will soon be 121 small Montana communities that will have access to high-speed Internet services because of the foresight and the hard work of these operators—just to name a few, in cities like Circle, Multa, and Plentywood that are not really on the large-city radar screen.

With these and many other contributions to our rural providers in mind, I'd like to examine the proceedings to make sure that it is consistent with the Act's requirement that universal-service support be specific, predictable, and sufficient. As a sponsor of the Universal Service Support Act, I view any artificial limits on universal service as a discouragement to investment and inconsistent with the 1996 act. I'm against imposing barriers to investment upon any new universal-service contribution regime.

Thank you, Mr. Chairman, again, for holding this hearing. I look forward to hearing from our witnesses.

Senator INOUYE. Thank you very much, Senator Burns.

Senator Rockefeller?

STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I want to first acknowledge that we have our director of Consumer Advocate Division in the Public Service Commission of West Virginia, Billy Jack Gregg, here. And I'm very happy about that, because he's very good.

And, second, I have to apologize, because I've got to go to that Intel hearing, so I won't be able to do all I want to do.

I want to make a couple of points, however. The FCC has to be much more aggressive and timely in, sort of, redefining this whole contribution system. I think some of the—my colleagues will remember that I had each of the FCC members swear that they would do nothing—swear, on their confirmation hearings, that they would do nothing to undermine the universal-service funding. And they all swore. Some of them are proceeding, however, to back off on that, particularly Chairman Powell.

It is—you know, what they are basically doing now is, they are taking uncommitted e-rate funding, and they are using it to keep universal-service contributions stable. Now, I could have made a heck of a fuss about that, and I do make a heck of a fuss out of it, and I decided not to because of—what it would have done is spiked up telephone rates and e-rate would have gotten a black eye. And, around here, and in the, sort of, climate here in Washington, you have to fight every year to protect e-rate. And I suspect that Byron Dorgan and Conrad Burns had some of the same feelings.

But let's just make no mistake about it. This is a really bad thing to do. It's a really bad thing to do to be using e-rate. In fact, Chairman Powell wants to use this way beyond the April date. He was the lone dissenting vote on this.

He wasn't the lone dissenting vote? Another matter.

He was the lone dissenting vote. And it was—that's very discouraging to me, because I'm not sure, one, of his commitment to e-rate, I'm not sure of his commitment to universal service, and I'm not sure of the FCC's ability, other than Michael Copps and our witnesses here, to withstand his cerebral force.

Nevertheless, we went ahead with it, but I'm very unhappy about it. The FCC is being very slow to look at this whole contribution thing. And I don't like that.

So I'm just saying, Mr. Chairman, as loudly as I possibly can, that we need to get a contribution system worked out, certainly by April, certainly not later than April, and not put the e-rate further at risk.

And just to add on as a freebie here, although we won't be able to discuss it, that I also don't like the fact that the FCC is redefining information services—Internet services—that they should be classified as information services under the 1996 act, rather than as telecommunications. That makes a very big difference. I won't get into that now, but it, again, has to do with how we're going to preserve universal service if we're going to do it, and if there's a will in the FCC, if they feel that that's something which is useful to the nation. Some of us certainly do.

The final point I want to make is that there is this problem of the migration of regulated voice services to unregulated Internet services. And that migration is very concerning to me. When the FCC has taken a number of steps recently to deregulate broadband service, I'm not sure that it has adequately explored the effects of these rulings, that they have on the universal-service funding. Universal-service funding is everything to those of us in rural states and inner cities. So I think this is too much business-as-usual.

The Chairman has handed me a little note here saying, "The change has a profound implication, not only for competition in the

telephone industry, but also for people who live in rural and poor areas where telephone services are heavily subsidized under current regulatory regimes."

So I think that the time for reform of the contribution system is long past due. The FCC is much too slow, of course, in my judgment. And I'm not really sure how anxious they are to change it, particularly at the leadership level.

So I will leave it at that, and I thank the Chairman.

Senator INOUYE. I thank you very much.

Senator Nelson?

STATEMENT OF HON. BILL NELSON, U.S. SENATOR FROM FLORIDA

Senator NELSON. Thank you, Mr. Chairman.

This is a subject matter that is extremely important to Florida, from two different perspectives. I'm doubly pleased that we have our chair of the Florida Public Service Commission here to testify. And you'll be hearing, essentially, that, not only do we have a lot of rural parts of Florida, but, of course, Florida being 16 million people now, we contribute into this, and we're concerned that we examine the existing contribution system and consider changes, because I'm concerned that there is a huge imbalance, that Florida is at the top of the list of states that put in the most and get back the least, as compared to all of the states. And yet I support the universal-service system. All consumers deserve access to telecommunications services, at rates that they can afford, and we clearly have a lot of our state that is rural that benefits from this program.

I've got some concerns about how transitioning to a per-connection system may impact Florida's senior citizens, because the elderly often make very few interstate and international calls. And, as you know, we have a greater percentage of the elderly in Florida, more than any other state. As a result, they might shoulder a disproportionate burden of a per-connection system.

So, Mr. Chairman, we have, on the floor of the Armed Services, a DOD Authorization Bill, of which my presence is needed there, and so I would just like to proffer some questions for you all to consider.

Do you feel there is a penalty or reward for state commissions that have already provided advanced services for schools and libraries prior to the passage of the 1996 Telecommunications Act?

What are better ways than increasing the size of the fund to address universal-service issues? And maybe our Chair can discuss some of the initiatives in Florida.

What types of consumer education has Florida initiated to tell customers about the lifeline linkup program?

And do you think that the size of the fund should be limited?

So, with proffering of those provocative thoughts, I'm going to request your permission that I might go and help out our Armed Services Committee chairman on the floor, Mr. Chairman.

Senator INOUYE. Thank you very much.

And now may I call upon Senator Dorgan?

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much. And let me add my thanks. This hearing is right on point, it's timely, and it's very important.

And, as I was listening to my colleagues, we all pretty much have the same mentality. We get up and put on a necktie in the morning and come here prepared to speak in our special language in very low and polite tones. But, you know, what's happening here is really an outrage—really an outrage—with respect to universal service. And I want to explain why I think that and why I think the FCC really owes us aggressive action here to respond to these issues.

Mr. Chairman, I grew up in a town of 300 people. We had a telephone number that had only four digits. Now, I—as is the case, perhaps, with West Virginia and Montana, I have a special understanding of high-cost areas. And why the universal-service fund decided that the telephone in Regent, North Dakota was just as valuable as a telephone on Donald Trump's desk? Because one was available to connect to the other. And without one, the other was diminished. That's why we have universal service in this country.

Now, we passed an act 6 years ago, and we included in that act Section 254. It's not foreign language. It's not in code. This isn't about wind-talkers having to convert it to understandable English. Let me just read a part of it. "Consumers in all regions of the nation, including low-income consumers and those in rural, insular, and high-cost areas, should have access to telecommunications and information services, including inter-exchange services and advanced telecommunications and information services that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably to rates charged for similar services in urban areas."

Now, that's not something that's hard to understand. And yet, through a series of bungling efforts by the FCC—not just the current FCC, but including the current FCC—and the FCC that began in 1996 to implement this act, I include them as special bunglers—through bungling, through court decisions, and through people who come to this job in the FCC with a philosophy that says, "You know, we're not interested in what the law says. We have our own philosophy about how things should work," we now end up in a situation where we have a universal-service program that, in my judgment, is in great jeopardy. The FCC should know, in my judgment, that the Congress placed the responsibility on the Commission to preserve and advance universal service, not to minimize it or neglect it.

And I'm not going to go through the whole series of things that we have to do, but there are three very quick points. Section 254 makes it clear universal-service support is supposed to support advanced services—not debatable, in my judgment; it's written in law. Second, universal service was to be the mechanism by which we have comparable service at comparable rates. And, third and finally, it was to require all telecommunications carriers to contribute to universal service.

Now, Mr. Chairman, we're in a situation where slowly, but surely, relentlessly over time this universal-service fund has been neglected and chopped away at, and we will not long have a universal-service fund that works relevant to he philosophy that we have embraced for many decades, and especially relevant to what is in Section 254 in the act. And I hope very much, Mr. Chairman, that we will get Chairman Powell down here, as well, at some appropriate time in the future, because I think we—I like him a great deal, personally, but I think the Commission has a lot to answer for with respect to what's gone on in recent years on universal service.

I thank you for allowing me this therapy of waking up and saying these things this early in the morning. But it's so important to a state like North Dakota and other rural states.

Mr. Chairman, thank you.

Senator INOUYE. I'm happy to oblige, sir.

Senator Stevens?

STATEMENT OF HON. TED STEVENS, U.S. SENATOR FROM ALASKA

Senator STEVENS. Mr. Chairman, I'm sorry to be late, so I'll be very short.

Along with you, I believe I'm one of the original sponsors of the concept of universal service, and I do believe that this concept has made modern communications a reality, in my state and many rural areas, facilities that would otherwise still be a dream. I'm delighted that you've permitted Ms. Thompson—Nan Thompson to appear here today.

I don't want to offend the Senator from West Virginia, but sometimes I think those of us who invented universal service are sort of watching the tail wag the dog, because the concept of taking money from universal service and using it to provide service to schools, libraries, and health facilities, the inner-core cities—what we call the urban centers of the country—has really provided—presented us with this problem. This universal-service fund cannot stand the continued deviation of funds from its original purpose if we don't find some way to assure that all concepts of communication carried through the airwaves will contribute to this fund and also put some limits on what is taken out of the fund for non-communications service. The hookup of the schools, libraries, and health facilities, we all supported, but we never dreamed it would be taking billions annually out of this fund.

And I'm anxious to hear the witnesses, because I do believe that there has to be some changes made if this basic concept is to survive. Contrary to my friend from the Dakotas, I commend Chairman Powell for what he's been trying to do to reform the way we use the universal-service fund, and I think that as long-distance revenues decline, we must find some way to have those who provide similar concepts of service in the communications field contribute to the support of the activities of the universal-service fund, or the day will come when, once again, rural America is not online. And if that happens, then I think we've lost our whole concept of the unity of this country, and we cannot afford that. So if we don't act aggressively, there's going to be no one paying into the uni-

versal-service fund if all of these concepts migrate to another form of service other than the traditional long-distance service.

Thank you very much, Mr. Chairman.

Senator INOUYE. I thank you very much, sir.

We have two panels this morning. Our first panel is made up of the chief of Wireline Competition Bureau of the FCC, Ms. Dorothy Attwood; commissioner of the Alaska Public Utilities Commission, Ms. Nan Thompson; commissioner of Florida Public Service Commission, Ms. Lila A. Jaber; and director of the Consumer Advocate Division, Public Service Commission of West Virginia, Mr. Billy Jack Gregg.

May I first recognize Ms. Attwood?

STATEMENT OF DOROTHY T. ATTWOOD, CHIEF, WIRELINE COMPETITION BUREAU, FEDERAL COMMUNICATIONS COMMISSION

Ms. ATTWOOD. Good morning, Mr. Chairman and senators. My name is Dorothy Attwood, and I'm chief of the Wireline Competition Bureau at the FCC. I appreciate the opportunity to appear before you today to discuss universal service.

Universal service is certainly a cherished principle, and I'm sure that all on this panel and everyone in this Subcommittee recognizes the importance of maintaining universal service support and achieving the goals of ensuring affordable and ubiquitous telecommunications service.

In the Telecommunications Act of 1996, Congress directed the Commission to ensure the affordability and availability of telecommunications for all Americans. Congress mandated that the implicit subsidies and universal service support in a monopoly environment be replaced by explicit, predictable, and sufficient support mechanisms. The task Congress set out for us was a monumental one requiring a massive overhaul of the existing universal service system so that it would be sustainable in an increasingly competitive marketplace.

The Commission's initial implementation of the universal service provision of the 1996 act is now complete. Implementing the statutory mandate, the commission made certain policy choices. First, contributions to support universal service are based on interstate telecommunications mechanisms service revenues. Second, we have seperate high-cost support for both rural and non-rural carriers. Third, high-cost support for competitors is based on the costs of the incumbents.

Now, as the marketplace evolves, though, each of these policy choices brings new complexities. Though the Commission has done much work, more work needs to be done in the future to account for the advances in technology, the shifting consumer preferences, and the realities of the competitive marketplace.

One striking development that we've witnesses in the interstate marketplace is the steady decline of interstate revenues. Although traditional long-distance revenues grew consistently between 1984 and 1997, they're now in a period of steady decline.

A variety of factors are responsible. First, new carriers are entering the long-distance market bringing aggressive price competition that benefits consumers, but also drives down the overall interstate

revenues. Second, wireless substitution is increasing. And, third, companies are marketing innovative bundled packages of service that blur traditional service categories.

These changes—price competition, technological substitution, and the development of service bundles—are precisely the kind of development that Congress sought to stimulate when it passed the 1996 act. They're good things. Nonetheless, they strain traditional regulatory distinctions. They present challenges to our current universal service framework, and they require us to consider difficult questions.

Now, the Commission is up to the task and is guided overall by the 1996 act and the principles of Section 254. Our reexamination of the policy choices we made to implement the 1996 act will rest on a few core concepts. First, the competitive telecommunications market requires a more sophisticated targeting of universal service support than in a monopoly environment. This support needs to be sufficient, but not excessive.

Second, universal service policy should not encourage inefficient investment or preclude innovation. In other words, the Commission must be cognizant of the market-distorting effects of universal service support and target support in a manner that reduces the impact of this distortion.

Finally, universal service must be maintained as technologies and markets evolve. The Commission's framework must be flexible so it can accommodate legal, technological and market developments.

The Commission already has begun to take on these issues in a new set of foundation proceedings. Throughout these proceedings, we seek to work closely and collaboratively with our state colleagues and our industry stakeholders.

First, in May of 2001, the Commission began a proceeding to reexamine the way in which contributions are assessed on carriers and recovered from consumers. We take this action in response to the contributors' concerns about the competitive effect of the current assessment system and the consumers' growing frustration with line items on their bills.

In February 2002, the Commission requested further comment on a specific industry proposal to replace the existing revenue-based assessed mechanism with one based on the number and capacity of connections provided to a public network. And we refreshed the record on a variety of other proposals. We've received a voluminous record and will be holding a public forum to further develop these records with our state colleagues this Friday.

The Commission intends to adopt a new foundation for a contribution methodology before the end of the year. In the interim, the Commission has acted to stabilize the contribution factor for consumers by using unused funds from the schools and libraries program to decrease the upward pressure on consumer line items caused by declining interstate revenues.

Second, in February of 2002, the Commission initiated a foundation proceeding concerning universal service and broadband technology. As traditional services migrate to broadband platforms, the Commission must assess the implications for funding universal

service and determine how to sustain universal service in an evolving telecommunications market.

In addition, the Commission has underway foundation proceedings to streamline and strengthen universal service support mechanism for schools and libraries and rural healthcare.

Finally, the Commission also intends to initiate other proceedings later this year which will examine other critical universal service issues. In particular, the Commission intends to begin a foundation proceeding to take a look again at the nature and level of support for competitive service providers whose costs may differ from those of the incumbent carriers.

As part of its comprehensive high-cost review, the Commission also intends to begin the complex process of examining the disparate rural and non-rural support mechanisms so that we can assure our universal service framework is resilient over time.

I'd like to thank you, Mr. Chairman, for the opportunity to appear before you today, and I look forward to working with you and other Members of the Subcommittee on these universal service issues.

Thanks.

[The prepared statement of Ms. Attwood follows:]

PREPARED STATEMENT OF DOROTHY T. ATTWOOD, CHIEF, WIRELINE COMPETITION BUREAU, FEDERAL COMMUNICATIONS COMMISSION

I. Introduction

Good morning, Chairman Inouye, Senator Burns, and Members of the Subcommittee.

My name is Dorothy T. Attwood, and I am the Chief of the Wireline Competition Bureau at the Federal Communications Commission. I appreciate the opportunity to appear before you today to discuss universal service.

Universal service is a cherished principle. I am sure that all of us on this panel and everyone on this Subcommittee recognizes the importance of maintaining universal service support and achieving the goals of ensuring affordable and ubiquitous telecommunications service. Universal service ensures that consumers living in rural, insular and high cost areas have access to telecommunications services. Universal service ensures that millions of school children and library patrons, including those in many of the nation's poorest and most isolated communities, obtain access to modern telecommunications and information services for educational purposes. Through universal service, rural health care providers can provide access to high-quality medical service in rural America. Universal service also increases the availability of telecommunications services in underserved areas such as Indian tribal lands. In short, universal service ensures the delivery of telecommunications to all Americans.

II. Background

In the Telecommunications Act of 1996, Congress directed the Commission to ensure the affordability and availability of telecommunications for all Americans. Congress mandated that the implicit subsidies that ensured universal service in a monopoly environment be replaced with explicit, predictable, and sufficient support mechanisms. The task Congress set out for us was a monumental one, requiring a massive overhaul of the existing universal service system so that it would be sustainable in an increasingly competitive marketplace.

The Commission's initial implementation of the universal service provisions of the 1996 Act is now complete. Starting with the First Universal Service Order in 1997, the Commission created an equitable and non-discriminatory assessment methodology for contribution to universal service, and implemented the statutory mandate to provide support to schools, libraries, and rural health care providers. The Commission removed implicit support from access charges and created explicit interstate support mechanisms in two proceedings in 2000 and 2001. The Commission also reformed intrastate high cost support for all carriers, creating separate mechanisms for non-rural and rural carriers in 1999 and 2001, respectively. In undertaking

these reforms, the Commission recognized the differences between the larger price cap carriers, and the rate of return carriers that typically operate in rural areas, and it proceeded in a staged fashion to minimize disruption to the smaller rural carriers.

In implementing the statutory mandate, the Commission has made certain policy choices. First, contributions to support universal service are based on interstate telecommunications service revenues. Second, we have disparate high cost support systems for rural and non-rural carriers. Third, high cost support for competitors is based on the costs of incumbents. As the marketplace evolves, each of these policy choices brings new complexities.

III. Changing Conditions for Universal Service

The preservation and advancement of universal service—the goals of which remain paramount—presents significant prospective challenges. Though the Commission has done much work implementing the 1996 Act, more work needs to be done in the future.

As Congress has recognized, universal service policy cannot remain static. The Commission must reexamine its regulatory framework in light of the changing and maturing nature of the telecommunications market as a whole. The foundation of universal service needs to be refined to account for advances in technology, shifting consumer preferences, and the realities of a competitive market environment.

In doing so, first, and foremost, the Commission is guided by the principles in the 1996 Act, informed by what we know about the telecommunications market today.

Interstate revenues are decreasing. Although traditional long distance revenues grew consistently between 1984 and 1997, they are now in a period of steady decline. A variety of factors are responsible. First, new carriers are entering the long distance market, bringing aggressive price competition that benefits consumers, but also drives down overall interstate revenues.

Second, wireless substitution is increasing. Consumers are substituting new mobile services for traditional wireline services such as payphones and second lines to the home. A small but growing number of customers have substituted mobile wireless for their primary residential lines. Many consumers now use their wireless service rather than traditional wireline interexchange service to make long distance calls. According to one report, 16 percent of customers now make most of their long distance calls using mobile services, which may skew the balance of universal service contributions.

And third, companies are marketing innovative bundled packages of service that blur service category lines. For example, carriers increasingly are bundling services together in creative ways, including offering flat-rate packages that include both local and long distance services. Carriers also are offering bundled packages of telecommunications services and customer premises equipment and packages with telecommunications and information services, like broadband Internet access.

These changes—price competition, technological substitution, and development of new service bundles and new services—are precisely the kind of developments Congress sought to stimulate when it passed the 1996 Act. These are good things. Nonetheless, they strain traditional regulatory distinctions. They present challenges to our current universal service framework. They require us to consider difficult questions.

The Commission is up to this task. The realities of the maturing telecommunications market require us to consider how, for instance, we can ensure that the collection of funds to support universal service does not favor one class of carriers or one technological platform over another. As a related matter, the Commission must consider how to maintain universal service as traditional communications services migrate toward delivery over convergent broadband platforms. In this changing environment, the Commission also needs to refine its thinking on how to provide sufficient support to eligible providers in order to ensure nationwide access to quality services in rural areas at rates comparable to those in urban areas. Inasmuch as these are significant challenges, the changed landscape does afford the Commission the opportunity to promote universal service objectives in economically sound ways.

Again, the Commission is guided above all by the statutory text. The paradigm we are developing rests on a few core concepts.

First, the competitive telecommunications market requires a more sophisticated targeting of universal service support than in a monopoly environment. This support needs to be sufficient, but not excessive.

In addition, universal service policy should not encourage inefficient investment or preclude innovation. In other words, the Commission must be cognizant of the market distorting effects of universal service support and target support in a manner that reduces the impact of this distortion.

Finally, universal service must be maintained as technology and markets evolve. The Commission's framework must be flexible so it can accommodate legal, technological, and market developments that we cannot even foresee.

IV. A New Phase in Universal Service Policy

In sum, the Commission is entering a new stage in the development of universal service policy. With implementation of the 1996 Act complete, the Commission's current task is to reexamine and reassess the foundation it has built in order to ensure the preservation and advancement of universal service in the modern telecommunications marketplace. Throughout this endeavor, we seek to work closely and collaboratively with our state colleagues and industry stakeholders.

The Commission already has begun to take on these issues in a new set of foundation proceedings. By examining universal service issues in these vehicles and others that will be introduced before the end of the year, the Commission will incorporate its understanding of the evolving market in an updated framework consistent with the basic principles in the 1996 Act.

In May 2001, the Commission began a proceeding to revisit its universal service contribution methodology. This system has two distinct but related components: the assessment of contributions on telecommunications providers and the recovery of contribution payments by providers from their customers. Contributors are assessed on the basis of their interstate and international end-user telecommunications revenues, based on a percentage or "contribution factor" that is calculated every quarter. Because interstate revenues are declining, the contribution factor—which carriers typically pass along as a line item on consumer bills—has increased over time. Consumers understandably are frustrated with these growing charges.

The Commission must work to ensure that our contribution system is both equitable and non-discriminatory. To this end, in February 2002, the Commission requested comment in a Further Notice on a specific industry proposal to replace the existing, revenue-based assessment mechanism with one based on the number and capacity of connections provided to a public network, and refreshed the record on other proposals. We have received a voluminous record, and will be holding a public forum to further develop the record on these pending proposals later this week.

The Commission intends to adopt a new foundation for contribution methodology before the end of this year. In the interim, the Commission has acted to stabilize the contribution factor for consumers by using unused funds from the schools and libraries program to decrease the upward pressure on consumer line items caused by declining interstate revenues.

In February 2002, the Commission also initiated a foundation proceeding concerning universal service and broadband technology. Universal service has historically been based on the assumption that consumers use the network for traditional voice-related services and that those voice services are provided over circuit-switched networks. As traditional services migrate to broadband platforms, the Commission must assess the implications for funding universal service and determine how to sustain universal service in an evolving telecommunications market. At the same time, the Commission must seek to avoid policies that may skew the marketplace or overburden new service providers. Thus, the proceeding seeks to answer the fundamental question: in an evolving telecommunications marketplace, should facilities-based broadband Internet access providers be required to contribute to support universal service?

In addition, the Commission has underway foundation proceedings to streamline and strengthen the universal service support mechanisms for schools and libraries and rural health care. As with other areas of universal service policy, the Commission seeks to ensure the continued efficient and effective implementation of Congress's goals as established in the statute, while taking into account the evolving nature of the telecommunications market.

Finally, the Commission also intends to initiate other proceedings later this year that will examine other critical universal service issues. In particular, the Commission intends to begin a foundation proceeding to take a look again at the nature and level of support for competitive industry providers, whose costs may differ from those of incumbent carriers. As part of its comprehensive high cost review, the Commission also intends to begin the complex process of examining the disparate rural and non-rural support mechanisms, so that we can ensure our universal service framework is resilient over time.

I would like to thank you, Mr. Chairman, for the opportunity to appear before you today. I look forward to working with you and other Members of this Subcommittee on these important universal service policy issues. I would be pleased to answer any questions you might have.

Senator INOUYE. Thank you very much, Ms. Attwood.

We will now recognize Commissioner Thompson.

STATEMENT OF G. NANETTE THOMPSON, CHAIR, REGULATORY COMMISSION OF ALASKA

Ms. THOMPSON. Mr. Chairman and Members of the Subcommittee, I want to thank you for the opportunity to testify today. I'm Nanette Thompson, the chairman of the Regulatory Commission of Alaska, and state chair of the Federal–State Universal Service Joint Board. The focus of my testimony today will be the importance of universal-service funding for rural areas.

Congress expressed its desire that universal service be preserved in light of emerging competition and other market forces through Section 254 of the Telecommunications Act of 1996. Section 254 was written largely for the benefit of small telephone companies in the rural areas of the nation. It is not clear that the full benefits of the universal service have been achieved as Congress intended.

In 1998, before the universal-service reforms enacted by the FCC, the total high-cost universal-service fund was about $1.7 billion and was devoted primarily to small and high-cost telephone companies. By comparison today, the universal-service programs total about $4.3 billion.

While the universal-service fund has seen exception growth since 1998, rural companies have been largely left behind as the FCC has concentrated its efforts to non-rural company support and access-charge reform. While the rural mechanism supporting local rates has remained largely unchanged, many non-rural companies receive substantially greater levels of universal-service support than they did before the act was passed. For example, even though the FCC's cost model deems only seven states worthy of non-rural high-cost support, the FCC has provided an additional $435 million to non-rural companies in 44 states under the CALLs access-charge support program. California, New York, and Virginia, which are all relatively low-cost states, receive about 20 percent of this funding.

Similarly, while the schools and library universal-service program, in concept, is a worthy effort, a high proportion of the $1.4 billion in program funding goes to the relatively urban, low-cost areas. For example, California, Illinois, and New York receive about $565 million, or 40 percent, of the total school and library funding. The funding to these three states is close to half of that available to all rural companies nationwide for high-cost loop support, which totals about a billion dollars. I'm not suggesting that California, Illinois, and New York shouldn't receive school and library support, but it's not evident that Congress intended such high levels of school and library funding to be so devoted.

As a member of the Federal–State Joint Board on universal service, I'm concerned that the fund not grow to such high levels as to burden consumers throughout the nation. We must use our universal-service funds wisely, and target funding to the most needing areas. Without universal-service funding, many areas of Alaska would face local rate increases ranging from $25 to $97 a month. Telephone service throughout much of rural Alaska would be unaffordable, absent Federal support.

I hope to work cooperatively with the FCC to ensure that the rural areas of the country are provided with sufficient support, while ensuring that universal-service funds benefit the public, as intended by Congress. We must ensure that any funding provided accrues to the benefit of consumers and not to the utilities' pocketbooks.

While I believe there may be need for room for improvement with some of the current Federal universal-service programs, I wish to express my strong support for Commissioners Abernathy, Martin, and Copps, who presently serve with me on the Universal Service Joint Board, as well as for Chairman Powell. This group, under the leadership of Chairman Powell, has worked well with the states and supported the Joint Board's efforts. The FCC has a daunting task in attempting to balance the conflicting public needs while addressing controversial and complex issues. This group has actively sought input from the states in important policy issues.

The Universal Service Joint Board is now working o three important issues. We've been asked to recommend additions or deletions to the list of services supported by universal-service funding, to recommend changes to the lifeline and linkup programs to make them more effective, and also to recommend definitions of reasonably comparable rates and sufficient support to be used to benchmark universal-service funding.

We are also participating with the FCC in a hearing later this week to take testimony on various proposals for modifying the fund's contribution mechanism. This joint board has been working effectively to analyze specific issues that have big impacts in the states. It provides an opportunity for me to strive to ensure that affordable, reliable telecommunications services are available to all Americans.

Thank you.

[The prepared statement of Ms. Thompson follows:]

PREPARED STATEMENT OF G. NANETTE THOMPSON, CHAIR, REGULATORY COMMISSION OF ALASKA

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify. I am Nanette Thompson, Chair of the Regulatory Commission of Alaska and state chair of the Federal-State Universal Service Joint Board.

The focus of my testimony today will be the importance of universal service funding for rural areas.

Congress expressed its desire that universal service be preserved in light of emerging competition and other market forces through Section 254 of the Telecommunications Act of 1996. Section 254 was written largely for the benefit of small telephone companies in rural areas of the nation. It is not clear that the full benefits of universal service have been achieved as Congress intended.

In 1998, before the universal service reforms enacted by the FCC, the total high cost universal service fund was about $1.7 billion and was devoted primarily to small and high cost telephone companies. In comparison, today the universal service programs total about $4.3 billion.

While the universal service fund has seen exceptional growth since 1998, rural companies have been largely left behind as the FCC has concentrated its efforts to non-rural company support and access charge reform. While the rural mechanism supporting local rates has remained largely unchanged, many non-rural companies receive substantially greater levels of universal service support today than they did before the Act was passed. For example, even though the FCC's cost model deems only 7 states worthy of non-rural high cost support, the FCC has provided an additional $435 million to non-rural companies in 44 states under the CALLs access

charge support program. California, New York, and Virginia, which are relatively low cost states, collectively receive about 20 percent of this funding.

Similarly, while the schools and library universal service fund, in concept, is a worthy effort, a high proportion of the $1.4 billion in program funding goes to relatively urban, low cost areas. For example, California, Illinois, and New York collectively receive $565 million, or about 40 percent of all school and library funding. The funding to these three states for their school and library programs is close to half that available to all rural companies nationwide for high cost loop support ($1 billion). I am not suggesting that California, Illinois, and New York should not receive school and library support, but it is not evident that Congress intended such high levels of school and library funding to be so devoted.

As a member of the Federal State Joint Board on universal service, I am concerned that the fund not grow to such high levels as to burden consumers throughout the nation. We must use our universal service funds wisely and target funding to our most needy areas. Without universal service funding, many areas of Alaska would face local rate increases ranging between $25 and $97 per month. Telephone service throughout much of rural Alaska would become unaffordable absent federal support.

I hope to work cooperatively with the FCC to ensure that the rural areas of the country are provided sufficient support while ensuring that universal service funds benefits the public as intended by Congress. We must ensure that any funding provided accrues to the benefit of consumers and not to the utilities' pocketbooks.

While I believe there may be room for improvement in many of the current federal universal service programs, I wish to express my support for Commissioners Abernathy, Martin and Copps who presently serve on the Universal Service Joint Board as well as Chairman Powell. The FCC has a daunting task attempting to balance conflicting public needs while addressing controversial and complex issues.

The universal service joint board is working on three important issues. We have been asked to recommend additions or deletions to the list of services supported by universal service funding, to recommend changes to the lifeline and linkup programs to make them more effective and to recommend definitions of reasonably comparable rates and sufficient support to be used to benchmark universal service funding. We are also participating with the FCC in a hearing later this week to take testimony on the various proposals for modifying the fund's contribution mechanism. The Joint Board has been working to effectively analyze specific issues that impact the states. It provides an opportunity for me to strive to insure that affordable, reliable communications services are available to all Americans.

Table 1: High-Cost Support by Jurisdiction - Non-Rural Support

(Total Projected 2001 Support Payments in Dollars)

Jurisdiction	Non-Rural Companies			Total Non-Rural Support	Percent
	High-Cost Model Support	Hold-Harmless Support	Interstate Access Support		
Alabama	$ 42,371,000	$ -	$ 17,433,612	$ 59,804,612	7.8%
Alaska	-	-	-	-	0.0%
American Samoa	-	-	-	-	0.0%
Arizona	-	-	-	-	0.0%
Arkansas	-	-	7,059,348	7,059,348	0.9%
California	-	5,977,972	27,094,908	33,072,880	4.3%
Colorado	-	-	16,345,008	16,345,008	2.1%
Connecticut	-	-	-	-	0.0%
Delaware	-	-	388,452	388,452	0.1%
District of Columbia	-	-	-	-	0.0%
Florida	-	-	43,938,096	43,938,096	5.7%
Georgia	-	-	11,682,312	11,682,312	1.5%
Guam	-	-		-	0.0%
Hawaii	-	-	3,030,516	3,030,516	0.4%
Idaho	-	-	-	-	0.0%
Illinois	-	-	12,440,220	12,440,220	1.6%
Indiana	-	-	20,781,876	20,781,876	2.7%
Iowa	-	-	-	-	0.0%
Kansas	-	-	730,356	730,356	0.1%
Kentucky	-	-	17,974,944	17,974,944	2.3%
Louisiana	-	-	11,234,532	11,234,532	1.5%
Maine	8,873,000	-	789,120	9,662,120	1.3%
Maryland	-	-	3,830,508	3,830,508	0.5%
Massachusetts	-	-	1,436,592	1,436,592	0.2%
Michigan	-	-	147,684	147,684	0.0%
Minnesota	-	-	2,139,420	2,139,420	0.3%
Mississippi	103,997,000	-	12,256,992	116,253,992	15.1%
Missouri	-	170,447	9,605,772	9,776,219	1.3%
Montana	4,383,000	-	29,664	4,412,664	0.6%
Nebraska	-	-	-	-	0.0%
Nevada	-	-	4,662,300	4,662,300	0.6%
New Hampshire	-	-	2,052,312	2,052,312	0.3%
New Jersey	-	-	4,770,684	4,770,684	0.6%
New Mexico	-	-	3,198,120	3,198,120	0.4%
New York	-	-	17,388,264	17,388,264	2.3%
North Carolina	-	2,450,352	11,540,460	13,990,812	1.8%
North Dakota	-	-	1,014,972	1,014,972	0.1%
Northern Mariana Is	-	-	-	-	0.0%
Ohio	-	105,840	7,710,408	7,816,248	1.0%
Oklahoma	-	-	7,085,580	7,085,580	0.9%
Oregon	-	-	13,907,052	13,907,052	1.8%
Pennsylvania	-	-	2,927,880	2,927,880	0.4%
Puerto Rico	-	121,936,623	-	121,936,623	15.9%
Rhode Island	-	-	100,968	100,968	0.0%
South Carolina	-	-	15,388,992	15,388,992	2.0%
South Dakota	-	-	73,308	73,308	0.0%
Tennessee	-	-	7,232,940	7,232,940	0.9%
Texas	-	-	29,168,088	29,168,088	3.8%
Utah	-	-	1,843,620	1,843,620	0.2%
Vermont	10,008,000	-	400,572	10,408,572	1.4%
Virgin Islands	-	-	-	-	0.0%
Virginia	-	-	44,390,076	44,390,076	5.8%
Washington	-	-	20,420,676	20,420,676	2.7%
West Virginia	25,875,000	-	11,859,264	37,734,264	4.9%
Wisconsin	-	-	2,338,560	2,338,560	0.3%
Wyoming	6,151,000	-	5,623,992	11,774,992	1.5%
Reserved (IAS)	-	-	TBD	TBD	
Total Industry	201,658,000	130,641,234	435,469,020	767,768,254	100.0%
Percentage:	26.3%	17.0%	56.7%	100.0%	

Source: October 2001 Monitoring Report Tables 3.13, Trends in Telephone Service, Section 20, released May 2002.

Note: Total Reserved (IAS) for Rural and Non-Rural support was estimated at $83.7M

Table 2: Federal Universal Service Support by Jurisdiction

Jurisdiction	Non-Rural Company Support*	Rural Company Support*	Schools and Libraries Fund**	Rural Health Care Support***	Total Universal Service Support	Percentage
Alabama	$ 59,804,612	$ 40,514,588	$ 15,955,276	$ -	$ 116,274,476	2.8%
Alaska	$ -	77,779,932	8,576,138	3,466,675	89,822,745	2.1%
American Samoa	$ -	529,360	2,043,145	-	2,572,505	0.1%
Arizona	$ -	43,247,244	34,664,287	178,027	78,089,558	1.9%
Arkansas	$ 7,059,348	73,932,064	11,942,693	63,112	92,997,217	2.2%
California	$ 33,072,880	57,269,388	267,129,828	131,607	357,603,703	8.5%
Colorado	$ 16,345,008	46,737,620	8,804,042	19,245	71,905,915	1.7%
Connecticut	$ -	763,396	20,958,026	-	21,721,422	0.5%
Delaware	$ 388,452	-	1,141,357	-	1,529,809	0.0%
District of Columbia	$ -	-	6,068,830	-	6,068,830	0.1%
Florida	$ 43,938,096	41,181,516	35,406,041	-	120,525,653	2.9%
Georgia	$ 11,682,312	79,412,540	39,018,529	-	130,113,381	3.1%
Guam	$ -	2,359,392	89,276	-	2,448,668	0.1%
Hawaii	$ 3,030,516	2,857,000	823,818	218,920	6,930,254	0.2%
Idaho	$ -	43,069,364	2,003,364	1,632	45,074,360	1.1%
Illinois	$ 12,440,220	26,413,804	90,628,861	56,454	129,539,339	3.1%
Indiana	$ 20,781,876	21,436,348	10,803,488	-	53,021,712	1.3%
Iowa	$ -	35,032,440	3,369,952	77,902	38,480,294	0.9%
Kansas	$ 730,356	81,040,068	5,293,851	70,217	87,134,492	2.1%
Kentucky	$ 17,974,944	19,523,616	16,787,150	14,488	54,300,198	1.3%
Louisiana	$ 11,234,532	69,076,404	18,697,179	8,478	99,016,593	2.4%
Maine	$ 9,662,120	21,376,040	2,004,785	-	33,042,945	0.8%
Maryland	$ 3,830,508	567,700	15,693,854	-	20,092,062	0.5%
Massachusetts	$ 1,436,592	639,752	28,398,141	-	30,474,485	0.7%
Michigan	$ 147,684	40,678,428	38,738,483	74,938	79,639,533	1.9%
Minnesota	$ 2,139,420	49,311,570	11,406,639	203,918	63,061,547	1.5%
Mississippi	$ 116,253,992	29,134,432	20,037,955	8,598	165,434,977	3.9%
Missouri	$ 9,776,219	80,235,148	50,825,775	8,892	140,846,034	3.3%
Montana	$ 4,412,664	47,855,592	2,425,496	200,704	54,894,456	1.3%
Nebraska	$ -	25,914,552	4,249,540	238,991	30,403,083	0.7%
Nevada	$ 4,662,300	18,429,196	2,421,372	-	25,512,868	0.6%
New Hampshire	$ 2,052,312	7,509,536	530,838	-	10,092,686	0.2%
New Jersey	$ 4,770,684	1,439,612	27,363,746	-	33,574,042	0.8%
New Mexico	$ 3,198,120	39,328,952	11,575,555	35,977	54,138,604	1.3%
New York	$ 17,388,264	45,193,764	207,677,445	-	270,259,473	6.4%
North Carolina	$ 13,990,812	29,180,788	21,983,634	64,577	65,219,811	1.5%
North Dakota	$ 1,014,972	26,591,148	1,302,463	188,376	29,096,959	0.7%
Northern Mariana Islands	$ -	2,811,752	76,608	-	2,888,360	0.1%
Ohio	$ 7,816,248	16,858,956	47,026,810	4,035	71,706,049	1.7%
Oklahoma	$ 7,085,580	69,794,708	15,794,765	8,328	92,683,381	2.2%
Oregon	$ 13,907,052	42,630,956	5,276,364	28,406	61,842,778	1.5%
Pennsylvania	$ 2,927,880	32,486,360	36,650,995	-	72,065,235	1.7%
Puerto Rico	$ 121,936,623	128,559,600	48,693,129	-	299,189,352	7.1%
Rhode Island	$ 100,968	-	3,110,793	-	3,211,761	0.1%
South Carolina	$ 15,388,992	40,180,168	37,733,366	17,909	93,320,435	2.2%
South Dakota	$ 73,308	23,739,180	1,125,849	132,687	25,071,024	0.6%
Tennessee	$ 7,232,940	34,283,552	26,658,931	1,148	68,176,571	1.6%
Texas	$ 29,168,088	154,339,652	100,978,840	-	284,486,580	6.8%
Utah	$ 1,843,620	12,521,300	3,810,352	-	18,175,272	0.4%
Vermont	$ 10,408,572	11,527,312	987,458	-	22,923,342	0.5%
Virgin Islands	$ -	25,293,544	670,408	87,673	26,051,625	0.6%
Virginia	$ 44,390,076	18,580,028	14,181,734	-	77,151,838	1.8%
Washington	$ 20,420,676	56,040,600	11,905,282	30,176	88,396,734	2.1%
West Virginia	$ 37,734,264	34,702,444	3,126,154	5,443	75,568,305	1.8%
Wisconsin	$ 2,338,560	59,255,372	16,636,171	4,149	78,234,252	1.9%
Wyoming	$ 11,774,992	26,660,480	886,730	14,921	39,337,123	0.9%
Reserved (IAS)	TBD	TBD			83,714,444	
Total w/o Reserve	767,768,254	2,015,828,258	1,422,171,591	5,666,603	4,211,434,706	100.0%
Total Industry	767,768,254	2,015,828,258	1,422,171,591	5,666,603	4,295,149,150	

Source: October 2001 Monitoring Report Tables 3.13, 4.4b, 5.2.; Trends in Telecommunications, Section 20, May 2002

* - Non-Rural Company support includes Model High Cost, Hold Harmless, and Interstate Access Support. Rural Company support includes Loop, Switching, Long Term Support, and Interstate Access Support. Data projected for 2001.

** - Funding Period July 1, 2000 through June 30, 2001, Funds Disbursed Through February 26, 2002

*** - Funding Period July 1, 2000 through June 30, 2001 (Activity through February 26, 2002)

Table 3: Change in Universal Service Support Over Time

Jurisdiction	1998 Support	Most Recent Support*	Percent Change
Alabama	$ 38,623,510	$ 116,274,476	201%
Alaska	60,404,979	89,822,745	49%
American Samoa	-	2,572,505	
Arizona	31,759,359	78,089,558	146%
Arkansas	68,521,453	92,997,217	36%
California	51,093,426	357,603,703	600%
Colorado	45,382,625	71,905,915	58%
Connecticut	1,209,123	21,721,422	1696%
Delaware	-	1,529,809	
District of Columbia	-	6,068,830	
Florida	21,737,296	120,525,653	454%
Georgia	72,651,716	130,113,381	79%
Guam	1,036,397	2,448,668	136%
Hawaii	1,347,560	6,930,254	414%
Idaho	28,359,910	45,074,360	59%
Illinois	22,976,092	129,539,339	464%
Indiana	16,316,272	53,021,712	225%
Iowa	28,202,998	38,480,294	36%
Kansas	59,622,933	87,134,492	46%
Kentucky	24,911,532	54,300,198	118%
Louisiana	65,313,667	99,016,593	52%
Maine	18,422,875	33,042,945	79%
Maryland	566,570	20,092,062	3446%
Massachusetts	480,094	30,474,485	6248%
Michigan	30,881,161	79,639,533	158%
Minnesota	37,842,002	63,061,547	67%
Mississippi	26,838,809	165,434,977	516%
Missouri	47,779,614	140,846,034	195%
Montana	42,389,980	54,894,456	29%
Nebraska	20,134,251	30,403,083	51%
Nevada	10,097,024	25,512,868	153%
New Hampshire	8,756,214	10,092,686	15%
New Jersey	3,244,810	33,574,042	935%
New Mexico	33,590,721	54,138,604	61%
New York	34,996,093	270,259,473	672%
North Carolina	40,935,388	65,219,811	59%
North Dakota	21,345,997	29,096,959	36%
Northern Mariana Island	4,269,284	2,888,360	-32%
Ohio	14,140,123	71,706,049	407%
Oklahoma	59,020,232	92,683,381	57%
Oregon	36,290,038	61,842,778	70%
Pennsylvania	22,326,922	72,065,235	223%
Puerto Rico	142,676,084	299,189,352	110%
Rhode Island	-	3,211,761	
South Carolina	44,719,106	93,320,435	109%
South Dakota	17,144,205	25,071,024	46%
Tennessee	26,005,629	68,176,571	162%
Texas	122,103,519	284,486,580	133%
Utah	9,109,789	18,175,272	100%
Vermont	12,152,466	22,923,342	89%
Virgin Islands	16,251,136	26,051,625	60%
Virginia	12,810,963	77,151,838	502%
Washington	41,764,358	88,396,734	112%
West Virginia	21,478,371	75,568,305	252%
Wisconsin	49,469,620	78,234,252	58%
Wyoming	21,756,317	39,337,123	81%
Reserved (IAS)		83,714,444	
Total w/o Reserve	1,691,260,613	4,211,434,706	149%
Total Industry	1,691,260,613	4,295,149,150	

Source: October 2001 Monitoring Report Tables 3.13, 4.4b, 5.2; Sept 2000 Monitoring Report Table 3.15.

* - A18 See Tables 1 and 2.

Table 4: Rural Company Support Dollars

Jurisdiction	2001 Loop	2001 LTS	2001 Local Switching	2001 Interstate Access Support	2001 Total	Percent
ALABAMA	25,629,000	7,444,164	6,692,000	749,424	40,514,588	2.01%
ALASKA	43,859,000	17,206,932	16,714,000	0	77,779,932	3.86%
AMERICAN SAMOA	59,000	258,360	212,000	0	529,360	0.03%
ARIZONA	24,443,000	3,172,000	11,307,000	4,325,244	43,247,244	2.15%
ARKANSAS	50,196,000	15,623,064	8,113,000	0	73,932,064	3.67%
CALIFORNIA	31,668,000	13,468,788	6,693,000	5,439,600	57,269,388	2.84%
COLORADO	30,243,000	12,292,620	4,202,000	0	46,737,620	2.32%
CONNECTICUT	0	165,396	598,000	0	763,396	0.04%
DELAWARE	0	0	0	0	0	0.00%
DISTRICT OF COLUMBIA	0	0	0	0	0	0.00%
FLORIDA	12,971,000	5,400,636	3,742,000	19,067,880	41,181,516	2.04%
GEORGIA	48,044,000	18,128,952	13,011,000	228,588	79,412,540	3.94%
GUAM	384,000	1,975,392	0	0	2,359,392	0.12%
HAWAII	1,277,000	0	1,580,000	0	2,857,000	0.14%
IDAHO	18,772,000	3,510,564	6,829,000	13,957.800	43,069,364	2.14%
ILLINOIS	8,157,000	6,304,812	11,788,000	163,992	26,413,804	1.31%
INDIANA	4,366,000	5,210,520	9,090,000	2,769,828	21,436,348	1.06%
IOWA	5,684,000	7,359,000	14,323,000	7,666,440	35,032,440	1.74%
KANSAS	48,929,000	11,622,384	14,227,000	6,261,684	81,040,068	4.02%
KENTUCKY	9,052,000	4,972,416	4,907,000	592,200	19,523,616	0.97%
LOUISIANA	44,796,000	16,978,404	7,302,000	0	69,076,404	3.43%
MAINE	7,748,000	6,098,040	7,530,000	0	21,376,040	1.06%
MARYLAND	0	92,700	475,000	0	567,700	0.03%
MASSACHUSETTS	50,000	103,752	486,000	0	639,752	0.03%
MICHIGAN	22,805,000	9,967,428	7,906,000	0	40,678,428	2.02%
MINNESOTA	17,720,000	12,334,758	17,761,000	1,495,812	49,311,570	2.45%
MISSISSIPPI	20,274,000	5,151,432	3,709,000	0	29,134,432	1.45%
MISSOURI	54,016,000	10,876,632	8,733,000	6,609,516	80,235,148	3.98%
MONTANA	27,729,000	10,158,348	9,495,000	473,244	47,855,592	2.37%
NEBRASKA	10,053,000	3,918,516	10,788,000	1,155,036	25,914,552	1.29%
NEVADA	6,662,000	930,024	6,770,000	4,067,172	18,429,196	0.91%
NEW HAMPSHIRE	1,029,000	1,534,536	4,946,000	0	7,509,536	0.37%
NEW JERSEY	0	0	1,082,000	357,612	1,439,612	0.07%
NEW MEXICO	18,232,000	6,263,000	10,334,000	4,499,952	39,328,952	1.95%
NEW YORK	12,687,000	6,907,692	18,375,000	7,224,072	45,193,764	2.24%
NORTH CAROLINA	11,410,000	12,232,788	5,538,000	0	29,180,788	1.45%
NORTH DAKOTA	11,076,000	6,071,148	9,444,000	0	26,591,148	1.32%
NORTHERN MARIANA ISLAND	1,721,000	0	843,000	247,752	2,811,752	0.14%
OHIO	6,876,000	5,290,956	4,692,000	0	16,858,956	0.84%
OKLAHOMA	38,404,000	16,656,708	14,734,000	0	69,794,708	3.46%
OREGON	23,809,000	9,391,344	7,606,000	1,824,612	42,630,956	2.11%
PENNSYLVANIA	1,065,000	14,347,404	6,680,000	10,393,956	32,486,360	1.61%
PUERTO RICO	37,473,000	91,086,600	0	0	128,559,600	6.38%
RHODE ISLAND	0	0	0	0	0	0.00%
SOUTH CAROLINA	19,851,000	11,263,620	7,444,000	1,621,548	40,180,168	1.99%
SOUTH DAKOTA	8,712,000	5,115,180	9,912,000	0	23,739,180	1.18%
TENNESSEE	13,889,000	10,547,916	7,755,000	2,091,636	34,283,552	1.70%
TEXAS	96,390,000	30,092,220	17,921,000	9,936,432	154,339,652	7.66%
UTAH	4,860,000	1,510,188	5,195,000	956,112	12,521,300	0.62%
VERMONT	3,802,000	2,424,312	5,301,000	0	11,527,312	0.57%
VIRGIN ISLANDS	17,980,000	7,313,544	0	0	25,293,544	1.25%
VIRGINIA	4,106,000	3,392,076	4,875,000	6,206,952	18,580,028	0.92%
WASHINGTON	30,601,000	15,577,000	7,987,000	1,875,600	56,040,600	2.78%
WEST VIRGINIA	22,015,000	1,077,144	3,759,000	7,851,300	34,702,444	1.72%
WISCONSIN	22,368,000	13,630,308	22,988,000	269,064	59,255,372	2.94%
WYOMING	15,454,000	4,568,004	6,202,000	436,476	26,660,480	1.32%
INDUSTRY	999,396,000	487,019,722	398,596,000	130,816,536	2,015,828,258	100.00%
Percentage	50%	24%	20%	6%	100%	

Senator INOUYE. I thank you very much, Commissioner Thompson.

May I now recognize Commissioner Jaber?

STATEMENT OF LILA A. JABER, CHAIRMAN, FLORIDA PUBLIC SERVICE COMMISSION

Ms. JABER. Thank you, sir.

Mr. Chairman and Members of the Committee, I, too, want to join in thanking you for the opportunity to testify before you today on this very important topic of universal service.

To give some context to my comments, I believe it is important for you to know some basic facts about Florida and the universal-

service fund. And let me say that I am here on behalf of the Florida Public Service Commission, although I do have the privilege of serving on the Universal Service Joint Board with Commissioner Thompson.

In the year 2000, the size of the fund was $4.7 billion, and Florida ratepayers contributed $438 million of that, or 7.24 percent of the entire fund. By comparison, Florida only received $121 million, or 2.59 percent, in benefits from the fund, making Florida, we believe, the net largest contributor to the fund. Based on recent projected data for the year 2002, we believe the fund will increase by an additional billion dollars from that seen in the year 2000.

Now, let me say that Florida is extremely supportive of the goal of access to all telecommunications services, and we support all of the programs currently under the universal-service umbrella. I think, though, that Florida believes that the current level of funding is sufficient to provide the continued support necessary to all states and everyone who seeks the support.

We have some concerns with respect to rules and procedures in the programs that have led or may lead to gaming and abuse with respect to the programs. In general, we believe that some adjustments to add more accountability to these programs make the programs more efficient and effective.

An example of the kind of problem I would like to see addressed by the FCC is the wide disparity in participation rates in the lifeline program. Specifically, some states use a self-certification process for determining eligibility for lifeline. Florida is concerned that verification procedures may vary across states and perhaps unintentionally lead to misapplication of the fund. At a minimum, we believe that the states should be required to inform the FCC of their efforts to ensure that only eligible customers receive the benefits from the fund.

Furthermore, we believe the FCC should address the disparity in the lifeline participation rates and identify the reasons for the disparity. In this way, a targeted and more economically efficient approach to addressing low participation could be identified, rather than simply expanding the eligibility criteria and, hence, expanding the fund itself.

Under the high-cost program, which is by far the largest universal-service fund program, in dollar terms, we believe the current provisions allow for multiline consumers in high-cost areas to receive support, not just for their primary lines, but additional lines. It's not clear to Florida that that sort of support which goes beyond the primary line is the intent of the universal-service provisions found in Section 254. This may be an area where greater stability and efficiency can be achieved by a change in the administration of the fund.

With respect to the issue of expanding the definition of "universal service" to include broadband, the Florida Public Service Commission has taken the position that it is premature to expand the coverage of the universal-service fund. We are concerned that expanding the fund to accommodate broadband Internet access, at this time, will prevent the marketplace from determining the most appropriate technology.

The marketplace should be permitted to work. Broadband is a relatively new consumer service. And, as we speak, entrepreneurs are busy developing the applications and the technologies to provide all of these good services to our end users. Just to give you an indication, without universal-service support, the FCC advanced-services report indicates that Florida ranks fourth nationwide in the number of high speed Internet access lines, and third in residential and small-business penetration. So we have that level of broadband deployment without the universal-service fund having supported those programs.

Second, recent reports from a variety of sources indicate that broadband demand is lagging behind broadband supply. The PSC believes that it is crucial to identify the reasons for the alleged lack of demand, and, as a result, as the chairman of the 706 Joint Conference, we are undertaking a study of take-rates, penetration rates, to determine what the reason is for low penetration in certain states and in certain areas within the state. And again, my belief is if we could target where the problems are, we could craft a solution that is more economical and efficient for those areas in those states.

Finally, I would like to reiterate my support of this hearing. And certainly I thank you for the invitation to testify. I, too, want to share in Commissioner Thompson's compliment to the FCC. What we've seen from the FCC is that they are reaching out to the states to identify where the problems are. I look forward to the en banc hearing this Friday.

In just the couple of seconds I have left, I'd like to address some questions that Senator Nelson asked before he left, with respect to examples Florida has in enhancing lifeline enrollment. We partnered with AARP and our consumer advocates and the FCC in the state of Florida in a proactive consumer-education program to make sure that consumers knew the benefits of lifeline and linkup and the assistance they could receive. We did a press conference. We have published brochures—in Spanish, as well—and sent them out, mass media, through the partnerships of news medias and press to make sure that the consumers knew about the lifeline program. Those are the examples we'd like to see the FCC undertake.

With respect to the reward or penalty question I think the Senator is referring to, Florida undertook, years ago, before the 1996 act was implemented, to wire its schools and libraries with the most efficient technology possible. So when the act was implemented and the universal-service fund was created, Florida did not need as much money in the schools and libraries program as other states did. So it looks like, for states like Florida, there is a penalty. We continue to contribute, although we may not need as much access to the fund as other states.

I don't see this as a state-versus-state issue, but certainly, we would be—we would advocate for an allocation or a reward or some recognition that Florida shouldn't contribute as much as it has because it was already ahead of the game with respect to schools and libraries.

Thank you.

[The prepared statement of Ms. Jaber follows:]

PREPARED STATEMENT OF LILA A. JABER, CHAIRMAN, FLORIDA PUBLIC SERVICE COMMISSION

I. Introduction

Thank you, Chairman Hollings, Members of the Committee, for the opportunity to testify before you on the important topic of Universal Service in telecommunications. I am here today on behalf of the Florida Public Service Commission (FPSC). I also have the privilege of currently serving as a member of the Federal-State Universal Service Joint Board and as the State Chair of the Federal-State Advanced Services Joint Conference. While I do not represent the positions of anyone other than the FPSC, I believe my participation in those bodies does give me a unique perspective on the issues of Universal Service and Advanced Telecommunications Services. I also want to commend the FCC for reaching out to the Joint Board in a way that allows greater state commission input.

The Florida Public Service Commission strongly supports the goal of access to telecommunications services at affordable rates, and we support all of the programs currently funded under the Universal Service umbrella. We do have some concerns about various rules and procedures in the programs that have led or may lead to gaming or abuse. In general, we believe that making some clarifications and adjustments to add more accountability to the programs will make the programs more effective and efficient.

II. Highlights of FPSC Comments on Universal Service Issues

The following are highlights of comments filed by the FPSC on the Universal Service issues:

A. Review of the Definition of Supported Service

1. The FPSC believes that the current services meet the criteria established in the Telecommunications Act of 1996 and recommends maintaining the current list of supported services at this time. In addition, the FPSC believes that expanding the definition to include advanced services or high-speed Internet access is not warranted in part because support is conditioned on the ability of a carrier to provide all of the supported services. As such, any proposal to expand the definition to include advanced services would not be technologically neutral.
2. The FCC invited comment on changing the definition of voice grade access, including whether support for a network transmission component of Internet access beyond the existing definition of voice grade access is warranted at this time. While we wholeheartedly support the idea of quality Internet access for all Americans and understand its importance to our nation, we do not believe that modification of the voice grade access is in the best interest of consumers. We also have technical concerns that if the intent of this proposal is to improve data transfer rates in the rural areas, the mere widening of the bandwidth specification, without concurrent standard setting for other specifications (i.e., signal-to-noise ratio), will not achieve the stated goals of improved transfer rates. The cost of requiring complex equipment to tweak the existing analog phone network could prove prohibitive and result in a misallocation of resources; resources that might be better deployed in a true digital system.

B. Review of Lifeline and Link-up Service for All Low-income Consumers

1. Before proceeding with changes to the current Lifeline program, the FCC should endeavor to understand the reasons for low versus high participation rates in the various states. The FPSC continues to support the original intent of the Lifeline program, which is to increase subscribership for low-income households that want, but cannot afford, telephone service.
2. States should make every effort to ensure that eligible households with and without telephone service are aware of and can easily enroll in the Lifeline/Link-up programs. Keeping the program objective in mind, low program participation should not be cause to manipulate eligibility criteria to increase the number of households that could qualify.
3. The FPSC recommends that the Joint Board and the FCC encourage states to explore various automatic enrollment strategies to effectively target funding to consumers and determine eligibility for Lifeline and Link-up support. We believe that it is necessary to certify consumers' eligibility and perform periodic verifications in order to prevent waste, fraud, and abuse, and to ensure the integrity of the program. We recommend increased promotion of the program through more frequent bill inserts and requiring all ETCs to post

application information about their Lifeline service on the Lifeline Support website.

C. Schools and Libraries Universal Service Support Mechanism

1. *Development of Rules to Limit Equipment Transferability*. The FPSC believes it is necessary for the FCC to establish rules governing when and how equipment can be transferred without charge, before seeking to acquire new discounted equipment. While the FPSC recognizes that there may be some legitimate reasons to upgrade facilities because of technological innovations, manipulation of the program consumes resources that otherwise would have been better targeted to other program applications.
2. *Accountability*. The FPSC believes that one way to deter waste, fraud, and abuse is to make the current program more transparent. Making available additional data about the recipients of support would build greater confidence that the program is fair. Currently, it is difficult to acquire data in significant detail and format. More information relating to what specific services have been committed to by a school or library should be made publicly available. This information, as well as the size of the school or library, would be of great use to increase the integrity and accountability of the system.
3. *State Funding Cap*. The FPSC believes that establishing a new, efficient direction for the E-Rate program can be achieved by focusing on an equitable distribution of funds to each state. We believe there is merit in establishing a state funding cap based on poverty. Schools and libraries within a state would only have access to an equitable distribution of the $2.25 billion according to the poverty level of a state.
4. *Application Process*. FPSC supports the FCC development of a list of specific eligible products or services that is accessible online. Applicants could select the specific products or services as part of their FCC Form 471 application. This could help reduce accidental funding of ineligible services. We believe it would be prudent to periodically review the eligibility of services on the list to ensure that ineligible services do not become bundled with eligible services.
5. *Internet Access When Bundled with Content*. The FPSC supports continuation of the FCC policy that schools and libraries may receive discounts on access to the Internet, but not for any proprietary content. Expanding support to include proprietary content would likely increase the expense, and the current annual funding requests already exceed the $2.25 billion cap.

D. Tenth Circuit Remand

1. The FPSC finds merit in the proposal filed by Verizon to define "reasonably comparable" as rates in urban and rural areas that are within two standard deviations of each other or of the national mean. We agree with several commenters that "reasonably comparable" does not mean identical. We believe that the data recently gathered by the General Accounting Office could serve as a useful sample of rates.
2. On sufficiency, the FPSC agrees with the comments filed by Verizon that a sufficient fund "must be one that allows reasonable comparability of rates in urban and rural areas without causing excessive demands on the total universal assessment and without impairing the amount of funds available for other universal service programs." The FPSC supports Verizon's proposal to define a "sufficient" federal high cost fund as a fund that would provide assistance to states that cannot maintain rates that are reasonably comparable to the nationwide average due to high costs within those states.
3. Regarding the high-cost benchmark, the FPSC said that the FCC should retain its existing cost-based approach in identifying states that need support from the federal fund. (The current benchmark is 135 percent).
4. On State Inducements, the FPSC said that the FCC should not dictate the method that states take to address high-cost support. The FPSC does see a benefit in adding a layer of accountability into the program as to the individual states' need for high cost support. The FCC could require that state commissions provide notification of the steps their state has taken to achieve this rate comparability. The FPSC agrees with Verizon that states should be allowed to verify rate comparability within the state by showing either: (1) that its rates in urban and rural areas are within two standard deviations of each other; or (2) that its rates in rural areas are within two standard deviations of the nationwide average urban rate.

5. In the alternative, the FCC should embark on a collaborative model of "state inducements" that will satisfy the Court's remand. Under this model, the FCC would undertake an outreach with the states to develop "inducements" in instances where rate comparability within a state has not been achieved. In no way should these inducements be preemptive of a state legislature's authority . . . The FCC could send a few staff to meet with individual State Commissions on this matter or establish individual conference calls to develop incentives for states to address their high cost universal service needs. The focus should begin with those states that are net recipients of the Federal program funds.

III. Key Concerns of Florida Public Service Commission

A. Accountability—The funds should go where they are supposed to go. We believe more can be done to make the programs more efficient and reduce the need to expand the size of the fund. I don't believe that it is necessary at this time to expand the Universal Service Fund to include broadband Internet access services. I would not preclude that ever happening but simply suggest that it is premature at this time.

B. Size of the fund—Some states are net contributor states and others are net recipients. Florida is a net contributor state and is concerned that the size of the fund is not any larger than it needs to be to serve its purpose. It is important to provide some basic facts about Florida and the Universal Service Fund. In 2000 (the most recent data available to us), the size of the fund was $4.7 billion. In that year, Floridians contributed $338 million or approximately 7.24 percent of the entire fund. By comparison, Florida received $121 million or only 2.59 percent in benefits from the fund, making Florida a net contributor state by a significant margin. Based on recent projected data for 2002 from USAC, we believe that the fund will increase by an additional billion dollars for 2002 from that seen in 2000.

C. Lifeline—This year, the FPSC, the AARP, and a representative from the FCC joined forces in April to kick off an education campaign for the Lifeline and Linkup programs in Florida in an effort to increase awareness and boost enrollment. I believe this is the kind of initiative that is vital to getting low income consumers on the network.

IV. Additional Information

We would be glad to provide the Florida Commission's comments on the above topics that we filed with the FCC. Contact Cindy Miller, head of our Office of Federal and Legislative Liaison, (850) 413–6082, for the additional information.

Senator INOUYE. Thank you very much, Ms. Commissioner.

May I now recognize Director Gregg?

STATEMENT OF BILLY JACK GREGG, DIRECTOR, CONSUMER ADVOCATE DIVISION, PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

Mr. GREGG. May it please the Committee, I'm Billy Jack Gregg, director of the Consumer Advocate Division of the Public Service Commission of West Virginia. My office is also a member of the National Association of State Utility Consumer Advocates, NASUCA. However, I should make clear that today I'm testifying on my own behalf and on behalf of my office, and not NASUCA.

I believe that universal service has been a great public-policy success. The biggest issue facing us today is how to sustain the universal-service fund, long-term. I want to go over a little bit of the history of the fund, first, before addressing the current problems facing the fund.

As Chairman Thompson indicated, before the passage of the 1996 act, the universal-service fund aggregated about $1.8 billion per year. As a result of the changes wrought by the act and the expansion created by the FCC pursuant to that act, the total funds from the universal-service fund have more than tripled, to about $5.7 billion this year, prior to the action of the FCC last Thursday to

use unused schools and libraries fund. That action will take about $240 million in each of the last two quarters of this year, resulting in total universal-service commitments for this year of about $5.2 billion.

Now, that sounds like a lot of money. And, indeed, it is. However, it must be kept in perspective. Last year, the total telecommunications revenues in the United States were more than $220 billion. What that means is that, in return for collecting and redistributing less than 3 percent of the total telecommunications revenues—in this nation each year, we have supported high-cost areas and kept rates affordable. We have supported rates for low-income individuals. We have wired schools and libraries. We have helped rural healthcare providers. Moreover, all states have benefited from the universal-service fund.

I have attached to my testimony, as Attachment 1, a listing of the actual disbursements during 2001, as listed by the Universal Service Administrative Company in its annual report. This attachment breaks down the funds received by each state under each support mechanism—the high-cost mechanism, the low-income mechanism, the schools and libraries mechanism, and the rural health mechanism. What is obvious is that all benefit. The success of the universal-service fund in distributing these benefits to all areas of our country is a accomplishment that all involved should be very proud of.

However, there are problems, as everyone here has recognized. As indicated by Ms. Attwood, the FCC decided to base the funding for universal service on interstate revenues. Initially, they had decided to base the funding for schools and libraries and rural health on all revenues. However, that was struck down by the Fifth Circuit Court of Appeals in 1999 based on the wording of the act. And this is the root part of the problem that we're facing today.

The principles of 254—listed in 254(b)—state that all providers of telecommunications services shall contribute to universal service. However, 254(d) limits that obligation to a subset of all providers, only those who are providers of interstate telecommunications services. So we have an anomaly whereby all benefit—all states, all areas benefit—but yet not all contribute.

And this has been the problem. Everybody loves universal service, but nobody wants to pay for it. The reality is that, since all benefit, all should contribute to universal service. And that is what we are grappling with today, how to transition our existing universal-service funding within the constraints of the existing law.

Now, I have listed, on Attachment 2 to my testimony, graphs and figures showing the growth of the fund and the various components of the fund since 1997. I've also listed the funding base, which is interstate revenues. As you can see from review of this attachment, interstate funding grew at a fairly rapid pace in the first few years and kept pace with the increases in funding for the universal-service fund. However, starting in 2000 and continuing to the present, interstate revenues have flattened out and now started to decline. The result is that, when coupled with an increasing demand on the universal-service fund, the assessments on carriers and ultimately on their consumers have risen rapidly.

In the fourth quarter of 2000, the assessment level was about 5.6 percent on all carriers, based on their interstate revenues. By the second quarter of this year, it had risen to 7.2 percent of interstate revenues. Without the FCC's action of last Thursday, the assessment rate would have risen to 8.77 percent on interstate revenues of all carriers. The impact on consumers would have been even greater.

I'm sure all of you have heard complaints from consumers concerning the fact that they are looking at assessments on their bills from their long-distance carriers of 11, 12, 13, 15 percent, much greater than the actual assessment on those carriers themselves.

This is the crisis, the fact that the funding base is not stable. Prior to looking at alternatives, though, I think it's important to keep in mind that, if you take a broader perspective, this is a crisis created by the wording of the law.

If you look at Attachment 3, you can see there charted universal-service funding, the interstate funding base, and total telecommunications revenues. If the law had been clear that we could base assessments for universal service on total telecommunications revenues, we wouldn't be here today. The assessment rate on all carriers would have been less than 3 percent, and we would have been able to achieve all of the universal-service goals set out in the act; plus, we would have room for future growth as revenues grew. Unfortunately, that is not the case, nor is it likely to be the case that we will get a quick and easy change in the law to make the contribution-base broader.

Given that, we have to look at different alternatives. One alternative is simply to tinker with the existing system to remove caps and safe-harbor provisions that have been provided for wireless carriers, for paging carriers, and other carriers. However, I think this is a short-term Band-aid that will not address the long-term sustainability of the fund.

Another alternative that has been mentioned by several parties here is the connection-based contribution system, whereby all carriers would be assessed based on the number of connections they provide to the public switched telephone network.

However, this proposal has its own problems. 254(d) requires that every provider of interstate telecommunications service contribute to the fund. Going to a connection-based system would exempt pure interstate long-distance carriers, the very carriers who are today carrying the majority of the burden in funding the universal-service fund.

While we look at the contribution base, we cannot ignore the funding outflow from the fund. The fund, in fact, should be based like a pyramid, have as broad a base as possible to be as stable as possible at the bottom; at the top, to have a sufficient but targeted place for these funds to go to benefit America.

In looking at the different funds, I want to highlight one issue that is very important that the FCC will be looking at apparently, from what Ms. Attwood said, and that is the fact that currently all lines are supported, all lines supplied by an eligible telecommunications carrier.

The conception, initially, when people thought about universal service, there would be competition for the subsidy provided by uni-

versal service in high-cost areas since all providers would be competing for the same per-line support. However, in 1999, the Commission decided to support all lines. That means if a family lives in a high-cost area, and they're getting $9 per month of support per line, and they have two lines—two land-line phones—they get $18—the phone company gets $18, $9 for each of those lines. If a wireless carrier happens to come in and get ETC status and provides three lines—three phones—three separate numbers to that family, they also get $9 per line for each of those numbers. This fact has the potential to greatly explode the fund in the future and must be looked at very carefully as more and more wireless carriers, who are supplying additional phones in high-cost areas, become eligible telecommunications carriers.

I want to thank you for allowing me to appear here today. We, as members of the Joint Board, will continue doing our best to look at both sides of the equation—the inflows of cash into the fund, as well as the outflows—and we will continue to try to ensure that we support access and not excess so that we can continue this great public-policy success that is the universal-service fund.

Thank you.

[The prepared statement of Mr. Gregg follows:]

PREPARED STATEMENT OF BILLY JACK GREGG, DIRECTOR, CONSUMER ADVOCATE DIVISION, PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

My name is Billy Jack Gregg and I am the Director of the West Virginia Consumer Advocate Division. My office is charged with the responsibility of representing West Virginia utility ratepayers in state and federal proceedings which may affect rates for electricity, gas, telephone and water service. My office is also a member of the National Association of State Consumer Advocates (NASUCA), an organization of 42 state utility consumer advocate offices from 39 states and the District of Columbia, charged by their respective state statutes with representing utility consumers before state and federal utility commissions and before state and federal courts. I am a former member of the Board of Directors of the Universal Service Administrative Company (USAC) and currently serve on the Federal-State Joint Board on Universal Service. I greatly appreciate the opportunity to testify at this legislative hearing on the future sufficiency and stability of the Federal Universal Service Fund (USF).

I. Introduction

First, I would like to commend Chairman Inouye, the Members of the Subcommittee, and your staffs for conducting this review of the operation of the universal service fund at this time. I and other members of NASUCA truly appreciate your continuing efforts to seek out the views of consumers and consumer representatives. We look forward to continuing to work with you in developing telecommunications policies and legislation that benefit all consumers and the nation as a whole.

II. Background

The most important issue facing the Federal Universal Service Fund is its long-term sustainability, that is, ensuring that the USF is sufficient, predictable and affordable for all parties involved: fund recipients, telecommunications providers and consumers. Before I address the current problems facing the USF, I believe it is appropriate to review the achievements of the USF since the passage of the Telecommunications Act of 1996 (the Act).

Section 254 of the Act enshrined and expanded universal service principles which had been followed by the Federal Communications Commission for decades. Based upon the requirements of Section 254, the FCC, after consultation with the Federal-State Board on Universal Service, created a new Universal Service Fund in 1997 containing several distinct support mechanisms. As a result, total USF funding has grown from $1.8 billion in 1997 to $5.7 billion during 2002. While these support amounts are large, they must be kept in perspective. Total telecommunications revenues in the United States last year were in excess of $220 billion. By annually collecting and redistributing less than 3 percent of these total revenues, we are able

to make phone service affordable in all high-cost areas of the nation; support low-income customers; assist rural health care providers; and connect all classrooms to the internet. Moreover, all states and territories benefit from the USF as shown on Attachment 1 to my testimony. That's quite an accomplishment, and one that everyone involved in the USF should be proud of as we move forward to ensure the long-term sustainability of the fund.

III. The Funding Base Crisis

As I mentioned earlier, total funding for the USF has grown from $1.8 billion to $5.7 billion. Unfortunately, the funding base for the USF has not kept pace with the growth in the fund, resulting in higher and higher USF assessments on carriers and their customers. The problem stems in large part from the wording of the Act itself. Section 254(b)(4) states that: "*All providers of telecommunications services* should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." However, Section 254(d) states: "Every telecommunications carrier that provides *interstate telecommunications services* shall contribute on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service." In other words, even though the principle set forth in the Act is that *all* telecommunications providers should contribute to the fund, and even though the fund benefits all areas of the country, Section 254(d) limits the obligation to support the fund to a subset of telecommunications carriers—providers of *interstate* telecommunications services.

In 1997 the FCC decided to base the funding for the high-cost and low-income support mechanisms on each carrier's interstate and international revenue, while the funding for schools and libraries and rural health support mechanisms were supported by assessments on all revenues, interstate and intrastate. The use of intrastate revenues for USF assessment purposes was struck down by the Fifth Circuit Court of Appeals in 1999. Since that time the contribution base for the USF has been limited to only interstate revenues. As the USF has grown in order to meet the Act's direction that support be sufficient and explicit, the assessment rate has also increased.

Attachment 2 to my testimony shows the change in USF funding since 1997, along with changes in the interstate revenue contribution base for the USF.[1] As you can see, the introduction of the schools and libraries fund and increases in the high-cost fund have driven the overall size of the fund. As a result, the fund has tripled, rising from approximately $1.8 billion in 1997 to approximately $5.8 billion this year.[2] So long as interstate revenues grew at a reasonable rate, the ultimate impact of fund growth on the USF assessment rate and customers' bills was fairly moderate. However, beginning in 2000 interstate revenue growth began to flatten out and during 2002 started to decline. The result has been a steep escalation in the assessment rate, from 5.67 percent in the fourth quarter of 2000 to 7.28 percent in the second quarter of 2002. Without the FCC's actions of June 13, 2002, the assessment rate on providers would have risen to 8.77 percent beginning July 1. The impact on customers would have been even worse. Clearly, a universal service fund which cannot depend on its funding base is not predictable, is not sufficient, and is clearly not sustainable.

IV. Alternatives for the Contribution Base

There are several alternatives available in order to stabilize the USF contribution base. One alternative would be to remove the caps or safe harbor provisions in current rules which artificially depress the existing interstate revenue contribution base. However, I believe such actions would amount to short term band-aids which would not address the long term needs of the fund.

Another alternative would be to grant the FCC the authority to base contributions to the fund on total telecommunications revenues. While growth in the interstate revenue base has flattened out and begun to decline, total telecommunications revenues from end-users have continued to grow at a healthy pace. Shown on Attachment 3 to my testimony is a comparison of changes in the universal service fund, the interstate revenue base, and total telecommunications revenues from 1997 to

[1] The interstate revenue base for a particular year generally represents revenues reported from the previous year. The USF assessment rate shown on Attachment 2 is not the actual rate used in any quarter, but is derived by dividing annual funding by the interstate revenue base. The interstate revenue base for years 1998—2002 comes from USAC reports. The interstate revenue base for 1997 is estimated. Full year data for 2002 assumes that the Fourth Quarter demand and revenue base will be the same as in the Third Quarter.

[2] The figures for this year do not take into account the actions taken by the FCC on June 13, 2002, to hold down the size of the fund by tapping unused schools and libraries funds.

2002.[3] As you can see, total telecommunications revenues would provide a healthy funding base for the USF. In fact, if total telecommunications revenues had been used as the funding base from the start, we would not be here today. The growth in the fund could have been accommodated while keeping the assessment rate below 3 percent.

Use of total revenues would also eliminate disputes about whether revenues are intrastate or interstate, and would equitably spread the obligation to support universal service to all providers and to all customers based on their use of the network. However, basing federal universal service on total revenues would require a statutory change to clarify that the FCC has the authority to base contributions on all revenues, intrastate as well as interstate. In addition, a total revenues base could be susceptible to erosion in the future as more and more traffic, including voice traffic, migrates to the internet and is classified as "information services" exempt from USF assessment.

A third alternative would be base assessments on connections to the public switched telephone network. The FCC is currently considering such a proposal. While the proposal does enlarge the base of the USF and open the opportunity for growth in the base in the future, it does have several flaws: (1) it radically shifts the funding of the USF among industry groups; (2) it appears to exempt a pure provider of interstate long distance from making any contribution to the fund in contravention of the plain wording of Section 254(d); and (3) it shifts responsibility for payment of USF charges from high-use to low-use customers. In spite of these flaws, the proposal does offer a promising avenue to avoid future problems with classification of services or revenues as information services, and deserves serious consideration.

IV. ISSUES RELATED TO PARTICULAR SUPPORT MECHANISMS

In looking at the long-term sustainability of the fund, we need to focus not only on the contribution base, but also on the individual support mechanisms which make up the overall fund. Each of these support mechanisms presents unique issues which will have to be resolved. Even though the focus of this hearing has been on stabilizing the fund—which implies that we should limit funding—we must be mindful that the Act requires the fund to be sufficient to carry out each of the universal service principles. For some mechanisms this may require a limitation in funding, while for others an expansion will be needed.

A. HIGH-COST SUPPORT

The high-cost support mechanism is the oldest portion of the fund, and is still the biggest. High-cost support has grown by over $1.2 billion in the last six years as the FCC has introduced three new parts to the fund: high-cost model support, interstate access support, and interstate common line support, which begins July 1. These new funds helped adapt the USF to the introduction of competition by making support explicit and portable. However, there is one issue common to all parts of the high-cost fund which threatens to enlarge the fund to an unsupportable size.

Under current rules, all lines provided by eligible telecommunications carriers (ETCs) in high-cost areas receive support. The support in any particular wire center is the same for all carriers, and is based on the costs of the incumbent carrier. Rather than competing for universal service support, all ETCs that provide service receive support in equal per line amounts. For example, a single family in a high-cost wire center could be provided two landlines by an incumbent ETC and three cellular lines by a wireless ETC. Each of these carriers would receive equal support for each of the lines provided. As a result, the potential exists for a large increase in the high-cost fund as more and more carriers, especially wireless carriers, attain ETC status. If the high-cost fund is meant to provide affordable access in all parts of the country, but not to subsidize the unlimited desires of each individual, then this issue will have to be dealt with in some manner.

B. LOW-INCOME SUPPORT

The FCC greatly expanded the eligibility criteria and the size of the low-income support mechanism in 1997. Nevertheless, the participation in the program varies widely among the states. As shown on Attachment 1, of the $584 million paid out for low-income support in 2001, over half went to one state, California. This is not

[3] Total telecommunications revenues are taken from the FCC's Telecommunications Industry Revenues reports. To be consistent with the interstate revenue base, reported revenues from a particular year are shown on the graph as the funding base for the next year. For example, the total reported revenues for 2000 of $229.1 billion are shown on the graph as the funding base for 2001. Total revenues available for 2002 have not been reported. The funding base for 1997 is estimated.

to disparage California's low-income program, but to point out that low-income support funds are distributed very unevenly throughout the nation. There are also overall fund size implications from this skewed distribution. If every state's program was as successful as California's, the size of the low-income support fund would almost triple to $1.5 billion. The FCC currently has a proceeding open to review the operation of the low-income support mechanism.

C. SCHOOLS AND LIBRARIES SUPPORT

The schools and libraries fund has been capped since its inception at $2.25 billion. Demand for schools and libraries funds have always far exceeded the cap. As noted by the FCC in its Order of June 13, 2002, demand in the current year is almost double the funds available. As more and more schools have become connected to the internet through the e-rate, the demand for recurring or priority one funds has increased. The result has been that the money available for internal connections in the schools yet to be wired has been declining. The FCC's resolution of the unused funds issue its June 13, 2002, Order may help resolve this problem, but pressure on the cap is likely to continue. The FCC is also currently considering comments on reforms to the schools and libraries fund.

D. RURAL HEALTH CARE SUPPORT

Unlike the other support mechanism, the rural health fund has had difficulty generating sufficient demand. The FCC originally anticipated a $100 million per year fund. However, in spite of repeated attempts to remake the fund, disbursements have remained low, only $7.9 million in 2001. Although the FCC is currently examining the operation of the rural health fund, the root cause of the problems for the rural health fund lie in the wording of Section 254. Unlike the schools and libraries support mechanism which provides discounts from regular prices on all telecommunications services, and pays for internal connections, Section 254(h) limits the rural health fund to the difference between rates available to health care providers in rural and urban areas of a state. Since many states have rural rates which are lower than urban rates, or have "postage stamp" rates for data services, the rural support mechanism has been of limited utility in meeting the needs of rural health providers. A statutory change should be considered which would make the rural health section of the Act parallel with the schools and libraries by providing services "at rates less than the amounts charged for similar services to other parties."

V. CONCLUSION

In order to be sustainable in the long-term, the USF must be configured like a pyramid: it must have a broad and stable base of contributions at the bottom, and a narrow but sufficient focus of support at the top. The current universal service fund requires work on both ends: issues related to the contribution base must be resolved, and the limited resources of the fund must be properly targeted. In order to continue the public policy success of the universal service fund, we must support access, not excess.

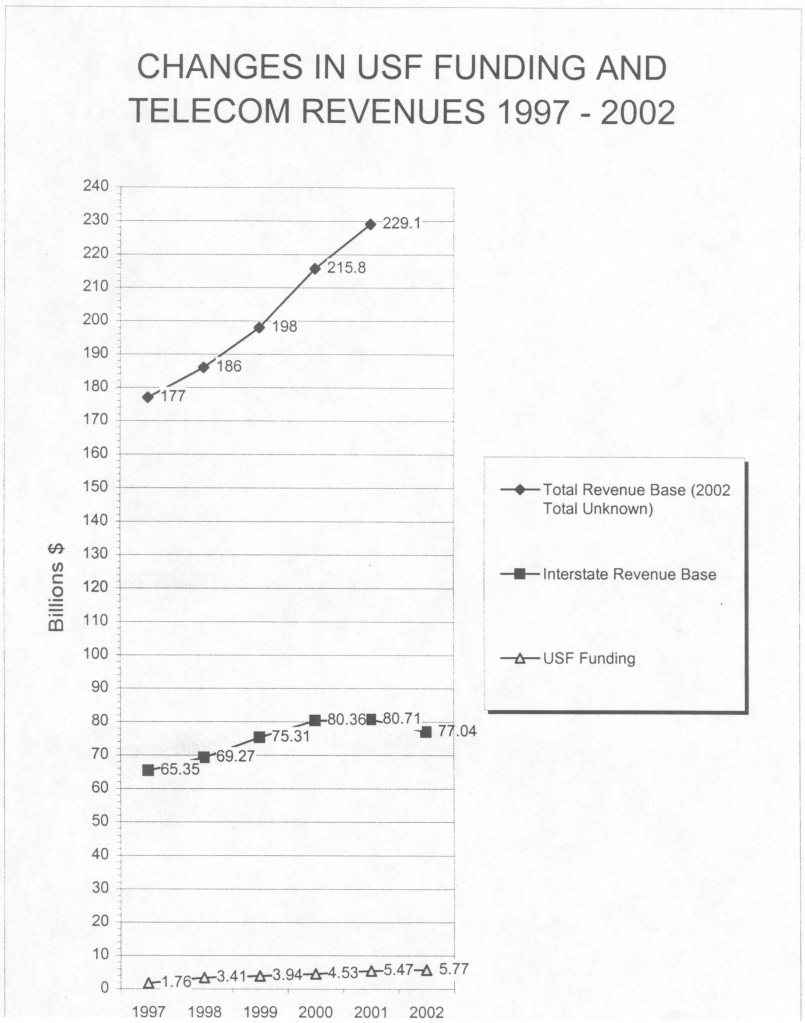
FEDERAL UNIVERSAL SERVICE SUPPORT IN EACH STATE 2001 DISBURSEMENTS IN MILLIONS

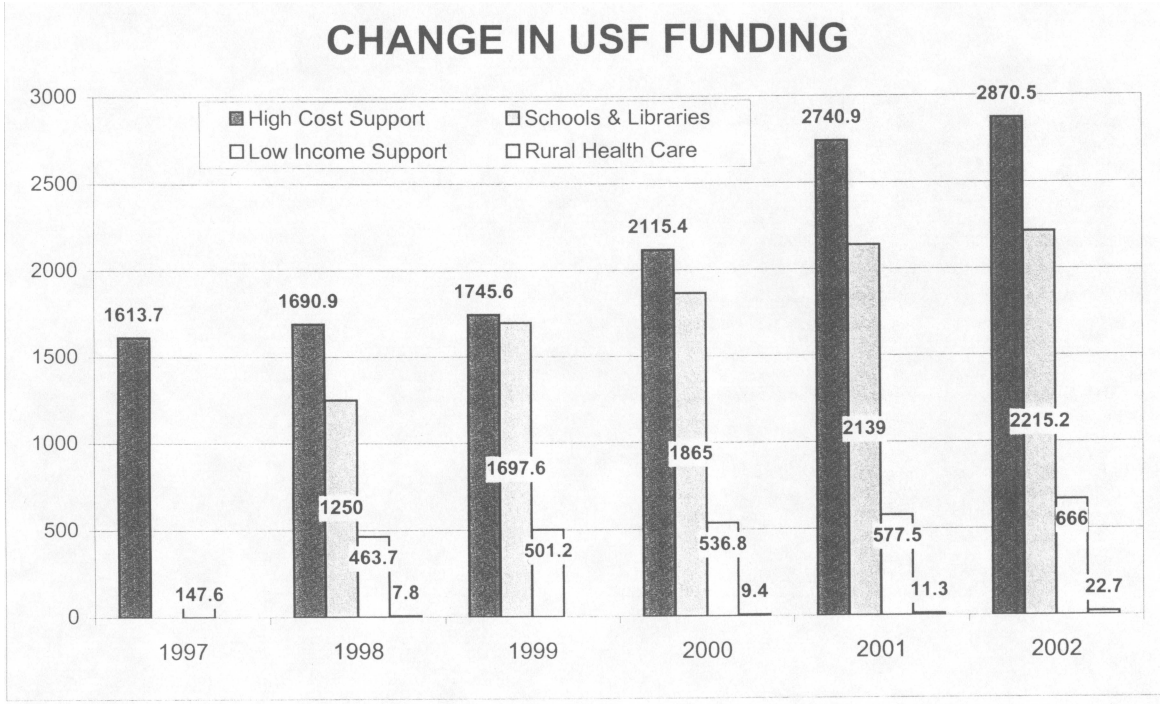
State	High Cost Support	Low Income Support	Rural Health Support	Schools & Libraries Support	Total Support
Alabama	$93.8	$2.3	$0.0	$14.1	$110.2
Alaska	$77.7	$1.4	$4.1	$10.1	$93.3
American Samoa	$0.5	$0.1	$0.0	$1.0	$1.6
Arizona	$51.4	$4.4	$0.3	$30.7	$86.8
Arkansas	$77.6	$0.6	$0.1	$11.5	$89.8
California	$82.6	$306.6	$0.1	$288.2	$677.5
Colorado	$62.0	$2.6	$0.1	$9.8	$74.5
Connecticut	$1.1	$5.0	$0.0	$18.8	$24.9
Delaware	$0.4	$0.1	$0.0	$1.2	$1.7
D.C.	$0.0	$1.0	$0.0	$7.4	$8.4
Florida	$84.1	$14.0	$0.0	$46.9	$145.0
Georgia	$91.1	$6.8	$0.0	$46.2	$144.1
Guam	$2.3	$0.2	$0.0	$0.2	$2.7
Hawaii	$5.6	$1.4	$0.2	$0.9	$8.1
Idaho	$43.5	$2.5	$0.0	$2.1	$48.1
Illinois	$38.9	$6.6	$0.1	$97.9	$143.5
Indiana	$42.5	$2.8	$0.0	$12.4	$57.7
Iowa	$34.2	$1.1	$0.1	$4.3	$39.7
Kansas	$81.7	$1.3	$0.1	$6.9	$90.0
Kentucky	$35.6	$4.5	$0.0	$21.9	$62.0
Louisiana	$81.8	$1.5	$0.0	$20.5	$103.8
Maine	$30.9	$8.6	$0.0	$2.2	$41.7
Maryland	$4.4	$0.4	$0.0	$16.9	$21.7
Massachusetts	$1.6	$16.0	$0.0	$23.7	$41.3
Michigan	$40.7	$12.0	$0.2	$40.5	$93.4
Minnesota	$50.6	$3.8	$0.4	$13.1	$67.9
Mississippi	$141.3	$1.9	$0.0	$17.2	$160.4
Missouri	$75.8	$2.7	$0.0	$32.7	$111.2
Montana	$52.3	$1.4	$0.3	$2.0	$56.0
Nebraska	$25.9	$1.5	$0.3	$4.3	$32.0
Nevada	$22.7	$2.1	$0.0	$2.6	$27.4
New Hampshire	$9.5	$0.6	$0.0	$0.6	$10.7
New Jersey	$6.1	$3.3	$0.0	$32.6	$42.0
New Mexico	$42.4	$4.0	$0.1	$11.9	$58.4
New York	$61.2	$46.8	$0.0	$208.4	$316.4
North Carolina	$38.8	$8.2	$0.1	$21.0	$68.1
North Dakota	$27.7	$1.4	$0.3	$1.3	$30.7
N. Mariana Is.	$3.8	$0.0	$0.0	$0.1	$3.9
Ohio	$29.2	$20.3	$0.0	$42.9	$92.4
Oklahoma	$76.7	$6.5	$0.0	$14.3	$97.5
Oregon	$60.5	$3.2	$0.0	$6.6	$70.3

Pennsylvania	$35.6	$6.0	$0.0	$49.3	$90.9
Puerto Rico	$118.1	$1.1	$0.0	$48.5	$167.7
Rhode Island	$0.1	$4.4	$0.0	$3.4	$7.9
South Carolina	$54.8	$2.0	$0.0	$32.1	$88.9
South Dakota	$24.1	$1.6	$0.2	$1.3	$27.2
Tennessee	$40.8	$4.4	$0.0	$26.0	$71.2
Texas	$167.2	$30.7	$0.1	$96.7	$294.7
Utah	$14.4	$1.9	$0.0	$3.9	$20.2
Vermont	$22.8	$3.0	$0.0	$1.0	$26.8
Virgin Islands	$25.3	$0.0	$0.1	$0.6	$26.0
Virginia	$64.3	$2.0	$0.0	$17.9	$84.2
Washington	$77.1	$8.8	$0.0	$13.7	$99.6
West Virginia	$71.8	$0.4	$0.0	$3.7	$75.9
Wisconsin	$59.7	$5.9	$0.0	$17.5	$83.1
Wyoming	$36.0	$0.2	$0.0	$0.5	$36.7
TOTAL	$2,602.5	$584.0	$7.9	$1,464.2	$4,658.6

CHANGES IN USF FUNDING AND TELECOM REVENUES
1997 - 2002

	1997	1998	1999	2000	2001	2002
Total Revenue Base (2002	177	186	198	215.8	229.1	
Interstate Revenue Base	65.35	69.27	75.31	80.36	80.71	77.04
USF Funding	1.76	3.41	3.94	4.53	5.47	5.77





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CHANGE IN USF FUNDING
1997-2002

USF Mechanism	1997	1998	1999	2000	2001	2002	$ Change 1997-2002	% Change 1997-2002
High Cost Support	1,613.7	1,690.9	1,745.6	2,115.4	2,740.9	2,870.5	1,256.8	77.9%
Schools & Libraries	0.0	1,250.0	1,697.6	1,865.0	2,139.0	2,215.2	2,215.2	n/a
Low Income Support	147.6	463.7	501.2	536.8	577.5	666.0	518.4	351.2%
Rural Health Care	0.0	7.8	-1.7	9.4	11.3	22.7	22.7	n/a
Total USF Funding	1,761.3	3,412.4	3,942.7	4,526.6	5,468.7	5,774.6	4,013.3	227.9%
Interstate Revenue Base	65,350.0	69,274.0	75,305.5	80,359.5	80,708.0	77,037.1	11,687.1	17.9%
USF Assessment Rate*	2.70%	4.93%	5.24%	5.63%	6.78%	7.50%	n/a	151.4%

*USF Funding Divided by Interstate Revenues. Not actual assessment rate.

All figures in millions of dollars, except where noted.

Source: USAC Reports; Universal Service Monitoring Reports

Data for 4Q 2002 estimated. Interstate revenue base for 1997 estimated.

Senator INOUYE. I thank you very much, Mr. Gregg.

As one can imagine, all of us receive many letters and calls from critics, and contributors. I think most of the calls focus on the funding or contribution mechanism and cite that there's a lag between prior reported revenues, which are 6 months old, and current revenues, which are assessed based on the contribution factor.

My questions are: Is it possible to eliminate this lag, but retain the revenue-based assessment mechanism? Are there ways to minimize the competitive distortion that one finds between carriers with rising revenues such as the RBOCs and carriers with falling revenues? And how would the adoption of collect-and-remit proposals advanced by some of the carriers affect the administration and stability of the fund. Anyone can take this one.

Ms. ATTWOOD. The answer would be yes, yes, and yes.

[Laughter.]

Ms. ATTWOOD. The questions you raise really go to the choices that are now before the Commission in the contribution proceeding—the contribution methodology proceeding. And as each of the panelists has described, there are a variety of proposals that are before us.

One proposal would be, in effect, to rely on projected revenues, for example, which goes to your first question, is there a way in which to minimize the lag. The Commission could adopt—and I'm sure we'll hear testimony about that on Friday in the Joint Board hearing—the Commission could adopt to look at forward-looking revenues. And that would do several things. One, in all likelihood, it would eliminate the lag which is caused by declining revenue being assessed on the basis of 6-month-ago revenue. It would also attempt to eliminate some of the distortions among industry players, because those that are in the increasing-revenue mode would, in fact, be paying more than those that are obviously in a declining revenue mode. So there are real advantages to looking at a projected mechanism.

There are disadvantages, however, as well. The projected-revenue mechanism doesn't address the overall decline in interstate revenue. That overall decline will continue as an industry. And the question that begs that is—whether some of these bundled services and technological migration to other platforms, in fact, threaten the long-term stability of the fund so that we need to look at the contributor-base generally more broadly than just those that are based on interstate revenues. So that's a disadvantage.

And those are the kinds of reasons why we're looking at the industry proposal that bases it on a per-connection approach, because the per-connection approach would, in fact, be arguably more stable, since the number of lines, or the connections, don't grow per quarter or fluctuate nearly the same way that the revenues might.

So the answer is, yes, there are a variety of proposals that could address some of the concerns that we've heard this morning on a projected-revenue basis, but there are also—it's not a complete answer—there are other advantages to some of the proposals that have been raised by industry.

Mr. GREGG. I'll have to disagree a bit. One of the reasons that's espoused by proponents of the connection-based system is that it is still growing at a health clip, and, thus, can keep up with any in-

creases in the fund. I believe that, even if you went to a connection-based system, you would still have the problem of lags with reporting lines. Those that are gaining lines would benefit from the lag. Those that are losing lines would be hurt by the lag.

On the collect-and-remit system, it would be easier for consumers to understand, in that they would be assessed exactly what the FCC assesses on carriers. The carrier's burden would be made somewhat easier, in that they are simply turning over whatever they collect. But it would have to be made up by the fact that USAC, the Universal Service Administrative Company, would have to carry some sort of reserve balance to protect against any shortfalls.

Happily, however, USAC at the end of last year was carrying a cash balance of about two-and-a-quarter-billion dollars. That was some of the money that the FCC tapped last Thursday to help stabilize the assessment factor in the fund. So the reality is you already have a built-in reserve fund just from the natural lag between collections for schools and libraries and disbursement for schools and libraries.

Senator INOUYE. Any others?

Should pay-phone services be eligible for universal-service support?

Ms. JABER. Mr. Chairman, I'll take a stab at that, and perhaps the other panelists would like to add something. We are currently reviewing that as a Joint Board in our review of the definitions of universal service, and there appear to be two schools of thought—without getting into the pending matter that's in front of us, there appear to be two schools of thought. To the degree that public-interest pay phones are in demand and necessary within the states, then perhaps the states should take the lead in crafting the appropriate funding mechanism. With respect to the general pay-phone industry, however, the school of thought is, perhaps that issue is important enough and strong enough that the FCC might want to spin out that discussion into a generic proceeding and receive additional information from the pay-phone industry itself.

They are current—the industry is currently funded with respect to the universal-service fund. They are receiving funds. It's a question of additional funding. From a Florida perspective, we have not spoken on that issue at all. I have to tell you, just because I want to be very inclusive with respect to getting information on the issue, I would very much be in support of the FCC taking a very good, hard look at the pay-phone industry and whether funding is appropriate, because they do serve public interest.

Mr. GREGG. In 1998, when the FCC deregulated pay phones, they found that the then-current number of pay phones, 2.2 million, represented widespread deployment of pay phones throughout the nation, as required by the act. Currently, there are only 1.7 million pay phones in the United States. There has been a rather dramatic decline.

The reasons for that are fairly obvious. Cell phones have increased in the same time period from 47.8 million up to currently 136 million. Incredible growth. And people are substituting cellular usage for pay-phone usage.

The issue of whether pay phones deserve special or extra support should be looked at as a separate matter, I believe, by the FCC. It doesn't fit nicely into any of the existing support mechanisms that we have. In fact, any pay phone in a high-cost area currently receives support as a line, just like any other line. But pay phones in low-cost areas receive nothing.

It may be appropriate to establish a separate and distinct support mechanism on top of state public-interest pay-phone programs in order to continue to ensure the widespread deployment of pay phones, because they continue to be necessary for public health and safety. All of us have had the experience of being on a dark, deserted road at night when we needed to make a call. And, second, it still represents a lifeline for low-income families throughout the country, in both rural and urban areas.

Ms. THOMPSON. Senator Inouye, if I could add, I believe—it is an issue that needs to be addressed. The decline of pay phones nationwide is one that's been dramatic. I believe it's one that should be addressed by the states. And the state of Alaska is a good example of that.

We have supported public-interest pay phones through our state universal-service fund. We've recognized in Alaska—we don't have dark and deserted streets, but we have dark and deserted air strips in most of our rural communities. And our state commission has funded through our state fund two pay phones in each community. The communities designate them, where they are necessary for rural health and safety issues. So I think it's an important issue to continue to look at, but I think it's one because of, at least in Alaska's case, where we have particularly unique health and safety concerns, the state's been able to effectively address.

Senator INOUYE. Thank you very much.

Senator Burns?

Senator BURNS. I'm going to yield to my friend. He has a Defense authorization and a lot of other things he's supposed to attend, and I wanted to defer to my friend from Alaska.

Senator STEVENS. I'm just going to take a brief moment. I'd like to ask the four of you this. We developed this concept of universal service. As a matter of fact, Senator Inouye and I started it with the idea of integration of rates—national integration of rates. That caused the creation of the interstate rate pool. And from that came the universal-service fund. All of that was intended to try and permit all Americans to have equal access to long-distance.

Many of you have been talking about local telephone service. We are dealing with something that's not a tax. It's a contribution from other users to a fund to assure that their telephone calls to some of those rural areas would get through, on an interstate basis.

Now, as I hear you, I think you're all talking about, in effect, taxing the users of telephone service to assure there's equal access to telephone service on a local basis, without regard to long distance and without regard to who's the provider. Are we justified in giving the FCC the power to tax users of communications services to provide such assistance, when if we authorize them to do that, the FCC will be levying a charge against users, which have nothing to do with interstate commerce. And I think we're headed toward the total collapse of the universal system fund.

Now, is it possible to get back to the point that we're trying to unite the communications systems so that one can communicate, without regard to where they are, to every other place in the United States without getting caught up in a battle over allowing the FCC to impose fees, which really are taxes, on all users in order to meet some social objectives?

The libraries, health facilities, and schools hook-up was one thing. I think I'm hearing now that we're supposed to pay for the service to those schools and libraries and health facilities, and pay for it by assessing the users of the system, nationally. Is that where you all are going?

Mr. GREGG. Senator Stevens, in fact, out of the two-and-a-quarter-billion dollars of the schools and libraries fund, which is capped and has been capped from the beginning, currently about $1.9 billion goes to pay for recurring or priority-one services. In fact——

Senator STEVENS. I know that, Mr. Gregg, but what I'm asking you is why? Why?

Mr. GREGG. Because the act——

Senator STEVENS. We didn't create that fund for that purpose.

Mr. GREGG. Under 254(h), it says that schools and libraries are to get services at prices less than offered to others, and it also says that they shall pay——

Senator STEVENS. That's——

Mr. GREGG.—for hooking up classrooms.

Senator STEVENS.—acquisition. It's not service. And we're going into service charges as we get into the complete digital concept, this fund won't survive. And what'll happen is my state will have areas the size of Texas that have no communications at all.

We designed it for rural America. And I've just added it up. Ten states took almost 50 percent of this fund in the last year. None of them were rural. None of them.

Now, why should we have a fund to do the inner-core city work that you're suggesting? Even Alaska paid for local funds out of state funds for the local pay phones. But I'm hearing here that this is to become a new social-services fund. And if it is, my people are out of business, because this fund will collapse soon.

Mr. GREGG. OK. If you look at Attachment 2 to my testimony, you'll see that the high-cost portion of the fund is still the largest portion of the fund—about $2.9 billion this year, compared to $2.2 billion for schools and libraries. As I said, the schools and libraries is capped. The high-cost fund is not capped and will continue to grow.

Senator STEVENS. High-cost fund, to you, means the problems of people in the inner-core city.

Mr. GREGG. No, no. It means everything, rural and non-rural.

Senator STEVENS. But the bulk of the money you're talking about went to the inner-core city. It did not go to—do you want to add up—I could add up for you pretty quickly the money that went to rural states for rural telephone service, rural communications service, and it's nowhere near $2.9 billion.

Mr. GREGG. $2.9 billion is the total high-cost support that went——

Senator STEVENS. Yeah, but then—see, you're using high-costs now, rather——

Mr. GREGG. Right. And it's——

Senator STEVENS.—than connection to people.

Mr. GREGG.—it's made up of a number of different mechanisms.

Senator STEVENS. We were trying to provide a fund to assist people who would not otherwise have service. You're trying to provide funds so that people can be subsidized for existing service.

Mr. GREGG. Part of the reasons why the high-cost fund has gone up, besides supporting rural carriers, as Nan Thompson said, a billion dollars for high-cost loop support, $400 million for local switching support, about $380 million for long-term support. All of that goes to rural carriers. There is also support that goes to non-rural carriers to support the rural portions of their service territory. For example, the Verizons and the BellSouths, while they serve the large metro areas, they also have very large rural areas, and some of those are so high-cost that they qualify for funds. All of that together is the high-cost fund.

Senator STEVENS. All right. Well, I've got to go, and I don't want to take time. I would urge you to keep your eye on ball.

Mr. GREGG. Yeah, and I would—I would just mention that 254(g), which you got added to the Telecom Act, is one of the most important things that came out of the 1996 Telecom Act, the ability that all people in the United States have access to the same long-distance rates is critical.

Senator STEVENS. But we started that before the act. That was in the rate-integration resolution that the Congress passed and the President approved. That's a long time ago.

But that goal was carried through in the 1996 act because of the concepts of the rural coalition. And those of us who tried to work out were sure our people would stay modern. But we didn't dream that this little amendment talking about schools, health facilities, and libraries would end up by taking more than half of the fund and causing such an increase now. I don't think it's too long until you get to the point that the people who pay the bills are going to complain that this service is not helping them. It's not to help them call their son or daughter in North Dakota or Alaska or Hawaii when they're stationed in some remote place.

Ms. JABER. Senator, may I——

Senator STEVENS. That was the theory, and we are abandoning the theory of it, and you're going to destroy the fund. And I want to put down a warning. We're going to fight—rural states are going to fight to keep this fund for its original purpose, and we're not going to have it turn into a slush fund for inner-core city activities. And if it is, we'll all lose.

Ms. JABER. Senator, may I agree with you and clarify? You said, with respect to the four panelists, you heard advocacy for increasing the fund and subsidies on the local level. I wanted to clarify. From Florida's perspective, we have identified the same concerns you have. And when I talk about accountability, we are talking about stepping back and analyzing the purpose of the fund, taking a look at where the money is going and the purpose for which it was intended before we increase the size of the fund, before we talk about eligibility requirements, and before we add more programs.

So I wanted to clarify, for the record, that's what Florida means by "accountability."

Senator INOUYE. Thank you.

Senator Dorgan?

Senator STEVENS. I'm told that this assessment could go as high as 15 percent on each bill, at the rate we're going right now. Fifteen percent. There's no state tax that high. It wasn't intended to be a tax. And I don't see any way that can survive if it goes beyond 15 percent. Matter of fact, I don't see it surviving if it goes up to 15 percent. And my fear is, if it doesn't survive, if Congress decides to call this off, what do we do for our states? Hawaii has an enormous problem. We have enormous problems in these Western states, and I just hope that people will listen to you and go back to the original purpose and try to see to it that all providers of communications services pay into a fund to assure that anyone who uses the service can reach any place in the United States. And leave it right there.

Thank you very much.

Senator DORGAN. Mr. Chairman, I'm going to come to this central point, but let me ask Ms. Attwood a question on the level of contribution. The FCC determines the carriers contribute 7.2 percent of their interstate and international revenues in the universal-service fund. Major carriers are charging customers roughly 11-plus percent in the universal-service line item. Tell me about how that happens.

Ms. ATTWOOD. The factor of 7.2 percent of interstate revenues reflects what we believe to be the costs that we will need to recover from each of the carriers. They—in addition to that measure, they also have to look, in terms of their uncollectibles, so they look and determine—they have the obligation to pay, regardless of whether the consumer pays them.

In addition to that, and as we've talked about this morning, we assess on the basis of revenues 6 months earlier, and there is a lag issue that we have taken one step to reduce. We used to have a lag of 12 months. Now it's 6 months. But as the base of customers declines, but the overall need to pay continues to be evident for that carrier, it's going to have to assess higher amounts on the existing customer in order to cover the fact that there's been a reduction in those consumers.

Senator DORGAN. And the carrier makes that judgment?

Ms. ATTWOOD. Well, right now, we actually don't tell the carrier that they must put a line item, but we permit them to——

Senator DORGAN. They do. They do, though.

Ms. ATTWOOD. Yes, for the most part.

Senator DORGAN. Have you ever audited to determine that which is being charged to the customers and being sent into the fund?

Ms. ATTWOOD. We have looked very closely at the arguments raised by the carriers because of the inexplicable difference between——

Senator DORGAN. I'm asking you about audits. Have you ever—there's a substantial amount of money involved in this. Any audits?

Ms. ATTWOOD. We've—actually, we've—well, investigations are not something that we comment on publicly. We have looked very, very closely at the explanations given by——

Senator DORGAN. I'm asking if you have an audit program.

Ms. ATTWOOD. We have audits at the Commission. Of course.

Senator DORGAN. You're auditing the charges that are occurring on the consumers' bills for the company?

Ms. ATTWOOD. Over the course—since the beginning——

Senator DORGAN. So that's not the case.

Ms. ATTWOOD.—where there has been a difference between what the carrier has charged and what has appeared on the line item, we have taken an active role in reviewing the difference. In fact, the contribution-methodology proceeding arose because of the fact that consumers were very confused by this difference.

Senator DORGAN. But you don't have an audit program, do you, down there?

Ms. ATTWOOD. We have an audit——

Senator DORGAN. I'm told you don't.

Ms. ATTWOOD. We have——

Senator DORGAN. Oh, you do?

Ms. ATTWOOD.—audit program, yes.

Senator DORGAN. OK. Would you send me information about it?

Ms. ATTWOOD. Sure.

Senator DORGAN. Let me go on to this other question that—I was not aware of that, but if you have an active audit program, send me information——

Ms. ATTWOOD. Sure.

Senator DORGAN.—so we can understand that.

The issue of the universal-service fund and what I think is a future of—shrinkage of that fund, based on judgments that the FCC is making and also assisted, in part, by a court decision, one court decision that was never appealed—so tell me, with respect to 254 and the language that deals with advanced telecommunications services—as I and others helped write that language, so we put it in deliberately and knew what it meant—how do you see the current universal-service fund support-mechanism supporting that which we intended with 254, including advanced services?

Ms. ATTWOOD. Well, the question of whether the advanced services should be directly supported is currently before the Joint Board, and the question of, what we call, the definitional question, whether, in fact, it is a supported service.

Senator DORGAN. Well, have you read——

Ms. ATTWOOD. That's actively being worked on by the Joint Board.

Senator DORGAN. Can I read 254 to you, though?

Ms. ATTWOOD. Sure.

Senator DORGAN. I mean, I don't think the—in my opening statement, I read the Section 254, in which we talked about advanced telecommunication—including inter-exchange service and an advanced telecommunications and information services. So, I mean, I don't want you to deliberate too long about this.

Ms. ATTWOOD. Well, I——

Senator DORGAN. We wrote it in a pretty explicit way.

Ms. ATTWOOD. And I appreciate that. And I think your points have been well taken and are really actively being reviewed by the Commission—both the state commissions and the federal commission.

There's also language in the Act, though—and I think this is what confuses the issue—there's language in the act that talks in

terms of the criteria for supported services, and that criteria include that the service, in fact, is being provided by a substantial—or taken by a substantial number of consumers.

And I think, in addition to that, there are concerns raised that—in order for you to receive support, that—under the terms of the Act, you have to be able to provide all of those supported services. So there is a concern that's been raised by several folks that if, in fact, there is a direct requirement that advanced services be supported, before that support could flow, the carrier would have to acknowledge that it was capable of, in fact, offering that service, which would require substantial upgrades to some carriers and would, in fact, cutoff their——

Senator DORGAN. Who are these——

Ms. ATTWOOD.—ability to receive money prior to being able to make themselves available to——

Senator DORGAN. Who are these "several folks" that have expressed that concern? Are you just being——

Ms. ATTWOOD. Oh, I'm—you know, we have all—in all forms of industry segments, and there are various industry segments that comment. So when I talk about "folks," I mean our industry folks.

Senator DORGAN. Do you agree that when you redefine wire-line broadband as something other than a telecommunications service, you're involved in the shrinkage in the potential for universal-service support in the long-term?

Ms. ATTWOOD. I wouldn't agree with that statement the way you stated it. I would say that the Commission is very concerned. And, in fact, when we launched the NPRM that looked at the question of how broadband services ought to be defined or how they are defined under the Act, the Commission was extremely concerned about the potential impact that that would have on the base for contributions—or in the current universal-service system. And that's why the Commission, in fact, issued a further notice that sought to have and generate comment on this. While we see migration, while we see this definitional question being resolved, we want to ensure that there is no effect on universal service and have developed a huge record on that point. It's not even fully closed yet.

Senator DORGAN. Ms. Attwood, I don't understand, because I think—I mean, I may be observing this inappropriately, but my observation is that you are systematically taking steps to shrink the base. And if you shrink the base, you're going to end up with less revenue.

Ms. ATTWOOD. Well, I give you credit, because, in the Act, it also indicates that—that support can be based on the fact that there is a telecommunications provider. And, as we indicated in the further notice, when you're a telecommunications service provider, you shall contribute. However, if there is an information service provider that, in fact, has a telecommunications component, the Act—and Congress, in its wisdom—gave the Commission discretion to, in fact, look at that contributing base. And that's the kind of question that we asked in that further notice.

Senator DORGAN. But my concern, for a long period of time—not just this commission, but for a long period of time——

Ms. ATTWOOD. Uh-huh.

Senator DORGAN.—my concern is that the FCC has used whatever discretion it has to shrink, rather than expand, the base. And the result is, I think you have precious little opportunity to provide universal service fund support for advanced services. In fact, I wonder whether we will be providing the kind of universal service support that we expect for basic telephone services.

Now, the thing I did not quite understand with Senator Stevens' comments—my impression of the universal service fund has always been that there are some parts of the country in which, if you were to create a telephone system there, based on its own pricing, it would cost you $200 a month for basic service. Well, nobody's going to afford that. And so we have a universal-service fund support so that the lower-cost areas—New York City, for example—can contribute into a universal-service fund to drive down the cost in North Dakota, for example, which would be very expensive. That's always been my notion of what the universal-service fund has been about. And then when we wrote this act, we explicitly called for reform——

Ms. ATTWOOD. Uh-huh.

Senator DORGAN.—of the universal-service fund. And my concern—I hope you'll take this back to the commissioners, and I would be happy to do this directly when we get Chairman Powell here—my concern is that in every opportunity where the Commission has had discretion, they've chipped away at the base, and, thereby, in my judgment, injured our opportunity in the long-term to use the universal-service fund support the way we intended it to be used—aggressively, in a robust way.

And so—at any rate, I think that's—that represents my concern. I did not ask others of you questions. I appreciate the testimony you've provided today.

This, I think, will become a festering, significant problem between the Congress and the Commission, because it—at its roots are the answers to the questions, who's going to be able to afford the kind of communications services in the future in this country? How will they afford them——

Ms. ATTWOOD. Right.

Senator DORGAN.—and how will they be priced. So that this will be a—this problem will grow, unless it's handled delicately and appropriately by the Federal Communications Commission.

Mr. GREGG. Senator Dorgan, I would just state, if you're concerned about the contribution base, you should look with interest at what the FCC does in the current inquiry on the connection-based system, because if we're going to change from a revenue-based to a connection-based system, this would present the golden opportunity to cast the net very far and wide to encompass all providers, including broadband providers. Today, when they serve only 10 percent of the customers in this country, even though about 80 percent have access to it, this would be the time to bring them under the tent.

Senator DORGAN. There are many issues that relate to that, of course. I understand your point that—my interest is in broadening the base in a way that provides a robust fund that allows us to do what the act intended to do.

Senator INOUYE. Senator Burns?

Senator BURNS. I am finding the testimony fascinating this morning and just looking at the numbers and everything. I'm wondering, on the board, the universal-service board, can we get—can this Committee—do you do any projections on—if we don't change anything—if Congress doesn't change anything, if the FCC does not change anything—where are we in 5 years, using current trends and projections?

Ms. THOMPSON. Senator Burns, we haven't done that kind of analysis, but I'd be happy to. We would work with the Universal Services Administrative Corporation that collects and distributes the funds. But I think that's a very interesting question.

Mr. GREGG. I would state that the commenters in the current contribution-base inquiry have presented various projections of where they think revenue growth will be and where they think line growth will be, because those will be the drivers of whether the fund stays affordable.

Senator BURNS. Well, if we just stay where we are now and at the present level of around 7 percent, I think we're headed for tough times if we just did nothing or the FCC did nothing to change those things. In light of that, and receiving that information, I'd like to see those figures and do some projecting on our working with those people. And you have knowledge of that.

Does Section 254 of the Tel-co Act of 1996, which codified our national longstanding universal-service policy—do you think we're going to have to revisit 254 and take a look at that? Because what I see, in the growth of these numbers—we had no idea that the growth of schools and libraries would be so huge and so dramatic, especially when we were being told that most of them had already been wired and we passed a regular tax that contributed to that. They also have access to that. I'm very concerned about that.

Is there abuse? And where do we go from here? Or is the majority of the growth already done? And can we see a decline in the use of those funds?

Mr. GREGG. Senator Burns, as I indicated, the schools and libraries fund has been capped, since its inception, at two-and-a-quarter billion. The actual disbursements under the cap have varied year to year, and now they're pretty much trending at the cap.

The only other portion of the fund that is capped is the rural high-cost loop support. There was a rebasing of the cap a year and a half ago as a result of the rural task-force order that the FCC issued. The cap grows each year based on a number of factors; however, the schools-and-libraries cap does not grow. That's why, if you look at my Attachment 2, you can see that once the schools-and-libraries fund reached about $2 billion, it has stayed there; whereas, high-cost continues to grow.

Senator BURNS. Do we need to revisit 254?

Mr. GREGG. I think perhaps you should. One thing that I would change would be the assessment-based language in 254(d). I would make it broader, give more discretion to the Commission to take whatever action necessary to keep that contribution base broad.

The other fix that I would recommend would be for the rural healthcare program. The way that it was originally conceived—and this goes toward making the fund bigger—almost every other part of the fund, we're worried about getting too big. Rural health is

just the opposite. Originally conceived, it was going to be a $400 million fund. And that's a mistake in my testimony. I said a hundred million. Originally, the FCC had said it was going to be $400 million a year. In reality, it has been closer to $10 to $15 million.

The problem is the statute. It was meant to eliminate the disparity between rural and urban rates for rural healthcare providers. In reality, a lot of rural rates are actually lower than urban rates, and a lot of states have postage-stamp data rates. In other words, it's the same wherever you are. There's no mileage component. Therefore, the rural health provisions have been of limited utility.

If you truly want to get rural health providers wired and into the new digital age, you might consider adopting parallel language to what you have for schools and libraries. But, on the other side of that, it's going to cost money. And if you're worried about schools and libraries and rural healthcare stealing money away from rural telephone providers, that's a consideration.

Ms. JABER. Senator, may I address——

Senator BURNS. Yes.

Ms. JABER.—with respect to the schools and libraries program and are there abuses? We have seen that there are. And I think, actually, the FCC has seen that there are. In their NPRM on the schools and libraries program, they talked about the potential abuse, documented abuse with respect to equipment transferability. And what that is, is when a school applies for equipment and connections to a given school, it's been alleged that that equipment stays in the school for a small amount of time and is transferred elsewhere and the same school applies other places. The FCC acknowledges that. Florida filed comments with respect to at least putting a cap or a time limit with respect to how long that equipment needs to stay at the location for which it was requested.

The accountability theme, though, whether that takes a change to Section 254 to give the FCC the absolute requirement to communicate with states in identifying where those abuses are, we talked about auditing, whether the FCC needs broad auditing authority or requires the states to be accountable for their own use of these programs, is something I would be an advocate for.

It's about accountability. No one disagrees, at this table, that the universal-service fund has benefited many, many people. I certainly have seen firsthand the benefits of universal service, but I'd like to see more people that need to benefit from the fund receive the benefits. And until we see that all of those end users have the benefits, we would advocate for an overall cap in the program. And, again, that may take a change to 254 to give the FCC the flexibility to cap the overall program until those sorts of abuses are identified and addressed.

Ms. ATTWOOD. Can I comment, just briefly?

Senator BURNS. Yes, ma'am.

Ms. ATTWOOD. Because I think that all the themes here, we would agree with. But I think there are two points that are important to recognize about the schools and libraries program.

First of all, the question of accountability and waste, fraud, and abuse. Obviously, it's of foremost concern to the Commission to make sure that the funds go where they're intended. There is no

value in funds not, in fact, being used to provide the service that it was intended for. So the Commission has clearly—and this chairman—has clearly made an effort to make sure that, in fact, we have those programs that would increase accountability. And, as Commissioner Jaber indicated, we flagged those in our recent schools NPRM.

But I also don't want to leave you with the impression that this is something that, in fact, is a huge problem, other than when you have a fund that is supporting large amounts of support, you're going to make sure that you have accountability and you have appropriate oversight. And so the Commission is acting very responsibly in that regard and ferreting out those issues where our rules need to be improved with respect to this fund and all other support mechanisms.

The other point I guess I think is important to make is that we talk about schools and libraries program as solely benefiting an urban area. And I think it's really worth mentioning and reminding ourselves that, in fact, what schools and libraries does is, it also dramatically helps those in rural areas, as well. What it does is—it, in fact, focuses on communities, and those communities that need additional assistance. And, for example, I know we were looking at the—Senator Stevens isn't here, unfortunately, but I know we were looking at the kind of support that schools and libraries has provided to Alaska, clearly a rural area. And when you look at the per-student amount of support, in fact, Alaska is No. 2 in the receipt of funds.

So, while clearly the program supports inner city as well as other areas, it also benefits, ultimately, the rural consumer. And when we look at all of our universal service policies, the focus isn't on helping rural carriers. It's on helping rural consumers. And that help comes from a variety of both big companies, small companies, and schools and library support.

Senator BURNS. Well, I'm well aware of the rural impacts, because we did two or three projects of distance learning that are still——

Ms. ATTWOOD. Uh-huh.

Senator BURNS.—operating today in the rural areas. We've got four schools wired together that one biology teachers teaches in four schools. Those schools are almost 150 miles apart. And so we're well aware of that.

You wanted to make a comment, Ms. Thompson.

Ms. THOMPSON. I did, Senator Burns, thank you. I wanted to—you asked about changes to Section 254——

Senator BURNS. Uh-huh.

Ms. THOMPSON.—and I wanted to let you know that I'm concerned that the current language of the act may not be able to accommodate the dramatic changes in technology we've seen since the act was passed. So in the context of this contribution proceeding—again, we have a hearing Friday, we'll hear more testimony—I'd like the opportunity to community with you further on specific changes that we feel are necessary after we've completed that process.

Accountability was another theme. And I think states have an important role in assuring accountability for use of universal-serv-

ice moneys. That's something that the FCC recently has, under the terms of the high-cost fund, given states that responsibility. And I think that we have an important role to play, in terms of the other programs, as well.

And, finally, I'd agree with Dorothy Attwood that the focus has been on supporting rural communities and the schools-and-libraries use. And I'm aware of the dramatic—the great work that's been done in the state of Montana to use that. You have the same problem we have, with distance and population, that can often be bridged by technology for benefit. But, again, the focus should be on supporting the educational process in those communities that need the support in order to be able to offer a level comparable to what folks in urban areas receive.

Senator BURNS. Well, we've had this panel up here, and we want to thank you for your patience and the same, but if you would supply to the Committee those projections and give us some information that we can base some sort of a judgment, because of a shrinking base and an increasing demand for money, we're going to have to make some hard decisions. There's no question about that. But I appreciate your good work, and I appreciate your testimony here. As soon as I look at those projections—and off of that, there'll probably be—we'll spin off a lot more questions. But I think we ought to look at that because I'm very concerned about the viability and the sustainability of that. So thank you for coming today.

And I thank the Chairman.

Senator INOUYE. I'd like to thank the panel in behalf of the Committee. Obviously, we have many other questions. And if we may, we'd like to submit them to you for your consideration and response. Thank you very much.

And now may I call upon the second panel: the chief financial officer of the MCI Group, Ms. Victoria D. Harker; the president of Regulatory and External Affairs, BellSouth Corporation of Atlanta, Georgia, Ms. Margaret H. Greene; the president and manager of the Public Service Telephone Company of Reynolds, Georgia, Mr. Don Bond; and the senior vice president for policy and administration and general counsel of the Cellular Telecommunications and Internet Association of Washington, Mr. Michael F. Altschul.

Before we proceed, I just receive word from the office of Senator Cleland advising me that he had to suddenly return to Georgia, and so he wishes me to extend to Ms. Greene and Mr. Bond his personal regrets. He would have wanted to introduce you.

But, with that, may I call upon chief financial officer, Ms. Harker?

STATEMENT OF VICTORIA D. HARKER, CHIEF FINANCIAL OFFICER, MCI GROUP

Ms. HARKER. Thank you and good morning, Mr. Chairman. My name is Victoria Harker, and I'm the chief financial officer and senior vice president of operations of the MCI Group, an operating unit of WorldCom.

I'm pleased to address a very important issue this morning, the continued sufficiency and stability of the universal-service fund. This issue arises because of the dynamic changes that have transformed the telecommunications marketplace since the enactment of

the 1996 Telecom Act. The benefits for consumers have been enormous.

MCI, of course, has been an instrument of that change. MCI pioneered competition in the long-distance industry. Today we are also the largest competitive provider of local services in the United States. In fact, MCI just recently launched "The Neighborhood," a set of national consumer products that serve to fulfill the vision of the 1996 act. Our flagship product, "Neighborhood Complete," is the first residential product that combines unlimited local and long-distance service plus features, such as call-waiting, caller–ID, and voicemail, all in one package for one flat monthly fee. Consumer response has been tremendous, with over 600,000 sales just since mid April.

We are proud of our pro-competition legacy. MCI's industry-leading products benefit all customers. Technology convergency and product bundling are hallmarks of our industry today. But industry change, while good for consumers, now threatens the sustainability of universal service.

The current funding mechanism must be reformed immediately to assure three critical policy goals—fund sustainability, competitive neutrality, and administrative efficiency. The existing mechanism fails to meet many of these goals.

WorldCom participates in a coalition of carriers and users that proposes to change the current mechanism to an assessment on all connections to the public network. Our proposal is the only one that achieves those three policy goals.

Because of declining interstate and international revenues, the existing fund mechanism is not sustainable. When the FCC created the current funding mechanism in 1997, interstate and international telecom revenues had been growing steadily for more than a decade. Bundling was not the norm, as it is today. But that's all changed. The rapid growth in interstate and international revenues in the late 1990's has been replaced by sustained annual decline. As shown in Chart 1, quarterly revenues have dropped nearly 12 percent from their peak of $21.2 billion in 1999 to just $18.7 billion in the first quarter of 2002.

Consider the substitution of other services that have reduced traditional long-distance calling—e-mail, and instant messaging, wireless packages that offer free long-distance service—and soon voice over the Internet will be a major factor. Bundled products make it difficult to clearly identify assessable revenues by links started with wireless products, but has since moved to local and long-distance wire-line packages.

The problem is even more complex for the large-business customers. As their USF charges approach 10 percent, they have a growing incentive to bypass the system. This creates a vicious cycle. As the assessment base declines, the USF rate and remaining revenues continues to grow, further encouraging customers to use services that are either unassessed, such as voice over the Internet, or under-assessed, like wireless. Residential customers will likely bear the brunt and face increasing assessments unless a more rational approach is adopted.

The existing funding mechanism fails to meet the competitive neutrality test. It was created before local long distance and wire-

less markets began to converge. With convergence, the existing mechanism creates competitive imbalances. For example, because their services are subject to much lower assessments, wireless carriers are provided with an artificial market advantage over long-distance carriers.

Also, because the current mechanism assesses carriers based on their actual revenues 6 months earlier, it disadvantages carriers whose revenues are declining, versus carriers with growing revenues. Thus, the long-distance companies are forced to increase the fees on customers' bills to fully recover their USF obligations, while the Bells and wireless carriers enjoy a windfall simply by charging their customers the FCC's assessment rate on a growing base.

The coalition plan is the only one that achieves all policy goals—fund sustainability, competitive neutrality, and administrative efficiency. Every carrier would pay on a collect-and-remit basis, based on the number of interstate or international connections to the public network that it provides to end users. Connections to the public network are stable and growing; thus, meeting the goal of fund sustainability.

Assessments would vary, based on customer class and capacity, rather than on technology. Carriers offering services that compete with one another would be assessed at the same rate. Thus, this plan is competitive neutral.

Initial rates would be set as follows. One dollar for residential lines, wireless, and single-line businesses. Approximately $2.75 for switched multiline business connection. Private-line assessments will be based on capacity.

Last, this plan is the most efficient. The provider of a customer connection already bills monthly for that connection. Generally, a long-distance or dial-up Internet service connection occurs by the local telephone wire. It's efficient for the assessment to be imposed on the provider of that connection. In most cases today, that would be the ILEC. Over time, though, a growing portion of those connections will be provided by competitive carriers.

As noted earlier, WorldCom is the largest competitive provider of local services. Because it is efficient, its overall impact on consumers would be positive. Lifeline customers would pay nothing. Residential customers across all income groups and demographics would pay less, on average, in USF fees than under the current mechanism or under a proposal advocated by FCC and BellSouth.

In conclusion, irreversible marketplace changes render the current universal-service funding mechanism insufficient and unstable. Prompt action by the FCC is needed to adopt an approach that makes an assessment on all connections to the public network. This is only approach that will achieve fund sustainability, competitive neutrality, and administrative efficiency.

Thank you.

[The prepared statement of Ms. Harker follows:]

PREPARED STATEMENT OF VICTORIA D. HARKER, CHIEF FINANCIAL OFFICER, MCI GROUP

Good morning, Mr. Chairman and Members of the Subcommittee. My name is Victoria Harker. I am the Chief Financial Officer of the MCI Group, an operating unit of WorldCom. I am honored to have this opportunity to testify before the Sub-

committee on a very important issue: ensuring the continued sufficiency and stability of the universal service fund (USF).

This issue would probably not command your attention but for the dynamic changes that have transformed the telecommunications marketplace in the last few years. The benefits for consumers have been enormous. Spurred in large measure by the historic Telecommunications Act of 1996, tremendous changes and opportunities have been experienced since its enactment. Technological convergence and product bundling are now two of the hallmarks of our industry.

MCI, of course, has been an instrument of change. More than 30 years ago, MCI pioneered competition in the long distance industry. Now a part of WorldCom, MCI is no longer just a long distance company. Among other things, we are now the largest competitive provider of local services in the United States.

In fact, MCI recently launched *The Neighborhood*, a new set of national consumer products that serve to fulfill the vision of the 1996 Act. Our flagship product, *Neighborhood Complete*, is the first residential product that combines unlimited local and long distance voice service plus features such as call waiting, caller ID and voice mail—all in one package for one flat monthly fee ($49.99 or $59.99 monthly, depending upon the customer's location). Consumer response has been tremendous. We didn't stop there. Last week, we also launched a similar program for small businesses—*Business Complete.*

We are proud of our pro-competition legacy. When MCI brings industry-leading products to market, all customers benefit. In this context, change is clearly good. But industry change, while good for consumers, now threatens the sustainability of universal service.

Universal service has been an essential feature of U.S telecommunications policy for almost a century and has benefited all Americans by extending the public switched network to rural communities and to low-income households and by supporting schools, libraries, and rural health care facilities. Adequate universal service support for these important programs and activities must be maintained. Given the rapid changes in the marketplace, however, the current funding mechanism must be reformed immediately to assure three critical policy goals: the fund's continued sustainability, competitive neutrality and administrative efficiency. The existing funding mechanism fails to meet any of those three goals.

In constructing the 1996 Act, Congress recognized that a major source of universal service support—revenues generated by above-cost access charges—could not be sustained if its overarching goal of competitive telecommunications markets were to be achieved. Congress therefore required the Federal Communications Commission (FCC) to reform both access charges and the universal service funding mechanism. It directed the FCC to replace the implicit subsidies with specific, predictable, and sufficient universal service funding mechanisms that telecommunications providers contributed to on an equitable and nondiscriminatory basis.

When the FCC first acted in 1997, interstate and international telecommunications revenues had been growing steadily for more than a decade. Except for the case of wireless offerings, interstate and international services were not being bundled with intrastate or information services and thus represented a stable and growing assessment base that was relatively easy to identify and measure.

This made possible a system for assessing and collecting universal service funds from carriers based on historical revenues. Carriers are required to report their interstate and international revenues on a periodic basis. The FCC estimates the total amount needed for the fund for a forthcoming period and, dividing that need by the total assessable industry revenues reported, calculates a "contribution factor" (currently 7.28 percent) that is applied to each carrier's reported revenues to determine the dollar amount owed by each carrier. Carriers recover their universal service costs from customers.

Problems arose, however, as market conditions changed. As I shall discuss in greater detail below, the sustainability of this revenue-based mechanism has been threatened as competition from products not subject to the assessment has substantially and irreversibly reduced total interstate and international telecommunications revenues. Moreover, the revenue-based assessment mechanism proved not to be competitively neutral as markets converged and now-competing services are subject to different levels of universal service assessment.

WorldCom participates in a coalition of telecommunications carriers and users that is proposing that the FCC change the current mechanism to an assessment on all connections to the public network. For reasons I'll explain, our coalition proposal is the only one that achieves the three policy goals of sustainability, competitive neutrality, and administrative efficiency. It has an additional advantage—it can be implemented immediately.

The Existing Funding Mechanism Is Not Sustainable

Changes in the marketplace are driving the need for reform of the USF funding mechanism. While these changes, by and large, have been very beneficial to consumers and business users, they pose a significant threat to the future sufficiency and stability of the universal service program. Time is of the essence. In the context of universal service policy, he who rejects timely and meaningful change is an architect of destruction.

The universal service funding mechanism that worked well just five years ago now faces a death spiral. The rapid growth in interstate and international telecommunications revenues in the late 1990s has been replaced by sustained annual decline (see Chart 1). Quarterly revenues have dropped nearly 12 percent from their peak of $21.2 billion in 1999 to just $18.7 billion in the first quarter of 2002. E-mail and instant messaging have replaced many long distance calls. Internet searches are used as a substitute for 800 calls. Of course, wireless service packages with "free" long distance have contributed enormously to this fundamental market change. Although not yet a major factor, voice over the Internet will soon have a significant impact on interstate and international revenues.

At the same time, it is becoming much more difficult to identify assessable revenues as customers demand that providers offer bundles of interstate and international telecommunications services, intrastate telecommunications services, information services, and even customer premises equipment priced in a fashion that does not explicitly measure the interstate and international telecom revenues generated. There is no simple way to measure assessable revenues for bundled products. Bundling started with wireless products but has since moved to local and long distance bundles offered by the Bell monopolies and competitive companies. The problem is even more complex for large business customers who negotiate contracts for the purchase of services and equipment that can exceed $100 million a year. As USF charges assessed to businesses approach 10 percent, these enterprise customers have a growing incentive to "bypass" the system to minimize the portion of revenues subject to the assessment, including a migration toward Internet solutions that could significantly reduce their universal service burden.

This creates a vicious cycle. As the current assessment base declines, the assessment rate on remaining interstate and international telecommunications revenues continues to grow, further encouraging customers to shift their purchasing decisions toward services that either are unassessed (e.g., voice over the Internet) or underassessed (e.g., wireless). Residential customers have fewer opportunities for avoidance and will likely bear the brunt of this cycle.

Most residential customers are already being assessed at least 9.9 percent of their interstate bill and will likely face even higher assessments unless a more rational approach is adopted. Prompt reform of the existing funding mechanism is an urgent necessity.

Although interstate telecom revenues are declining, customers still must connect to the public network. Fortunately, connections to the public network are stable and growing. For that reason, WorldCom and its partners in the Coalition for Sustainable Universal Service (CoSUS) have submitted a detailed funding mechanism proposal to the FCC that would assess the provider of every customer connection to the public network.

Existing Funding Mechanism Fails Competitive Neutrality Test

The current funding mechanism was created before local, long distance, and wireless markets began to converge, and thus it had little competitive impact on the marketplace. Today, however, several imperfections in the mechanism have a glaring impact on the marketplace. When the Commission could not identify the proportion of wireless service that was interstate a few years ago, it created a temporary 15 percent "safe harbor" for wireless carriers based on the proportion of local exchange carrier (LEC) traffic that was interstate in nature. Wireless carriers therefore bear a federal USF assessment on, at most, 15 percent of their revenues. As we all know, however, the major wireless carriers concentrate their marketing efforts today on regional and national calling plans that provide large buckets of all-distance minutes for a fixed monthly rate. Many customers increasingly use these plans for long distance calling. These service offerings compete directly with both the long distance and all-distance offerings of wireline carriers. Because their services are subject to much lower universal service assessments, wireless carriers are provided with an artificial market advantage.

Similarly, international carriers with no or minimal interstate revenues enjoy an advantage over carriers that offer domestic as well as international services because they are exempt from the universal service assessment. For example, a carrier with mostly international revenues (such as Loral Space Communications or Lockheed

Martin) that does not have to contribute to universal service would be able to provide a customer with a service offering free of any universal service surcharges, while WorldCom would have to charge that same customer a universal service recovery fee. This obviously provides some of our international competitors with a significant yet artificial advantage.

Also, because the current mechanism assesses carriers based on their actual revenues six months earlier, it disadvantages traditional long distance carriers vis-à-vis wireless and local carriers, particularly those Bell companies that are now entering the long distance market for the first time. Traditional long distance companies are experiencing sharp declines in interstate revenues. Wireless carriers and Bell companies gaining entry into the long distance market, on the other hand, are experiencing substantial increases in interstate revenues. Long distance companies are forced to increase the federal universal service fee on customers' bills to recover fully their USF obligations, while the Bells and wireless carriers enjoy a windfall simply by charging their customers the FCC's assessment rate on a growing base.

While it is important to remove these anticompetitive distortions in the market, simply correcting these competitive imbalances would not achieve the other two policy goals—sustainability and administrative efficiency.

The CoSUS Plan Is the Only One That Achieves All Policy Goals

Under the CoSUS proposal, every telecommunications carrier and private carrier would pay universal service contributions based on the number of interstate or international connections to the public network that it provides to end users. The assessment would vary based on customer class and capacity, rather than on the technology used to provide service, so that carriers offering services that compete with one another would be assessed at the same rate. Initial rates would be set as follows:

- $1.00 per residential line, single-line business, and non-paging wireless connection. Lifeline connections are exempt.
- $0.25 per paging connection.
- Approximately $2.75 per switched multiline business connection, determined as follows: during a one-year transition period for carriers to develop tracking, reporting, and billing systems for high capacity connections, the contribution for private line and special access connections would remain the revenue-based contribution percentage in effect for the last quarter under the current mechanism. Switched lines would then be assessed on a per connection basis to cover the residual between the fund size and the other USF funds generated. Centrex lines would be assessed one-ninth the basic switched access line rate.

Switched connection providers (LECs and wireless carriers) already have a line item for universal service recovery, so billing systems changes are not needed other than to change the amount of the USF fee. After the one year transition period, per connection multiline business connection assessment rates would be established based on the total contribution that would have been collected from the combination of switched multiline business and private line/special access connections had the transition continued. That total contribution would be collected through simple capacity-based charges, relying on the long-standing industry categories of DS0, DS1, and DS3 to assign greater weight to higher-capacity connections. Going forward, depending on the growth of the fund size relative to the growth in the number of (weighted) connections, all assessment rates would increase or decrease in uniform proportion.

Under the CoSUS proposal, the impact on consumers will be positive. Lifeline customers would pay no universal service fees. Residential customers across all income groups would pay less, on average, in universal service fees under the CoSUS proposal than under either the current revenue-based mechanism or the proposal advocated by SBC and BellSouth (see Chart 2). In addition, a single per-connection charge will be much more understandable and more uniform for similar services, simplifying the customer task of comparing alternative offerings.

Carriers would pay contributions on a collect and remit basis that is analogous to the efficient process used to collect the federal excise tax. The CoSUS proposal can be implemented without the FCC first determining how it intends to define and regulate broadband providers; it can accommodate any FCC decision on that issue in other pending proceedings.

The CoSUS Proposal Would Achieve the Greatest Administrative Efficiency

It is essential that the assessment mechanism be as administratively efficient as possible because the cost of universal service funding is ultimately borne by telecommunications users. As explained earlier, it is no longer possible to identify read-

ily which revenues are generated by interstate telecommunications services. By collecting assessments for any customer connection from the single provider of the connection to the public network, rather than from multiple intermediate service providers (long distance companies and ISPs), transaction costs are minimized.

A long distance company or Internet dial-up service provider will not know the particulars of the connection its customer uses to receive that service. In these cases, the customer's connection occurs via their local telephone wire. If MCI, for example, were assessed based on those connections (as proposed by SBC and BellSouth), my company would have to depend on data that only our customer's local exchange carrier possesses.

The industry and many customers learned from painful experience that it is cumbersome and expensive to create mechanisms to transmit that information from connection providers to intermediate carriers in a usable and auditable form. When implementing access charge reform, the FCC required the large ILECs to assess a per-line charge, called PICC, on long distance carriers. That charge varied according to connection characteristics—such as whether a residential line was a primary line or whether a business line was a Centrex line—for which only the ILECs had the relevant information. The IXCs could neither audit the charges they received from the ILECs nor determine the right amount to recover from their end-user customers. These large ILECs ultimately developed electronic systems to provide and update the connection information (for which they charged the IXCs), but they had no incentive to accurately maintain the data and thus the IXCs had to develop complex systems to compensate for errors in the data and to this day are forced routinely to issue credits to customers to offset charges billed as a result of inaccurate identification of customer line types.

As difficult as the PICC experience has been, the SBC-BellSouth proposal would be worse. Only the 13 or so very largest ILECs charged PICCs and therefore only they had to construct the electronic systems needed to provide the relevant line information to IXCs. Under the SBC-BellSouth proposal, all 1,300+ ILECs—most of which are very small—would have to construct the electronic systems. Moreover, the data they would have to provide—customer specific information on the capacity of connections, the number of Centrex connections, etc.,—is increasingly market-sensitive as recipient companies, like mine, become actual or potential competitors to the ILECs. ILECs, then, would have even stronger incentives not to provide the data that the IXCs would need in order to know how much to pay into the fund and how much to collect from individual customers.

These administrative costs could be as great as the assessments themselves and would have to be passed on to the customer. Moreover, many long distance customers have zero usage during a particular month and therefore do not generate a bill. If the long distance companies were assessed for each customer to which they provided service, they would have to send out bills to millions of zero-usage customers each month just to recover the universal service assessment.

By contrast, the provider of a customer connection to the public network will know the characteristics of the provided connection and already bills monthly for that connection. Therefore, it is administratively efficient for the universal service assessment to be imposed on the provider of that connection. In most cases today, that would be the incumbent local exchange carrier (ILEC). In many cases, though, the obligation would be imposed on a competitive carrier. For example, it is efficient to impose a USF assessment on WorldCom for each interstate private line connection we provide to our customers (even if the ILEC is providing the underlying access circuit to us) because we have all the relevant billing and line characteristic information. Similarly, it is efficient to impose a USF assessment on all the switched connections we provide to our residential and business customers, whether we use our own facilities, unbundled loops, UNE-platform, or resale. As noted earlier, WorldCom (including its MCI operating unit) is the largest competitive provider of local services.

The CoSUS proposal also would improve the efficiency of the universal service assessment process by implementing "collect and remit," by which carriers would only have to remit those universal service charges they actually collect. Rather than requiring carriers to perform "true-ups" lagged over the period of time necessary to determine which of their universal service revenues are uncollectible, carriers would simply report their connections and (subject to audit) their historical uncollectible rate for those connections, and pay into the fund accordingly. This not only eliminates the need for carriers to recover their uncollectible universal service charges from paying customers, but also eliminates the lag between setting and recovering the carrier's assessments.

Legislative and Regulatory Threats to USF Sustainability

While my testimony explains why the current system of USF funding is not sustainable, I also must add that certain proposed changes at the FCC and in Congress would also jeopardize the universal service system.

The FCC has proposed to eliminate the *Computer II* unbundling requirement for ILEC broadband Internet access services. Under current rules, the elimination of the *Computer II* unbundling obligation for broadband Internet access services could also exempt the ILECs from the universal service contribution obligation associated with those services. Not only would there be an immediate reduction in the contribution base, but the impact on the contribution base would only grow as the ILECs acted on their incentive to expand the scope of services offered through the contribution-exempt Internet platform.

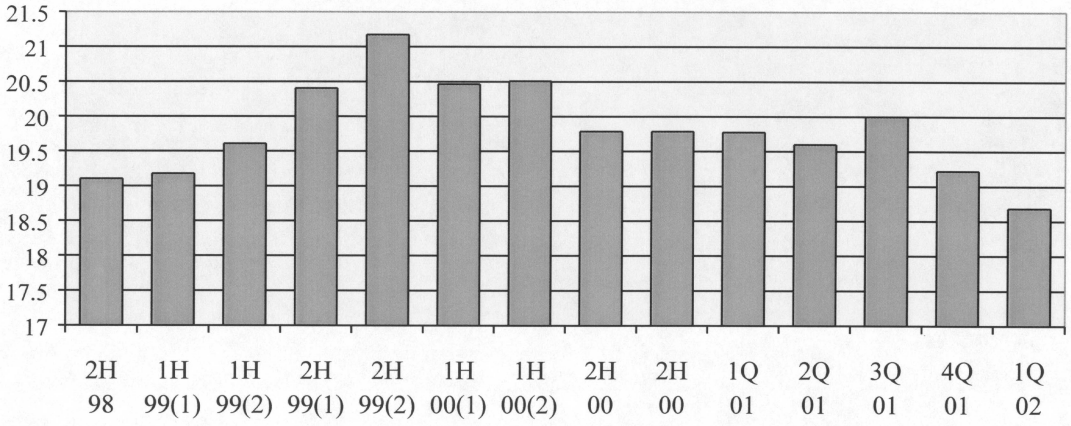
Also, legislation pending before the Commerce Committee would have negative consequences for universal service. S. 2430, the Breaux-Nickles bill, is objectionable for many reasons, particularly the devastating impact it would have on telecommunications competition. My testimony today, however, addresses only its impact on universal service. The proposed legislation states that all providers of broadband services must be subject to the "same regulatory requirements, or no regulatory requirements" and that this policy must be implemented "without increasing regulatory requirements applicable to any provider of broadband service." Since non-LEC broadband providers do not currently contribute to universal service, the bill would seem to require the FCC to relieve the Bells of the current and future contribution requirements on their broadband services.

Under the current revenue-based mechanism, as the Bells shift more and more traffic to high speed data service, Internet access and IP telephony, the potential base for contributions to the universal service fund would decrease. This would further destabilize the USF and raise even greater concerns about the sustainability of its current programs, such as the high cost fund designed to keep rural subscribers on the network. In addition, under Breaux-Nickles, the contribution burden would fall increasingly upon those consumers with the most basic of telecommunications services.

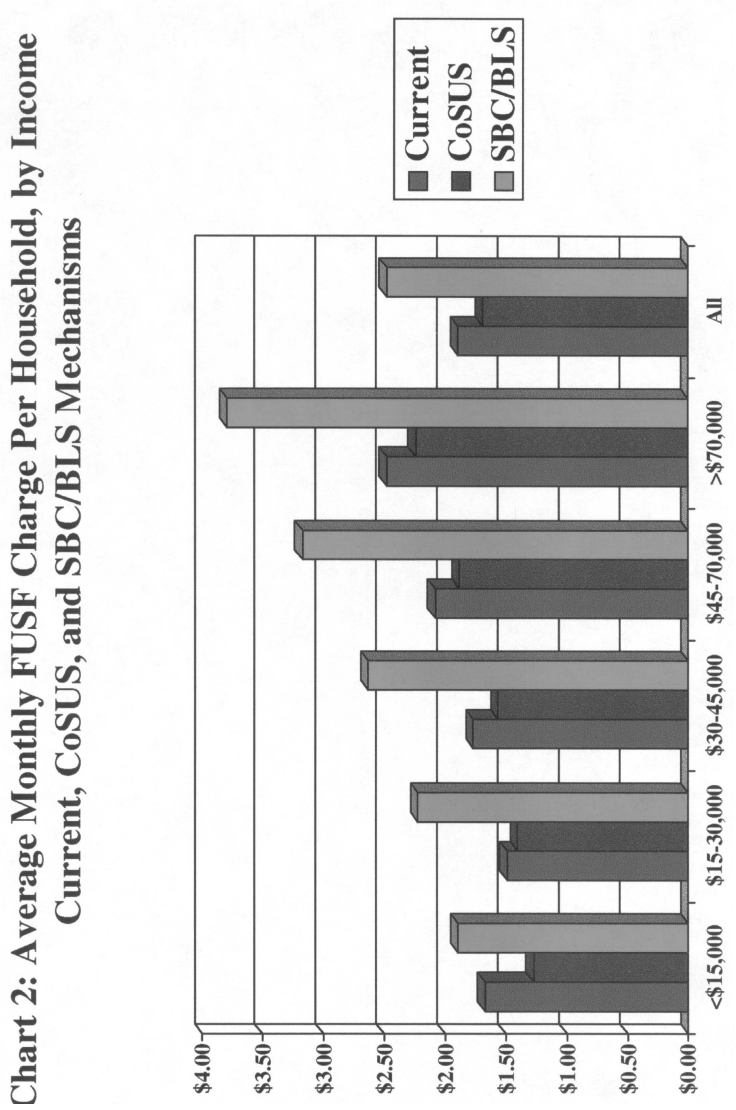
Conclusion

WorldCom shares this Subcommittee's strong commitment to universal service. Irreversible marketplace changes render the current funding mechanism insufficient and unstable. Prompt action by the FCC is needed to avert disaster. Now is the time for the FCC to adopt an approach that makes an assessment on all connections to the public network. This is the only approach that will achieve three critical policy goals: fund sustainability, competitive neutrality and administrative efficiency.

Chart 1: FCC-Reported End User Interstate and International Telecommunications Revenues, 1998-2002



Source: FCC Universal Service Contribution Public Notices; FCC, Telecommunications Industry Revenues: 2000; Universal Service Administrative Co., Federal Universal Service Support Mechanisms Quarterly Contribution Base for the Third Quarter 2002 (filed May 31, 2002).



Senator INOUYE. Thank you very much.

Ms. Greene?

STATEMENT OF MARGARET H. GREENE, PRESIDENT, REGULATORY AND EXTERNAL AFFAIRS, BELLSOUTH CORPORATION

Ms. GREENE. Thank you, Mr. Chairman, Senator. I'm Margaret Greene, president for——

Senator INOUYE. Pull the microphone closer.

Ms. GREENE. OK. I'm Margaret Greene, president for Regulatory and External Affairs for BellSouth, and thank you for inviting me here today.

Today, in this country, we have achieved universal telecommunications service. That has taken decades to accomplish, plus a great deal of industry investment. We've accomplished this universal service, moreover, by guaranteeing universal industry participation. Existing FCC rules in the 1996 Telecom Act require all carriers to participate fully in the FCC's universal-service program, and that approach has worked.

But today we face several critical choices. First, there's the overall state of our telecommunications economy. Market conditions are leading company after company to temper their investment plans. Concerns regarding the overall fairness of the regulatory system may also be having a negative affect. Where regulatory burdens are unbalanced, unnecessary, or excessive investment will, and, indeed, has been, deterred. We need to address this challenge.

Second, however, we face very real questions about the sustainability of the current universal-service system over time. At present, the Federal universal-service support level is about $6 billion a year. Some $2.65 billion of that goes to support schools and libraries and rural medical Internet connections. That support obligation, in turn, is assessed against the interstate revenues associated with traditional wire-line services.

But, as I describe in my full statement, today's bundling of local and long-distance services, of wire-line and wireless services, of information and video services is making it increasingly difficult to identify and separate interstate revenues. For example, the FCC believes that some 20 million cell-phone customers today buy a bucket of local and long-distance minutes for which they pay a flat monthly rate. Wireless traffic is displacing wire-line traffic and, as a result, eroding the traditional revenue base for universal-service support. And most experts, including the FCC, believe this situation will deteriorate over time.

Several approaches have been advanced. The Universal Service Coalition, as discussed by my—the person who immediately preceded me, for instance—has proposed that there would be a flat monthly charge per connection—$1 per cell phone and wire-line connection, and so forth. This option seems simple and appealing. But the practical effect, if not the purpose, of this plan would be to exempt long-distance carriers and their customers from paying universal-service support.

Then there's the approach which Sprint PCS has urged. This would basically freeze universal-service contributions by wireless carriers, despite an increase in their provision of interstate communications. The practical effect of this approach would be to confer a competitive advantage on wireless carriers for the foreseeable future. They would not have to bear the burden of universal service placed on wire-line companies, and would no doubt acquire a large share of interstate revenues based on that free pass.

Mr. Chairman, the 1996 act requires a universal-service approach that is competitively neutral. The act does not envision conferring a special advantage on one group of carriers or on one technology. We should not depart from our tradition of ensuring uni-

versal carrier participation in these support programs. That would be unfair. It would also deter the future investment in new network capabilities that American consumers expect and deserve.

BellSouth and SBC have developed a connections-based contribution mechanism that would meet the statute's requirements. We think our approach guarantees the support the program needs. It avoids the creation of new loopholes. It is a broad-based approach designed to create a strong fabric for sustainable universal service.

In conclusion, we share your commitment. We want to continue to work with you to ensure that every American has access to telecommunications services at reasonably comparable rates. In BellSouth's view, it is not an overstatement to suggest that the nation's economic well being and its security depend on it.

Thank you again for the opportunity to appear before you today.

[The prepared statement of Ms. Greene follows:]

PREPARED STATEMENT OF MARGARET H. GREENE, PRESIDENT, REGULATORY AND EXTERNAL AFFAIRS, BELLSOUTH CORPORATION

Mr. Chairman, my name is Margaret Greene; I am President for Regulatory and External Affairs at BellSouth. Thank you for the invitation to participate in today's hearing.

BellSouth Corporation is a leading communications services company headquartered in Atlanta, Ga., with $51 billion in assets and 85,000 employees serving nearly 45-million customers in the United States and 14 other countries.

BellSouth is also one of the fastest growing ISPs in the Southeast with over 1 .3 million customers including 729,000 households and small businesses that subscribe to our high-speed DSL Internet access service.

Through a joint venture with SBC Communications, we also operate Cingular Wireless, the nation's the second largest wireless carrier with more than 22 million voice and data customers across the United States.

I mention the breath of BellSouth's involvement in the communications marketplace because it places the company in a unique position to comment on how universal service funds should be collected and from whom.

The Principal of and Need for Universal Service

Today, Mr. Chairman, virtually every American has access to telecommunications—regardless of where they live or are visiting. This is the product of more than 50 years of Federal and state policy, and literally hundreds of billions of dollars in capital investment. Universal service also is a product of universal industry participation.

The provision of universal services extends beyond the $6 billion annual universal service support mechanism that is administered under the auspices of the FCC pursuant to Sec. 254 (d) of the Telecommunications Act of 1996, which many Members of this Subcommittee helped craft.

Simply put, universal service is about investment in telecommunications networks that serve all Americans. Never before has the importance of America's communications networks been more clear. As the drama and tragedy of September 11th unfolded, Americans reached for their phones. Never before has the capacity and reliability of our nation's telecommunications network been put to such a test—or played a more important role in preserving national security.

It is for this reason, Mr. Chairman, that the Subcommittee should be very concerned about the state investment in the nation's telecommunications network. According to published reports, capital expenditures by telecommunications providers are at disturbingly low levels and falling. Industry analysts estimate that telecommunications capital investments will be sharply reduced this year from last year's already depressed levels. R&D spending by U.S. communications equipment companies has slowed dramatically along with equipment sales and in some cases is moving off shore. And, nearly every telecommunications company has seen its market value drop in the last year.

The confluences of market, regulatory and universal service conditions are leading company after company to temper their investment plans. The ability to deliver modem, affordable universal services depends not only on a workable universal service support system, but a healthy business and regulatory environment.

In general, if the regulatory environment is fair, the private sector will invest in telecommunications networks. Where the rules and regulatory burdens are unbalanced, unnecessary or excessive, investment will and, indeed, is being deterred.

The most powerful universal service tool is a fair set of rules. Companies should compete for customers, not regulatory classification. Success in the marketplace should be based on a carrier's ability to respond to customer needs at reasonable rates not regulatory preference and those rules should treat providers of like services alike. Unfortunately, that is not the current state of telecommunications regulations today.

While the focus of this hearing is the universal service support system, it is critically important for the Subcommittee to consider the larger question of whether the conditions are right for companies to make the investment that will be needed to keep the capabilities of the nation's telecommunications networks in sync with user needs for traditional voice services as well as new data applications like high speed Internet access. Too often, in BellSouth's view, regulators look at universal service policy as a discreet and separate discipline, rather than a fundamental guiding principal for all policy.

We believe that a competition policy and a universal service policy, which is based on a principal of treating all providers fairly and equitably, best facilitates the delivery of universal services.

The Universal Service Support System

The universal service support system is an important driver of investment. There are areas of high cost and low density where market forces alone will not lead companies to invest. There are also families who cannot afford market prices for essential telecommunications services. That is where the universal service support system comes in. Congress also determined that schools, libraries and rural health care providers should improve their access to modem telecommunications and information services through the universal service support system. This alone entails some $2.65 billion in support each year.

In section 254 of the Telecommunications Act, Congress did not prescribe a particular system of support, but outlined a set of essential principals that must be followed. Specifically, Congress stipulated that:

> Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service. [1]

Since the passage of the Telecom Act, Federal and State regulators have spent a great deal of time dealing with competitive issues, sometimes without fully considering the effects of those policies on the delivery of universal services. There also has been significant attention on the uses of universal service funds. Only recently, however, has much focus been placed on how universal service funds will or should be collected in an increasingly competitive market environment.

These questions are now being raised because changes in the telecommunications marketplace have raised concerns that the current the universal service support system no longer collects requisite funds in an "equitable and non-discriminatory basis," as is expressly required by Sec. 254 (d) of the Telecom Act. These concerns unfortunately, are symptomatic of a larger problem of technology and customer choice outpacing regulatory classifications. The convergence of technologies and services and the changing market have placed the current support mechanism under considerable stress. That convergence also raises doubt about the consistency of the current system with the requirements of the law.

Just as the regulatory environment must keep pace with the dynamic nature of the telecommunications market, so must universal service policies.

In the past, BellSouth has recommended that the Congress consider using the current federal excise tax to fund the nation's universal service support system. While we understand the political and budgetary challenges of such a reform, the mathematical coincidence of the projected cost of the universal service support system and the revenues generated by the excise tax is compelling. Each is about $6 billion a year. Using excise tax revenues to pay the cost of universal service also is good public finance in that it would correlate those who pay for universal service with those who benefit by it. Analogs include the Federal excise tax on gasoline which is used to help underwrite the cost of maintaining the nation's highways, and the Federal excise tax of airline tickets which is used to help keep airports in good working order.

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[1] 47 U.S.C. § 254(d).

Short of major legislative action, however, any regulatory reform of the universal service system, as well as a continuation of the current system, must fully comply with the requirements of the Telecommunications Act of 1996 as written.

Universal Service Contributions

The FCC has sought comment on the assessment and recovery of universal service contributions. The current system is based on an assessment or surcharge on revenues attributable to interstate and international services.

The Commission identified trends that raise questions about the viability of the current revenue-based contribution mechanism. The Commission noted, for example, that interstate revenues have recently declined for interexchange carriers and that the contribution base could continue to erode over time. That, in turn, could necessitate increasing the universal service contribution factor just to maintain existing levels of support.[2] Most carriers pass those costs along to customers in the form of line items on monthly bills.

The FCC also raised concerns about the current contribution mechanism's reliance on historical revenues and the ability to adjust quickly to relative changes in carriers' revenues. Because a carrier's contribution is based on revenues earned six months prior to the calculation of the factor, the FCC noted the possibility that carriers with increasing revenues obtain a benefit, albeit for a short duration, to the detriment of carriers with decreasing revenues.[3]

The FCC identified another market change that is having a profound effect on universal service support. That change is the growth of wireless communications. The Commission observed that carriers are bundling services together in flat-rate packages that include both local and long distance services. According to the FCC's *Further Notice,* nearly 20 million mobile wireless customers subscribe to these types of (flat rate) calling plans.[4]

The bundling of long distance and local services, wireline and wireless services, offerings of information services and telecommunications and the one-stop offers of voice video and data service make it increasingly difficult to identify and segregate interstate revenues.

The FCC opened a much-needed debate on the current assessment mechanism. The *Further Notice* sought comments on ways to ensure the stability and the sufficiency of the universal service fund as the marketplace continues to evolve, to reduce regulatory costs, to continue to have an assessment mechanism that is equitable and nondiscriminatory and to provide contributors with certainty.[5]

BellSouth shares the FCC's concerns. The marketplace is witnessing a substitution of bundled local and long distance packages for discrete local and interstate long distance offerings. With these market changes, interstate revenues are becoming masked. The decline in discretely identifiable interstate revenues, however, does not necessarily mean that the interstate revenue base is unstable. Instead, interstate revenues are mixed into packaged revenues and require a more sophisticated approach to identification and attribution.

While the identification and segregation of interstate revenues that are in packaged arrangements of both wireline and wireless carriers presents an increased challenge, such a challenge does not make a revenue-based contribution mechanism unworkable. The FCC has the authority to obtain the information and data that is necessary to adjust the revenue mechanism to insure that the universal service assessment mechanism captures the interstate revenues that have migrated away from traditional forms of interstate interexchange services toward the bundled offerings. However, the Commission would have to close the current contribution loopholes that allow for interstate communications to shift to internet-based offerings provided by Internet service providers ("ISPs") and, thus, escape assessment for universal service purposes.

While the question of having ISPs contribute to the universal service fund is before the FCC in a different proceeding, there is an important principle that must be recognized. Regardless of the assessment mechanism, if it contains exceptions, loopholes, and special treatment; providers and customers will gravitate toward those exceptions in order to avoid universal service assessments.

Exceptions instill instability and inequality in the assessment mechanism. Exceptions could undermine any future system as well. It does not matter whether the mechanism continues to be revenue-based or whether the Commission adopts a flat-rate mechanism. The only way to avoid instability is to follow the law's requirement

[2] *See Further Notice* ¶¶ 7–8.
[3] *Id.*, ¶ 10.
[4] *Id.*, ¶ 12.
[5] *Id.*, ¶ 15.

that all providers of telecommunications contribute to universal service support on a competitively neutral basis.

The statute is unequivocal in its requirement—every carrier providing interstate services must contribute to the universal service fund. The only exemption from contributing to the fund that the Commission is permitted to make is for a carrier or class of carrier "if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution to the preservation and advancement of universal service would be de minimus."[6]

Any assessment mechanism must be evaluated in terms of this statutory requirement. If the mechanism fails to pass statutory muster, it must be rejected. The statutory requirement is non-optional.

In this regard, The FCC's *Further Notice* seeks comment on the proposal submitted by the USF Coalition.[7] The essential elements of the Coalition's proposal are that residential wireline and wireless connections would be assessed $1.00 per connection per month and pagers would be assessed $.25 per month; business connections would be assessed based on connections and capacity. Under the Coalition proposal, ILECs and CLECs would be responsible for paying the wireline assessments, the wireless carriers would be responsible for the wireless assessments and paging carriers would be responsible for pager assessments.

While simple, the Coalition proposal nevertheless exemplifies the type of mechanism that does not stand up to the statute's requirement that all interstate carriers contribute to the universal service fund on a nondiscriminatory and equitable manner. Indeed, adoption of the Coalition's proposal would reduce the level of contributions from the interexchange carriers from just less than 60 percent under current FCC rules to less than 10 percent.

The Commission also sought comment on Sprint's proposal that would create per-connection contribution obligations based on the proportion of industry interstate revenues currently reported by the different industry segments. The specific question asked by the Commission, *i.e.,* would the proposal be equitable, nondiscriminatory and competitively neutral, signals the infirmity in the proposal. The concerns that led the Commission to consider alternatives to a revenue-based contribution mechanism are imported to Sprint's connection-based proposal. For example, Sprint's proposal would not adjust a wireless carrier's contribution despite an increase in the provision of interstate communications. An assessment mechanism cannot freeze contribution levels in the face of known industry changes and pass muster. Such a freeze is not equitable nor is it competitively neutral. One industry segment—wireless carriers, in the case of Sprint's proposal—is favored at the expense of all other industry segments. It is not equitable for non-wireless carriers to shoulder the universal service contribution burden that properly belongs to wireless earners. Equally significant is the competitive advantage wireless carriers obtain over both wireline local exchange carriers and interexchange carriers. Wireless carriers' services are competitive alternatives for wireline exchange and interexchange services. Shifting a portion of the wireless carriers' contributions to wireline carriers provides a price advantage to the wireless carrier because the wireline carriers' universal service recovery charges are higher than they would otherwise be if the wireless carriers bore their equitable share of the universal service burden.

Despite the infirmities of the USF Coalition and Sprint's connection-based proposals, such infirmities do not mean that a connection-based proposal cannot be designed in a manner that conforms to the statute's requirements. A connections-based mechanism can be formulated that is equitable, nondiscriminatory and competitively neutral. Such a formulation will require an innovative view of connections.

In order for a connection-based contribution mechanism to meet statutory muster, it should recognize that every provider of interstate telecommunications that sells service to an end user has an interstate connection that should be counted and contribute to the universal service fund. Looking at connections in this manner enables the Commission to adopt a mechanism that not only fulfills the statutory mandate that all interstate carriers contribute to the fund but also encompasses the full range of interstate telecommunications providers. A broadened view of connections forms the foundation of a contribution mechanism that is fair and equitable among all providers, and, equally important, minimizes the opportunity for manipulation or avoidance of the contribution obligation through the way services are packaged or classified.

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[6] *Id.*

[7] The USF Coalition is comprised of AT&T, Ad Hoc Telecommunications Users Committee, WorldCom and e-TUG.

A broadened view of connections would be competitively neutral because no provider of interstate telecommunications would gain an advantage vis a vis a competitor simply by the way it chooses to offer service. Competitive neutrality is a particularly important component of a connections-based mechanism in an environment that continues to be characterized by disparate regulatory regimes. Ensuring that all providers of interstate telecommunications contribute to the universal service fund will bring stability to the fund.

BellSouth and SBC have jointly developed a proposal for a connections-based contribution mechanism that would meet the statute's requirements. It counts all connections. It avoids the creation of new loopholes and seeks to close existing loopholes.

Summary of BellSouth/SBC Proposal

Under our plan, universal service support would come from all interstate telecommunications activity. Interstate telecommunications activity occurs when a service provider sells interstate telecommunications services or services that use an interstate telecommunications component. These services require that a connection be established so that a retail customer can gain access to other users of interstate telecommunications services. The connections can be provided through a variety of service architectures that have an access and a transport component. Universal service contribution requirements would apply to both the access and transport components. For example, in the case where a customer has established two retail relationships, one with a local telephone company (access) and another with a long distance carrier (transport), both the local telephone company and the long distance carrier would bill the customer to recover its universal service contribution. The total amount that individual customers pays would simply reflect the total amount of universal service support divided by the total number interstate (access and transport) components.

BellSouth's and SBC's proposed universal service contribution and recovery mechanism is consistent with the requirements of Sec. 254 and provides a number of important benefits. First, the proposal provides a stable universal service fund in an evolving market by assessing contributions on all interstate telecommunications activity. By including all interstate telecommunications activity, the proposal ensures that residential telephone customers will not be forced to bear an unreasonable share of the universal service costs as more and more customers migrate to alternative technology platforms that are outside the scope of the current contribution mechanism.

Second, the proposal establishes a straightforward method for assessing universal service contributions that does not rely on the distinctions such as residential versus business, circuit versus packet-switched connections, or interstate versus intrastate revenues. The proposal addresses the concern about fluctuating revenues and the ability to identify the jurisdiction of the revenue.

Third, the proposal correlates the amount of assessment to the provider's interstate telecommunications activities. Higher bandwidth services would be assessed more based on a progressive contribution methodology.

BellSouth and SBC have developed its contribution proposal in good faith. As this testimony indicates, there are alternative ways to design a universal service support system of assessments, which meet the requirements of the Telecommunications Act. We welcome the opportunity to work with the various industry sectors, federal and State regulators and the Subcommittee to find a workable solution to this serious problem.

More broadly, it is not too early to begin a dialogue on the next chapter of the universal service story. The various universal service plans, which have been adopted by the FCC including the CALLS plan, the Rural Task Force Recommendations and the Multi Association Group plan, operate for a limited period of time. It would be an understatement to say that the resulting universal service system is complex.

Conclusion

BellSouth appreciates the opportunity to present its views to the Subcommittee. The coming crisis in the universal service support system is real. That crisis is a symptom of a larger problem of technology and customer choice outpacing regulatory classifications. The convergence of technologies and services and the changing market place make the current base of support unsustainable. The reduced levels of investment in the nation's telecommunications networks also raise concerns about the current regulatory, market and universal service landscape.

BellSouth also supports, without reservation; the vision embodied in Section 254 of the Telecommunications Act, which we know many Members of this Committee were deeply involved in when Congress wrote the 1996 Act. We share your commit-

ment that the universal service system should ensure that citizens in all regions of the Nation have access to advanced services and that all Americans deserve comparable services at comparable rates. We look forward to working with this Committee, the FCC, and the states to achieve these important goals.

For America to stay connected the regulatory and universal service policies must keep pace with the dynamic nature of the telecommunications market.

Thank you Mr. Chairman.

Senator INOUYE. And thank you very much.

President Bond?

STATEMENT OF DON BOND, PRESIDENT AND MANAGER, PUBLIC SERVICE TELEPHONE COMPANY, GEORGIA

Mr. BOND. Mr. Chairman and Members of the Committee, I'd like to thank you for allowing me to testify this morning, and I'd certainly like to thank Senator Cleland for the help that he gave me in getting me here.

I am the president of Public Service Telephone Company in Reynolds, Georgia. My grandparents began the company in 1911 by installing a magneto system. My father, in 1953, extended service to the rural area even further and installed a dial system with the help of financing from the Rural Utility Service.

The company today serves a little over 12,000 customers in a thousand-square-mile area between Macon and Columbus. We continue to rely on national programs, including Federal universal-service fund support, which we are here to talk about this morning.

In addition to wire-line service, we are also—we also provide wireless, Internet access, cable TV, long-distance resales—long-distance resale services. Public Service Telephone Company, like hundreds of small companies throughout the nation, links its customers into an essential communications backbone for their social and economic lives and the nation's safety and security.

That is why I'm also appearing on behalf of hundreds of other rural telephone companies represented by the National Rural Telecom Association, the National Telecommunications Cooperative Association, the Organization for the Promotion and Advancement of Small Telephone Companies, the Western Alliance, and the Independent Telephone and Telecommunications Alliance. I also bring to the table my experience as a director and the current chairman of the National Exchange Carriers Association, although I'm not speaking on their behalf today.

Mr. Chairman, Judge Greene and Charlie Brown started an economic slowdown caused by uncertainty of the consent decree. If you believe what the Wall Street Journal publishes and Bloomburg has on TV, the communications industry in this nation is headed into a communications depression. Rural American communications system must not be forced into an economic crisis through regulatory and judicial actions.

On the forefront of these actions is the national universal-service fund program. There are three areas that I would like to discuss today. First, the system allocates payment responsibilities among interstate carriers based on historical interstate end-user revenue. The inter-exchange carriers say that—those distortions are caused by lag between the historical revenue and assessment. Their plan, connections-based proposal, has a major flaw in that it is inconsistent with the requirement under Section 254(d) of the Commu-

nications Act, which requires that all providers of the interstate communications service should contribute to universal service. In other words, the connections-based plan largely exempts the large inter-exchange carriers from paying into the fund. Congress should ensure that the inter-exchange carriers continue to contribute in a fair and reasonable manner.

Also, the current safe-harbor reporting percentage for interstate commercial mobile service—radio service providers appears to be substantially understated. We should all pay our fair share.

Second, all facility-based broadband, Internet, cable, and satellite providers of communication, regardless of our technology, should be included in the list of contributors to USF.

The third key issue is how additional carriers qualify for universal-service-fund support and the basis on which the support—they receive the support once they're qualified. Some states have moved aggressively forward establishing the practice of making support available in the name of stimulating competition, but hardly taking notice to their statutory universal-service responsibilities.

Also, the FCC has put enormous pressure on the size of the Federal support program for the high-cost rural areas by providing support without regard to the competing carriers' cost in trying to prevent states from adopting requirements to assure the carrier provide value in return for the supports they receive.

Congress should remind the FCC that to support—the purpose of the Federal support in high-cost areas is neither to double the cost of the nationwide universal service in order that the new carriers will receive huge profits, nor to provide service where very low—at very low cost to the customers.

Under the FCC rules, competitive carriers must receive universal service based upon the incumbent's cost, rather than their own cost. The Commission rules should require that each eligible telecommunications carrier's support payments should be based on its own cost of providing service and are actually put into use for statutory purposes. If the goal is to have consumers' universal services to be low—as low as possible, then the carrier support amount should be based on their own cost. Mounting pressure on the fund size also comes at a time when the fund is growing because of a court-ordered substitution of universal service for access-cost recovery.

In conclusion, we ask Congress today to work with us to stem the tide of regulatory and legal decisions that are unraveling the universal-service program, and to, once again, sustain the nation's commitment to this important national policy.

[The prepared statement of Mr. Bond follows:]

PREPARED STATEMENT OF DON BOND, PRESIDENT AND MANAGER, PUBLIC SERVICE TELEPHONE COMPANY, GEORGIA

Executive Summary

An unending string of Federal Communications Commission (FCC) regulations and court decisions may be putting our national universal service system at great risk.

First, the FCC is proposing to relieve long distance carriers of the duty the Telecommunications Act of 1996 gave them to support federal universal service programs by shifting an unfair support burden onto carriers that connect end user customers to the public switched voice telephone network. It is undisputed that the

FCC needs to ensure that universal service funding is sufficient and sustainable. While there is still controversy about how to improve the current system, it is clear that the FCC needs to follow the law and ensure that interstate long distance carriers continue to provide their share of support, as is mandated by statute. It is also clear that the FCC has to make all service providers that offer competing services and functions contribute to universal service funding to avoid both marketplace distortions and saddling some customers with too much of the cost of national policy.

Second, the FCC has to make sure that support for new carriers is not excessive, carries real responsibilities, and provides real customer benefits. Even though Congress specifically expanded and spelled out the nation's long-standing commitment to universal service in the 1996 Act, the FCC's notion of "competitive neutrality" has led it to squander support collected from the nation's consumers and businesses by guaranteeing windfall payments to "competitors." The FCC has put enormous pressure on the size of the federal support program for high cost rural areas by providing "support" without regard to a competing carrier's costs and trying to prevent states from adopting requirements to ensure that carriers provide "value" in return for the support they receive.

It is time for Congress to remind the FCC that the purpose of federal support in high cost areas is neither simply to double or triple the cost of nationwide universal service to provide new carriers with premium profits nor to provide customers with subsidized choices.

The 1996 Act recognized the delicate balance that would have to take place for its two-fold objective of universal service and competition/deregulation to coexist. Yet the regulators and the courts have routinely assigned a higher value to what one Commissioner has called "creating competition," to the distinct disadvantage of both the rural markets and consumers it is designed to help and the users of the network that pay the tab.

Today multiple carriers may receive universal service support based upon the incumbents' costs, rather than their own. In addition, competitors are receiving such support without "capturing" any customer lines or serving any new lines. In other words, far more support is flowing through the universal service system than necessary. Such needless support adds to the pressure from the costs of the newer programs developed under the 1996 Act's provisions for schools, libraries and health care discounts. Mounting pressures on fund size also come at a time when the fund is growing because of decisions that substitute universal service support for access charge cost recovery in furtherance of controversial court rulings about what constitutes "implicit support" that should be made "explicit."

The states generally have only exacerbated the situation, with many failing to place a high premium on the public interest when evaluating eligible telecommunications carrier (ETC) requests or determining whether to develop state universal service plans. States need to provide a fair share of state support for added carriers they designate. They also need to use their oversight duties to ensure that non-cost based support paid to competing carriers is used solely for valid universal service purposes.

Considering the world we live in today, we believe there can be no denying the critical role universal service plays in ensuring the future of our nationwide integrated network—a network that has been proven again and again to be so critical to our national and economic security. Thus, we call on the Congress today to work with us to stem the stream of regulatory and legal decisions that are unraveling the universal service program, and to once again sustain the nation's commitment to this important national policy.

Introduction

Mr. Chairman, Members of the Committee, my name is Don Bond, and I am the third-generation president of Public Service Telephone Company in Reynolds, Georgia. My grandparents Hiram Columbus Bond and Bessie Marie Bond were the first generation of our family to enter the telephone business. Among his many efforts to help our company grow, my father H. C. Bond, Jr. worked to acquire Rural Utilities Service (formerly Rural Electrification Administration) financing to upgrade equipment and further extend service into rural areas. Today Public Service Telephone Company serves 1,050 square miles of territory between Macon and Columbus, Georgia.

The dream of my grandparents and parents to provide affordable voice grade service to residents and businesses in rural Georgia has been advanced as my family's company has grown to provide a variety of services through Public Service Communications. Through its subsidiaries, Public Service Communications provides wireline and wireless telephone service, Internet access, cable television, and long-distance services in Georgia and Alabama. Like the majority of rural telephone com-

panies all across the nation, my company was formed to bring quality communications service to a rural market that was overlooked by the nation's largest carriers. Because we are a community based telecommunications provider, we have a special interest in fulfilling the varied communications needs of our community.

The challenges facing Public Service Telephone Company are representative of those facing rural incumbent local exchange carriers (ILECs) in markets throughout the nation. And for the most part, the hundreds of other rural ILECs throughout the nation are offering a similar array of communications services to their markets. That is why today I am also appearing specifically on behalf of those hundreds of other ILECs that are represented by the Independent Telephone and Telecommunications Alliance, the National Rural Telecom Association, the National Telecommunications Cooperative Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies, and the Western Alliance which is a partnership of the Western Rural Telephone Association and the Rocky Mountain Telecommunications Association.

I also bring to the table my experience as a director of the National Exchange Carriers Association (NECA) of which I am currently the board chairman, although I am not speaking on behalf of NECA today. NECA and its subsidiaries play an important role in administering the federal universal service and access charge programs that are so important to ensuring that telephone service remains available and affordable in all parts of the country.

The Essence Of Our Concern

Universal service is the cornerstone of our nation's telecommunications policy. It is a social compact embracing (1) the ideal that all Americans, both urban and rural, are entitled to quality telecommunications services at affordable rates and (2) the economic fact that the value of a network to every customer is enhanced by ensuring that the greatest possible number of customers are connected to the network. So important is this national policy that its historic high-cost and low-income mission, begun under the mandate of the 1934 Communications Act, was specifically enshrined in clear, concise terms in the 1996 Act. At that time, Congress also expanded the policy, adding the new objective ensuring that schools, libraries, and rural health care facilities may fully access the advanced telecommunications features that are available via our nationwide, integrated network.

Yet we continue to have ample reason for concern with the future of our nation's universal service program. Generally, these concerns date to the development of the rural and universal service provisions of the 1996 Act. While we are grateful that Congress worked such strong provisions into that statute, we are, as we were then, nevertheless wary of several elements of the provisions—particularly, those that allow additional carriers to receive universal service support in a given market without adding any value for the support they receive.

Ensuring The Stability And Sufficiency of Universal Service

The Committee has asked for testimony on the FCC's open proceeding considering a proposal to relieve the long distance carriers from almost all of their current statutory duty to contribute to federal programs that support universal service. The plan would assess contributions based on the number and capacity of "connections" provided to the public switched network. This is a highly controversial proposal, and, to be honest, the associations I represent have taken different positions on how to solve the current universal service dilemma. One view is that the FCC should continue to assess interstate revenues to fund support programs. The other is that the FCC should only move forward on a flat-rate, non-revenue based contribution assessment method if it makes significant changes in the proposal.

The interesting thing is that these seemingly opposite recommendations are really the only differences between what the associations have said about the "end-user connection" scheme. Let me tell you about the points we all agree about. First, we all oppose the plan as proposed because the statute expressly says that all carriers that provide interstate telecommunications services have to contribute on an equitable and nondiscriminatory basis. While end users connect with local exchange carriers for exchange access—origination and termination of calls within the local area—actual *interstate* service requires the customer to use an interstate long distance carrier's state-to-state service. Whether the FCC fixes the end user connections plan or stays with interstate revenues, the associations all agree that the interstate carriers have to be the principal contributors.

Second, we all agree that universal service support needs to be sufficient and sustainable and should be fair to all providers and users of all kinds of networks. We are all aware of growth in the fund and concerns about shifts in what carriers are providing interstate services. These developments have created a serious issue about

how to prevent erosion and evasion of support mechanisms. Thus, we all agree that the FCC needs to assess the broadest possible list of contributors to keep each carrier's contribution and the amount it needs to recover from its customers as small as possible. The law allows the FCC to assess all providers of "telecommunications" if the public interest requires, even if they are not common carriers. We all agree that all providers that compete with each other and provide the same functions should have the same contribution responsibilities. This means that cable modem providers and information service providers that provide their own transmission should contribute, just as ILECs presently contribute for their transmission role in providing Internet access. This also means that wireless carriers need to be assessed on a fairer basis than the current "safe harbor" adopted as a temporary measure before the dawn of the new wireless era of nationwide toll and local calling plans.

Therefore, we all oppose the plan that is the subject of this panel and want everyone in the same shoes to contribute on the same basis. The only difference is in whether we have urged the FCC to continue the present method with a broader contribution base or suggested ways to make a flat-rate monthly assessment method work.

Universal service programs have successfully connected rural American households and businesses, schools and libraries, low-income families, and others to the public switched network. In addition to connecting people to the network, a strong universal service policy provides other economic and social benefits. For example, rural Americans in particular see opportunities for their communities to thrive and prosper through rural economic development fostered by modern telecommunications. Indeed, few would argue that the nation has already achieved many benefits from pursuing universal service as a national public policy goal.

With this in mind, it is critically important that Congress continue to ensure a sustainable funding mechanism that provides stable and sufficient universal service funds. This is necessary because the sufficiency and the sustainability of the fund will be even more seriously challenged in the days ahead for two reasons: (1) an increasing demand for universal service funds; (2) a convergence of technology and growth in the Internet.

Our concern is that the size of the universal service fund may become so large that the current funding mechanism can no longer provide sufficient support dollars. For example, in the year 2000 approximately $4.5 billion in universal service funds were needed to support all existing programs. However, given recent FCC decisions regarding access and universal service issues in the CALLS and MAG access orders, it is currently estimated that for the year 2003, universal service fund requirements will exceed $6 billion.

Moreover, the number of competing carriers seeking designation as eligible to receive universal service support is growing at an ever-increasing pace. And the resultant effect on the universal service program is predictably significant. In the first quarter of 2001, competing carriers were receiving their redundant universal service support at an annualized rate totaling nearly $4.7 million. Just a little more than a year later, in the third quarter of 2002, such carriers are receiving duplicative support at an annualized rate totaling nearly $76.4 million. Truly, the growing size of the fund is taxing the ability of current contribution methods to generate sufficient funds.

Moving to the second point, converging communications technologies and the rapid growth of the Internet pose long-term challenges to the "sufficiency" and sustainability of funding for Universal Service. Evolving technologies are causing the revenues of traditional telecommunications providers that contribute to the fund to dwindle as they are replaced by a new cadre of players. In addition, new technologies are creating new ways to deliver telecommunications and information services that, so far, enable the users and providers to avoid universal service contribution responsibilities.

For example, the gradual but ever-growing use of broadband platforms and Internet Protocol (IP) networks plays a significant role in the present instability of the contribution base. Consumers use IP networks in a variety of ways (e.g. access to the World Wide Web, e-mail, instant messaging, Internet telephony) and via various platforms (e.g. cable, wireless, satellite) to substitute for interstate calls on the public switched network. As "Internet substitution" grows, traditional interstate revenues providing the funding base for universal service will diminish. And there will be little offsetting gain, since presently only wireline telecommunications carriers are required to contribute on the basis of revenues earned from Internet access service while all other Internet access providers utilizing other platforms remain exempt from the obligation.

Given these threats to the fund, it is time to reassess the overall fund composition, as well as the services and service providers that should be contributing to uni-

versal service. Fundamentally, all facilities-based providers of telecommunications, regardless of technology platform, should contribute to the universal service fund. Contributions should be based upon interstate telecommunications activities, and not be tied to a narrow definition of "interstate telecommunications services."

Essentially, what this means is that the contribution base should be broadened for all purposes funded by the universal service mechanism. Broadband service providers, whether considered information service providers or telecommunications service providers, should be included as supporters of universal service. And all broadband service providers should be assessed in a similar manner. In short, there should be parity in the contribution methodology applied to all telecommunications providers.

It is important that the funding mechanism operate in a competitively neutral fashion. Customers of both information and telecommunications services should not be driven to one provider over another based on differences in responsibility for contributing to universal service. And for the benefit of consumers and providers alike, an administratively simple and flexible method for assessing and collecting funds from interstate service providers should be implemented to ensure a sustainable fund.

In reassessing the makeup of contributors to the fund, Congress should insist that interexchange carriers, Internet access providers, wireless carriers, bundled service providers, payphone providers, dial-around services, and IP telephony providers, as well as local exchange carriers *all* contribute to the universal service fund. Contribution obligations imposed on a particular telecommunications industry segment or consumer group, e.g., multi-line business, should be equitable, competitively and technologically neutral, and not so large that they drive users off the public network. For example, centrex customers have already faced an access charge hike to $9.20, and cannot weather steep new contributions pass-throughs.

In sum, for the reasons outlined above that threaten the existence of the current universal service fund, it is important that Congress reaffirm its commitment to a sustainable universal service fund. Congress should direct the FCC to identify a better funding mechanism in accordance with the statute that will provide a reliable and sufficient source of funds. The funding mechanism chosen should be applied to all facilities-based interstate telecommunications or information service providers that provide an interstate telecommunications component as part of their end user services.

Finally, the responsibility to ensure that schools, libraries and rural health care providers have access to telecommunications, Internet access, and internal connections is a national responsibility and should not solely be the responsibility of the telecommunications industry. For one thing, the schools and libraries and rural health care programs should be collected and administered as a separate fund.

States Must Take ETC Responsibilities More Seriously

Finding a better way of assessing contributions to universal service support on carriers is only one problem the FCC needs to resolve to make universal service support funding sustainable. Another key issue is how additional carriers qualify for universal service support and the basis on which they are supported once they qualify.

We argued for tighter language at the time of the 1996 Act's implementation, but the emphasis on moving to a so-called competitive deregulated environment was such that a more restrictive universal service section was ultimately precluded. Owing to misguided interpretations and implementation of the 1996 Act, today we are at the point where pressures on the program have grown to the degree that we are now very concerned about its long-term viability.

Although we have never agreed with the concept of allowing multiple carriers in a market served by a rural telephone company to receive universal service support, we had hoped that the safeguards in the law would prevent the duplicative support provisions from doing unintended harm. In fact, we have always noted that the great majority of rural markets that are served by our members are not and may never be in a position to sustain more than one carrier. Artificial competition—that is competition that is based upon a business plan relying on duplicative universal service support—is not market driven competition at all and should be discouraged, not encouraged. Technically, the statute contemplates multiple carrier support in non-rural telephone company areas and even requires it in the large urban-centered markets. In our view, however, the provision allowing an existing support recipient to voluntarily relinquish its ETC designation when a new recipient qualified indicates that the congressional intent behind the provision was that new entrants into a market would be making a genuine, carrier of last resort-like, commitment to the market in order to receive universal service support.

The legislative history leading to the creation of the section of the statute that provides the states with the responsibility of making ETC determinations shows that the Congress believed state authorities would be in a better position to make ETC determinations than the FCC. State policymakers, after all, would have the best information with regard to the needs of their respective rural markets and would have a vested interest in ensuring such markets were efficiently and well served. Unfortunately, to a large extent state policymakers have simply followed the direction and directives of the FCC, without a great deal of thought being given to their individual, unique circumstances.

The FCC first tried to prevent states from adopting any additional requirements for carriers seeking to qualify for support. The 5th Circuit decided that the law did not permit this prohibition. The FCC has, since then, issued an unnecessary declaratory ruling threatening to preempt state requirements the FCC perceives as obstacles to the publicly-supported "competition" it wants to foster.

Spurred by the FCC, multiple state authorities have moved aggressively forward to establish interconnection and universal service environments that heartily embrace competition and deregulation, but hardly take notice of their statutory universal service responsibilities. The practice of making support available in the name of stimulating competition has led to the granting of ETC status to new market entrants without regard to the impact on efficiency, the cost or who would pay.

In case after case state authorities have granted ETC status to competitive carriers based on extremely loose public interest tests. In fact, for the most part "competitive neutrality" is often judged to be equivalent to artificially inducing competition and even such synthetic competition has been assumed to be in the public interest. Such theory has no place in the regulatory arena as it applies to rural markets. In the case of the rural markets served by my company and those of my rural company colleagues, the entire communities are typically already receiving high quality, affordable communications services and the existing provider is doing all it can to provide advanced capabilities.

As noted, section 214(e)(2) of the Communications Act of 1934, as amended, requires state commissions to designate additional ETCs in areas served by non-rural ILECs. However, Congress had reservations as to whether the introduction of subsidized competition into the areas served by rural telephone companies would immediately or in all cases be beneficial to the provision of universal service. These concerns led Congress to require a public interest determination prior to the designation of additional ETCs in rural company service areas. It follows, then, that the introduction of competition in a rural service area cannot be considered, itself, a demonstration of serving the public interest. That is exactly the question Congress required the states to determine as a prerequisite for designating an additional ETC in a rural telephone company's study area.

We call upon Congress to work with us to strengthen the federal statute in a way that makes it clear that ETC designations are to be taken seriously and that the responsibilities associated with receipt of this designation must be of a carrier of last resort level of commitment that are demanded of incumbent carriers. Providing universal service support to a carrier that is unwilling to provide service within the evolving definition is wasteful and serves no one well. The fact of the matter is that we incumbents have always provided real value to our customers and to the nationwide end-user contributors in return for our ETC designations, and we would not have it any other way. Nevertheless, Congress should no longer sit still and watch others take advantage of this critical program.

Providing Support For Multiple Carriers At The Incumbent Carrier's Cost

But as I alluded in my opening, the states are not the only ones running up the costs for the universal service program without increasing the benefits. The FCC is also responsible. One of the most controversial and costly FCC actions "implementing" Congress's universal service requirements is its revision of the pro-consumer policy into a consumer-funded windfall for competing carriers in rural areas. This unjustified consumer burden came about because the FCC uses the incumbent local telephone company's actual costs for providing a line to its customers to calculate the universal service support for competing carriers.

The FCC originally said that it would use its proxy model, based on an imaginary state-of-the-art lowest-cost network for rural carriers' support. However, its Rural Task Force, made up of representatives of consumers and all sorts of carriers, determined that the proxy model simply would not work for the extremely varied rural telephone companies and the differing conditions in their service areas. And we agree. Nevertheless, the FCC still wants to force rural companies into its misshapen proxy mold. Fortunately, for now it is still using actual costs, which accurately measure the need for support for incumbents under the current formulas.

Fixated on the principle of "competitive neutrality" it had added to the list of principles Congress adopted, the FCC decided to make support "portable." By this, the FCC meant that universal service support for high cost, rural, and insular areas would be shifted to a competitive ETC that "wins" or "captures" a customer from an ILEC. It later spoke of support for "new" customers, too. The idea is that the new eligible carrier would receive the same level of universal service support for a customer no longer served by the incumbent as the ILEC would have been eligible to receive for serving that customer.[1]

The FCC's rationale was that "paying the support to a competitive eligible telecommunications carrier that wins the customer or adds a new subscriber would aid the entry of competition in rural study areas."[2] The FCC simply brushed aside the statutory language, ignoring that section 254's requirements for "sufficient," "predictable" and, above all, "specific" support are totally at odds with basing support on *another carrier's* cost-specific support.

The FCC has never even required new eligible carriers to show which lines they have "captured" or which lines are "new." Instead, it developed rules that now provide support for whatever lines the new designated carrier serves when it is designated, including lines that it has been providing for years without the need for any support from the nation's consumers. Moreover, basing support on the incumbent's actual costs means that the competing carrier's subsidy per line has no link whatever to its own costs or rates. Thus, the support is not "specific" and is almost certain to be more than "sufficient," since unlike ILECs, competitors can choose where to serve and where to seek support.

As a result, wireless carriers get support based on the high costs of providing a copper or fiber line to a remote ranch in Montana. However, the economics of how wireless carriers incur costs are entirely different, and they do not need to install lines to the customer's premises. They also get support based on the greater costs per line for necessarily small switches provided by small incumbent carriers in areas with few subscribers, regardless of the size, location, or efficiency of their switches or the scope of their service areas. The mismatch between support and costs has become even greater now that the FCC has adopted Interstate Common Line Support (ICLS) to replace cost recovery that ILECs used to get via their access charges to long distance carriers. However, while the incumbents lowered their access charges to qualify for support, the competing subsidized carriers claim that they must get the additional support per line without changing their rates or services at all.

The claim that support is necessary to bring competitors into rural areas is not supported by the facts. What has generally been the case, for example, is that the additional support is claimed by a rural cellular carrier that is already serving the area where it draws support. Under current FCC policies, it immediately obtains support at nationwide consumers' expense for the lines it is already providing to paying customers. The lure of support for nothing is quickly inducing wireless carriers to cash in on the consumer-financed bonanza.

Incumbent local phone companies serve as the so-called carrier of last resort in their service areas. This means that they must provide service in response to any reasonable demand, including, for example, when competitors cease to provide service, and cannot discontinue service without regulatory permission. These obligations are key safeguards against any community or consumer losing the ability to connect into the public switched network at just and reasonable rates.

In contrast, the wireless carriers that are beginning to line up for the right to draw support are also the strongest opponents of any requirements that competing subsidized carriers provide proven value to consumers in return for the support they receive. These carriers claim that section 332(c) of the Act, which exempts them from state rate and entry regulation, also bars any state from requiring them to meet rate level requirements to justify their subsidies under universal service support programs. They expect the general public to cover some of their costs of providing service under the national policy of providing universal service in high-cost markets. But they refuse to recognize the difference between state regulation—setting rates or placing obstacles that prevent them from providing competing service

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[1] *Federal-State Joint Board on Universal Service,* CC Docket No. 96–45, *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge*, CC Docket Nos. 96–262, 94–1, 91–213, 95–72, Fourth Order on Reconsideration in CC Docket No. 96–45, Report and Order in CC Docket Nos. 96–45, 96–262, 94–1, 91–213, 95–72, 13 FCC Rcd 5318, 5364–5365, para. 79 (1997) (4th Order on Reconsideration), citing *Federal-State Joint Board on Universal Service*, CC Docket No. 96–45, Report and Order, 12 FCC Rcd 8776, 8932–34, 8944–46 (1997) (Order).

[2] Order, 12 FCC Rcd 8944, para. 311.

at all—and requiring them to provide value to the nation's ratepayers to justify the support they receive. These carriers even complain that it is against government policy to ask competing carriers to calculate their costs of service to qualify for support from nationwide users of the network. It is as if applicants for hurricane disaster assistance took the position that they could not be asked to demonstrate that they had been affected by hurricane damage because financial information and information about the condition of their property is private.

Under section 253 of the Act, carriers are free to enter and provide competing service in markets throughout the nation without regulatory obstacles. However, it is not forbidden "regulation" to ask that they justify the need for and use of the support they draw from the network under the consumer-centered purposes for which universal service support has been established. Nor should the section 332 prohibition on requiring wireless carriers to provide equal access so that their customers can select among competing long distance providers mean that they are shielded from meeting that universal service requirement if they voluntarily seek high cost subsidies. It is absurd to equate regulatory requirements that apply as a condition for providing service as a carrier with conditions that attach only to carriers that choose of their own volition to seek support under programs designed to spread the cost of nationwide service at affordable rates throughout the nation.

Indeed, section 254(e) of the Act requires that carriers that obtain federal universal service support use it only for the legitimate universal service purposes for which it is intended. Since the support for incumbents is based almost entirely on their own past actual investment and expense payments, it is clear that the support has been used for purposes covered by the cost-based support formulas. The use to which competitors will put support based on the *incumbents'* actual spending record, cannot be discerned from the formulas or records. Their unsupported self-certification that they use the support for appropriate purposes is suspect, at best, when they need not capture customers, add new customers, change their rates, increase their investments, improve their services or make any other legitimate use of the windfall payments they receive. Congress owes it to the nation's telecommunications customers that fund the federal universal service programs (a) to base each ETC's support payments on its own cost of providing service and (b) to verify that non-cost-based payments are actually put to use for the statutory purposes.

Finally, the argument of wireless carriers that the definition of universal service must not be upgraded unless they can meet the new standard is a perversion of the pro-consumer foundation on which the national universal service policy rests. While competitive local exchange carriers (CLECs) have tried to provide broadband in their markets, wireless carriers that are entering markets on the basis of what universal service subsidy is available put their own interests ahead of the consumers Congress sought to benefit. To make the level of support available to particular carriers a test for whether and when consumers should be able to count on the evolving definition of universal service the law requires is an affront to the statutory principles of reasonably comparable urban and rural rates and services, including advanced telecommunications and information services and to the section 706 objective of universally available access to broadband services. Although it is too early to change the definition at this point in the development of the broadband marketplace, who can qualify for support will never be a reasonable standard for evolving the supported universal services within the definition.

Universal Service Is Good Public Policy For America

I noted earlier that today, the high-cost component of the universal service program handles approximately $3 billion in annual carrier-to-carrier support transactions, which represents about half the amount that is channeled through the overall fund each year. The high-cost component is a "safety-net" of sorts for rural markets and their subscribers, but it is also a tool to ensure that all Americans enjoy the benefits and security of a nationwide integrated network. Congress and successive administrations have wisely recognized the value of this component of the program and now, above all else, need to take steps to ensure its ongoing ability to function according to statutory intent.

The high-cost element of the fund is used to build telecommunications "platform" infrastructure. Without a telecommunications platform, our schools and libraries, rural health care, and lifeline and link-up programs, and millions of rural Americans, have nothing. Modern telecommunications infrastructure in rural America enables diversity of education, and health and other social services comparable to those in urban areas.

Our nation's first priority for rural areas should be to provide a stable environment for continued telecommunications investment. Technologies and businesses, even the likes of MCI, come and go. But one of the most important ways rural

Americans have benefited from universal service is that it has sustained a telecommunications commitment to rural communities for decades. "Rural telephone companies," as defined in the 1996 Act, have become an integral part of rural communities throughout America and have remained economically viable in these high-cost areas due, in large part, to strong universal service policy.

In recent years, rural areas have become increasingly dependent on universal service funds. FCC decisions to resolve interstate access pricing have consistently shifted ILEC revenue requirement and the matching cost recovery to the high cost component of universal service. Many small and rural ILECs today rely on interstate access and universal service dollars for 45-to-70 percent of their revenue base.

The 1996 Act promoted both competition and universal service for the telecommunications industry. However, those who focus solely on competition for the industry believe that communications should ultimately be viewed as a commodity. That certainly makes discussions about the benefits of competition more applicable to communications. But that is not reality for rural America, let alone what Congress had in mind when formulating the public policy goal of universal service.

The commodity concept is too limiting when discussing the role of communications, especially in rural America. Certainly the first objective of universal service is getting people connected to the network. But there is a much broader social context and objective for rural America that is tied to universal service. How far Congress and regulators are willing, or are permitted, to go to move away from "commodity" thinking and discuss social outcomes has a lot to do with maximizing the benefits to be derived from our nation's universal service policy.

Commodity and competition simply mean delivering a quality widget at the lowest price possible. There is no consideration given to other synergies and tangential outcomes that can have a positive impact on rural communities—their economies and quality of life. Rural telephone companies have demonstrated their commitment to their communities by bringing and improving service in areas the largest companies were not interested in serving. Their record speaks for itself. So, demonstrably, rural communications is much more than a commodity. It is both a utility and an engine for economic development. It is a tool for local business leaders, local telephone company management, and local government officials to use in growing their communities, to use in improving the local economy and quality of life.

Rural telephone companies are working hard to support rural America and promote rural economic development. The public policy provisions that will be applicable to small and rural carriers must give them assurance that they will have a reasonable opportunity to recover their infrastructure investments, which will support future broadband services.

In sum, a strong universal service policy is still needed today to ensure a stable environment that encourages continued telecommunications investment in rural America. Incumbent rural telephone companies have met the challenge of deploying telecommunications infrastructure in high-cost rural areas. With a strong universal service policy, they can continue to help rural communities and rural Americans realize diversity of education, improved health and other social services, and economic development through modern telecommunications.

Senator INOUYE. Thank you, Mr. Bond.

And Mr. Altschul?

STATEMENT OF MICHAEL F. ALTSCHUL, SENIOR VICE PRESIDENT, AND GENERAL COUNSEL, CELLULAR TELECOMMUNICATIONS AND INTERNET ASSOCIATION

Mr. ALTSCHUL. Thank you, Mr. Chairman and Members of the Subcommittee. I, too, thank you for the opportunity to appear before you today.

My name is Michael Altschul, and I'm the senior vice president and general counsel of the Cellular Telecommunications and Internet Association. I think, as you know, CTIA represents all categories of commercial wireless companies in this country, including cellular and PCS carriers.

I'm mindful of the hour, and I ask that my full statement be made a part of the record.

Senator INOUYE. Without objection.

Mr. ALTSCHUL. I have the benefit, as do you, of the prior statements, so I think I can be brief here.

First, I can't ignore the fact that CTIA and the wireless industry recognizes the role of universal service and the role that telephone service provides, providing a vital link to all Americans. We support the program. We also support our contributions, pursuant to the direction that Congress has provided in Section 254.

We believe that Congress directed, in the 1996 act, that all carriers that provide interstate service, which includes wireless carriers, have a role in promoting the availability of nationwide telecommunications service to the Federal universal-service fund. We are willing to pay our fair share of the universal-service fund, as directed, on an equitable and nondiscriminatory basis.

In that regard, I'd like to note that wireless carrier support payments for universal service have grown proportionally as wireless carriers have grown their proportion of the nation's total telecommunications revenues. I've heard a lot about a proxy and a fixed fee, but, as our share of the overall industry has grown, so have our contributions into the universal-service fund. Indeed, in the last year for which data is available from the FCC, universal-service payment contributions from the wireless industry increased by 28 percent.

As you know, the FCC is considering a proposal that will radically change the method by which funds are raised to support universal service. The immediate and most dramatic effect of this proposal would be to shift the responsibility for funding universal service from the nation's long-distance carriers, who currently provide 63 percent of the payments, to customers, even those customers who make no interstate calls in a given month. We believe that this proposal is unlawful, unfair, and unnecessary.

You've heard others talk about the reasons why the proposal is unlawful. It would exclude some carriers and not follow the congressional mandate that all carriers must contribute. It also will, as I mentioned, require payments from those customers that will make no calls, certainly no interstate calls, in a given month.

Wireless is somewhat unusual in the mix of telephone service providers in this country, in that we have a significant percentage of users who subscribe for what some carriers call peace-of-mind service, who like to have the phone with them in case the car may break down. These are relatively low-cost, low-usage plans available by every carrier in every state in the country, typically for less than $20 a month. Many of these customers will make no interstate calls. Many—some of them will make no calls in a given month.

Similarly, we have a number of prepaid subscribers in the wireless industry. These are customers that use wireless services, but they don't use it on a predictable monthly basis. And assessing a per-month contribution based on a pre-paid customer's usage is something that can't be determined in advance. It would require additional assumptions and leaps to be made.

So those are our primary objections to the proposal that you've heard.

I also want to point out that despite the comments from others that the current contribution mechanism is inadequate to the task,

the overall size of interstate telecommunications revenues is not changing that dramatically. Indeed, over the past 3 years, the nation's interstate revenues have remained surprisingly constant, from $74 billion in 1998 to $79.4 billion in the year 2001. And you can see, over that range, that it actually increased a little bit.

What has happened is that the allocation of these revenues has changed. You've heard, and there's no denying that traditional long-distance companies' share of this pie has been shrinking. Wireless carriers, I'm happy to say, have been growing their revenues. And we've heard about bundled plans, ILEC entry, voice over the Internet, services like that. So while the individual proportions and slices of the pie may be changing, the overall size of interstate revenues has not been subject to dramatic changes.

We are paying more as our share grows, as I mentioned. There is a very good basis for the safe harbor you've heard about. This is a mechanism the FCC developed that creates an assumption—a proxy, if you'd like—that the percentage of interstate revenues that wireless customers use is 15 percent a year—or 15 percent of total revenues. That is based on the FCC's own data about the overall percentage of all telecommunications revenues being 15 percent.

We have, obviously, a very mobile user group. We have licenses that are licensed without respect to jurisdictional separations or state boundaries. And wireless service uses radio waves that obviously don't stop at a state boundary. I'm fond of pointing out Washington D.C. is the absolute best example of all of these factors, where carriers that provide service in this market will typically serve as many as four states, plus the District of Columbia. Area codes can be assigned to any of us from any of these regions. I can have a 202 area code on my mobile phone, use the phone in Northern Virginia, and have the wireless carrier switch that call to the public switch network from a switch in Maryland and, driving down the Whitehurst Freeway in Georgetown, have the call physically handled by an antennae in Rosslyn, Virginia.

To deal with those issues, the FCC developed the proxy. It's a reasonable approach. It's based—it's competitively neutral, because it puts wireless carriers on the same national overall percentage of interstate revenues as wire-line. We'd certainly be happy to have that proxy adjusted as the overall mix of—in this entire basket of services adjusts, but we think that it does create a fair proxy for both wire-line and wireless users.

Finally, I just wanted to make two or three quick points. If there is a crisis, as you've heard, it exists by the expansion of demand, not by the source of supply. And it makes no sense to exclude from the source of support for universal service the long-distance carriers that traditionally have been the largest single contributors.

Second, very important issues facing all of us concerning the definition of supported basic services and the expansion, or not, to broadband services. CTIA believes that technology neutrality and funding-support affordability is the best way of ensuing that competition is not precluded in rural America.

And, finally, something that's very important to CTIA and its wireless members is the determination of eligible telecommunications-carrier status, or ETC status. This is a huge challenge to

state and Federal regulators. This wireless industry supports a policy of competitive neutrality in this determination. Federal guidelines should not be biased against new entrants. We have had success. Some wireless carriers have gained ETC status in a handful of states and on a few Indian reservations. We believe that consumers benefit from competition. They benefit from gaining new services. And this competition spurs improvements to existing services.

[The prepared statement of Mr. Altschul follows:]

PREPARED STATEMENT OF MICHAEL F. ALTSCHUL, SENIOR VICE PRESIDENT, AND GENERAL COUNSEL, CELLULAR TELECOMMUNICATIONS AND INTERNET ASSOCIATION

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before you today. I am Michael F. Altschul, Senior Vice President and General Counsel of the Cellular Telecommunications & Internet Association (CTIA) representing all categories of commercial wireless telecommunications carriers, including cellular and personal communications services (PCS).[1]

CTIA and the wireless industry recognize that telephone service provides a vital link to all Americans. We believe, as Congress directed in the 1996 Telecommunications Act, that all carriers that provide interstate service, including wireless carriers, have a role in promoting the availability of nationwide telecommunications service through the Federal Universal Service Fund. Wireless carriers support Universal Service and are willing to pay their fair share of the Universal Service Fund "on an equitable and nondiscriminatory basis" as Congress has directed.

Prior to the 1996 Act, only long distance companies paid fees to support the Federal Universal Service Fund. In 1996, Congress passed a law that expanded the types of companies contributing to Universal Service. Currently, all telecommunications companies that provide service between states, including long distance companies, local telephone companies, wireless telephone companies, paging companies, and payphone providers, are required to contribute to the Federal Universal Service Fund. Under FCC rules, telecommunications companies must pay a specific percentage of their interstate and international revenues into the Universal Service Fund. This percentage is called the Contribution Factor. The Contribution Factor changes each quarter of the year, depending on the needs of the Universal Service Fund and the consumers it is designed to help. Because the Contribution Factor will increase or decrease, depending upon the projected needs of the Universal Service Fund, the amount owed to the Fund by each affected telecommunications company will also increase or decrease accordingly.

Recently, the Federal Communications Commission sought comment on a proposal that would radically change the universal service contribution mechanism by assessing contributions based on the number and capacity of connections provided by a carrier instead of on the basis of the carrier's interstate revenue. Under this proposal, residential, single-line business, and mobile wireless connections (excluding pagers) would be assessed a flat amount of $1.00 per connection per month. Paging connections would be assessed $0.25 per connection, and the remaining universal service funding needs would be recovered through capacity-based assessments on multi-line business connections.

CTIA believes that this proposal is unlawful, unfair, and unnecessary. In the alternative, CTIA supports the current revenues-based funding formula for Universal Service, including the "safe harbor" for CMRS carriers.

The Commission is bound by the statutory mandate set forth in Section 254(d) of the Communications Act, as amended. The connection-based universal service funding proposal must be rejected by the FCC because it would exclude interexchange carriers ("IXCs") with billions of dollars of interstate telecommunications activities from the obligation to fund universal service. This would violate the plain meaning of what Congress passed into law in Section 254(d)—which requires that:

[1] CTIA is the international organization which represents all elements of the Commercial Mobile Radio Service (CMRS) industry, including cellular, enhanced specialized mobile radio, personal communications services and wireless data. CTIA has over 750 total members including domestic and international carriers, resellers, and manufacturers of wireless telecommunications equipment. CTIA's members provide services in all 734 cellular markets in the United States and personal communications services in all 50 major trading areas, which together cover 95 percent of the U.S. population.

> *Every carrier* that provides interstate telecommunications service shall contribute, on an equitable and non-discriminatory basis, to the specific, predictable; and sufficient mechanism established by the Commission to preserve and advance universal service. The Commission may exempt a carrier or class of carriers from this requirement if the carrier's *telecommunications activities* are limited to such an extent that the level of such carrier's contribution to the preservation and advancement of universal service would be *de minimis*. Any other provider of interstate telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires.[2]

Section 254(d) imposes a universal service funding requirement on *all carriers,* and the sole exception to this mandate applies only to carriers whose *interstate telecommunications activities* are so limited that the carrier's contribution to the universal service fund would be de minimis. The connection-based universal service funding proposal must be rejected because the exclusion of billions of dollars of interstate revenue generated by the telecommunications activities of interexchange carriers cannot be made to pass through the eye of the "de minimis" needle.

The connection-based universal service funding proposal also fails the legal requirements established by the U.S. Court of Appeals for the Fifth Circuit. In *Texas Office of Public Utilities Counsel v. FCC,* the Court ruled that Section 2(b) of the Communications Act, read in conjunction with Section 254(d), prohibits the Commission from adopting a contribution mechanism that includes intrastate revenues in the calculation of universal service contributions.[3] The Fifth Circuit stated that Section 2(b) denies the FCC "jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service . . . "[4] In perfectly clear terms, the Court explained that "the inclusion of intrastate revenues in the calculation of universal service contributions easily constitutes a charge . . . in connection with intrastate communication service."[5]

A connection-based assessment is just as much of a "charge" as the revenue-based charge addressed by the Fifth Circuit. To the extent the services provided over the connections are intrastate, the charge is "in connection with intrastate communication service" and thus is subject to the jurisdictional restriction of Section 2(b). This would require the Commission to assume "jurisdiction over intrastate matters stemming from the agency's plenary powers." In so doing, the Commission would again overstep its jurisdiction and violate Section 2(b).

The connections-based funding approach also violates the requirement in Section 254(d) that every carrier "shall contribute, on an equitable and non-discriminatory basis." At the present time, contributions from interexchange carriers constitute 63 percent of the federal universal service fund assessments, reflecting the fact that the interexchange carriers are, by far, the largest providers of interstate telecommunications services. Excluding these carriers' provision of interexchange services from the contribution base is neither equitable nor is it non-discriminatory.

But even if Sections 2(b) and 254(d) did not present a complete bar to the connection-based funding proposal, the proposal would still have to be rejected as bad public policy. A connection-based flat-fee acts, in effect, as a regressive tax that places a disproportional funding burden on low-volume users (often low income individuals and small businesses) in order to subsidize the largest (and often richest) consumers of telecommunications services. CTIA agrees with the consumer advocates and state commissions who submitted comments to the FCC that the connections-based proposal is neither equitable nor nondiscriminatory. As Consumers Union observed in its Comments to the FCC, "both average-use and low-use residential customers utilizing any of the 13 calling plans of carriers studied would pay more per month under the Commission's proposed connection-based fee system than they do under the current revenue-based system."[6]

The proposal is particularly problematic to prepaid wireless customers and to the millions of customers who subscribe to the "peace of mind" tier of wireless service offerings primarily for occasional or emergency use. These customers pay a low monthly fee—$19.99 per month for 400 minutes, for example—or subscribe on a prepaid basis (i.e., purchasing minutes in advance of their use.) Adding a flat-fee of even $1 would represent a significant addition to these bills—potentially discouraging the use of these important services. The universal service fund, a system de-

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[2] Secton 254(d) Communications Act, as amended, (emphasis added). 47 U.S.C. § 254(d).
[3] *Texas Office of Public Utilities Counsel v. FCC,* 183 F.3d 393, 447 (5th Cir. 1999).
[4] *Id.*
[5] *Id.*
[6] Comments filed by Consumer Union, et al. at 11.

signed to advance the ubiquitous provision of telecommunications services, should not discourage consumers from purchasing these essential services.

It also is clear from the comments to the Commission that the proposed connections-based funding system will create a new set of additional administrative burdens and uncertainties. Rather than simplifying the current contribution mechanism, the proposed connections-based funding system will impose a monthly reporting obligation on all carriers and require the creation of an entirely new system of complex allocations to implement the capacity-based charges to be recovered from multi-line business connections. Indeed, this portion of the proposal raises difficult administrative issues that may far exceed the problems the Commission has identified with a revenue-based assessment mechanism.

The difficulty stems from the proposal to base the residual multi-line business assessment on the maximum capacity of the connections, and using bandwidth instead of lines to avoid the need to establish voice-grade equivalency ratios for these connections. However, rapidly evolving wireline and wireless broadband technologies promise to make high bandwidth applications available to all subscribers. The complexities of dealing with capacity-based or bandwidth-based assessment mechanisms (especially in light of section 254(d)'s command that the contribution mechanism be "equitable and non-discriminatory" as technologies and services rapidly evolve) may far exceed the problems the Commission has identified with the current revenue-based assessment mechanism.

Not only is the connection-based funding proposal unlawful and unfair, it is also unnecessary. As many of the comments to the FCC observed, the predicate for making such a dramatic change in the current universal service funding mechanism is lacking. Contrary to the implicit assumption that changes in the interstate telecommunications market mandate a fundamental change in the universal service funding mechanism, the overall size of the interstate telecommunications market has been remarkably stable. Indeed, interstate end-user telecommunications revenues increased 6 percent in the past three years—from $74 billion in 1998 to $79.4 billion in 2001.[7]

We note that the specific allocation of these revenues among telecommunications providers is changing. For example, the entry of ILECs into the interstate long distance telecommunications market has now been approved in several states. And, wireless interstate revenues are keeping pace with the overall growth of wireless revenues. In other words, the interstate telecommunications revenue "pie" remains constant, even growing, even though the "slices" of that pie among different telecommunications providers may be shifting. Since the universal service funding mechanism is dependent on the size of the interstate "pie," the distribution of the individual slices is not particularly significant.

I also want to note that wireless' contribution to the universal service fund is on the rise. With the rise in wireless revenues, wireless universal service surcharges are increasing as a result, fairly and appropriately according to the existing contribution methodology.

CTIA supports continuation of the wireless "safe harbor." The FCC established this fifteen percent proxy for a wireless carriers' contribution based on the Commission's own data, and in recognition of the difficulty wireless carriers face separating their interstate revenues for Universal Service funding purposes. Simply put, radio waves do not stop at a state boundary, wireless users are very mobile customers, and the FCC licensed CMRS carriers without respect to state boundaries. This makes it impossible for a wireless carrier to precisely identify the percentage of its revenues that are attributable to interstate communications. Washington, DC provides a perfect example. First, the CMRS licenses serving Washington, DC include the District of Columbia, Virginia, Maryland, and even part of West Virginia and Pennsylvania. Within this market, wireless customers can be assigned phone numbers from area codes associated with any one of these jurisdictions, and can access the wireless network from anywhere in the market. Thus, I can have a "202" area code for my wireless phone, be in Virginia, and have my wireless carrier connect my call to the Public Switched Telephone Network from a switch in Maryland. Moreover, I can be driving along the Whitehurst Freeway in Georgetown, and if I use my wireless phone, the signal will be transmitted to and from an antenna located across the Potomac River in Rosslyn, Virginia. Under these circumstances, a proxy is required as an alternative to the jurisdictional separations performed by wireline carriers using the area code of the calling and called parties. While CTIA would not oppose review of the safe harbor percentage, to assure that it continues to reflect the Commission's best data on the actual interstate usage of CMRS serv-

[7] *See Universal Service Monitoring Report,* Table 1.1. (Dec. 1999), and the Commission's Quarterly Contributions Factor *Public Notices*.

ice, CTIA believes that a safe harbor is still the best approach to dealing with jurisdictional complexities of CMRS traffic.

For the foregoing reasons, CTIA believes that the connections-based proposal is unlawful, unfair, and unnecessary. The current system, even if not perfect, more closely follows the Congressional mandate to fund Universal Service on an equitable and nondiscriminatory basis.

In the view of the wireless industry, there are, however, significant challenges facing the universal service fund in the immediate future. First, to the extent there is a funding "crisis" it has been triggered by the expansion of the *demand* for universal service funding, not by a reduction in the *supply* of support funds generated by the current system. During the past three years, while revenues remained stable, the federal Universal Service Fund disbursements soared from $3.6 billion in 1998 to $5.5 billion in 2001.[8] Changing the contribution mechanism will do nothing to address this fundamental imbalance. Indeed, rather than proposing to exclude the single largest source of interstate telecommunications revenues from the obligation to fund its universal service programs, the Commission should be seeking to expand the base of contributors.

Will the disbursements from the federal Universal Service Fund continue to grow at their present rate? This is the key question. If so, there may be a need for significant changes in contribution methodologies. If not, the continuing stability of the interstate telecommunications revenues will serve to meet funding needs. Many have suggested that the implementation of the "schools and libraries" program has been largely accomplished and the on-going charges for maintaining the program should not require significant increases in funding demands. But, this is not an area of expertise for CTIA and we leave this to others to provide definitive judgment.

A second challenge is whether other carriers will contribute to the support of Universal Service, as Congress intended when it passed the 1996 Telecommunications Act. For example, the Commission under its discretion can extend universal service obligations to providers that use telecommunications who are not telecommunications carriers (who must contribute to universal service). This indicates Congress recognized classes of services, other than telecommunications service that may have to be reached by Commission discretion, rather than mandatory application under the statute. Similarly, the schools and libraries provisions make specific reference to information services as being covered by the provision, entitling schools and libraries to discounted service. The FCC now has a proceeding that is looking at these issues.

Third, will the current definition of supported basic services be expanded to include broadband services. Increasing universal service funds to support deployment of broadband capabilities would involve government in selecting, for the first time, which of many possible advanced broadband services would be given preference (and thus depressing demand for—and investment in—other broadband services.) Technology neutrality and funding support portability will ensure that competition is not precluded in rural America.

A fourth challenge involves the determination of Eligible Telecommunications Carrier (or, ETC) status. The wireless industry supports a policy of competitive neutrality in this determination—federal guidelines should not be biased against new entrants. A few wireless carriers have gained ETC status in a handful of states and on a few Indian Reservations. Consumers benefit from competition, gaining new services and improvements to existing ones. CTIA further a system that subsidizes a few, can only discourage competition and, ultimately, rob the consumer.

CTIA and the wireless industry appreciate the opportunity to testify before the Subcommittee. I look forward to answering any questions you may have. Thank you.

Senator INOUYE. Thank you very much.

Ms. HARKER AND MS. Greene, you have the coalition plan and the BellSouth plan. The average residential consumer, how much would he pay under your plan, Ms. Greene, and, Ms. Harker, under your plan?

Ms. GREENE. Our calculation is the average residential consumer would pay 65 cents under our plan. According to our calculations, or according to their plan, the average consumer would pay a dollar.

[8] *Id.,* Table 3.7 (Oct. 2001).

Ms. HARKER. That's correct. And our calculations who, on average, that would be less for—on average, for all customers across all income types than they currently pay today.

Senator INOUYE. How much was yours, Ms.——

Ms. HARKER. A dollar.

Senator INOUYE. A dollar? And——

Ms. GREENE. Sixty-five cents.

Senator INOUYE. Sixty-five cents.

Ms. GREENE. What we've tried to do, Mr. Chairman, in our plan is make our plan modular, technology-neutral, and competitively neutral so that if you had a residential consumer that was not a long-distance subscriber, not a wireless carrier, not a broadband user, didn't use an ISP, they would pay only based on one connection. But if you had a household that was a relatively affluent household that had a computer, had ISP connection, had broadband services, and was a long-distance user, that household would pay more than the simple residential user.

Senator INOUYE. Mr. Bond, as you know, there's a lot of bundling services packages. As a result, oftentimes, the bundled service would allocate less and less to interstate revenues. If that is the case, would a flat-rate assessment be better than a revenue-based assessment?

Mr. BOND. Well, in our particular case, we do not bundle services, as such. The fee that we pay is paid by the National Exchange Carriers Association, and they calculate the amount and pay the amount of us. And then, of course, we reimburse them. So it's choosing between those two plans which would—you know, would be the best, it puts—you know, since we don't have that—offer that type service, it wouldn't be a good thing for me to pick, sir.

Senator INOUYE. What do you think, Mr. Altschul?

Mr. ALTSCHUL. Well, wireless carriers do bundle. And the FCC's proxy addresses this bundling. They, again, are looking at the total telecommunications revenues of wireless carriers and assessing—making an assumption that the interstate percentage of those revenues is the same as with wire-line. And that's a way of dealing with this bundling issue.

Senator INOUYE. I have many other questions, but looking at the clock, it seems that we have other meetings going on that—may I submit my questions to all of you for your consideration and response?

Mr. ALTSCHUL. Absolutely.

Senator INOUYE. Senator Burns?

Senator BURNS. I was going to do the same thing. It's lunchtime. I've never missed a meal, and I don't plan to.

[Laughter.]

Senator BURNS. I don't want to start now.

I'm interested in your testimony and what you've offered here today, and thank you for offering suggestions on how we may approach the problem and maybe solve the problem. So I'll read some more of Ms. Greene's—I was interested in your suggestions today—and also Ms. Harker.

I have no further questions for this panel. I just appreciate your coming today and offering testimony, and I want to see those projections. I want to see how this projects out, and I think all of us

do, on what's ahead of us and the direction that we're going to have to change in order to address that projection.

So thank you very much for coming today.

Senator INOUYE. Once again, I thank you, On behalf of the Committee. Obviously, this Committee is very interested in this subject matter, and I can assure you that your statements will be very seriously studied, and we will be submitting questions, not just from the two of us, but the others have indicated an interest in doing so.

So, with that, the record will be kept open for 3 weeks. If you wish to make changes in your statement or addendums, feel free to do so.

The meeting is adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF SENATOR OLYMPIA J. SNOWE, U.S. SENATOR FROM MAINE

Mr. Chairman, I thank you for holding this important hearing today.

We are here today discuss very timely issues related to the overall stability and sufficiency of the universal service fund. Due to a declining universal service revenue base, the FCC has expressed its intent to carefully assess the *long-term* viability of the universal service fund and, as a subset, the manner in which universal service contributions are collected from the telecommunications companies. Changes would be implemented by April, 2003.

Some of the panelists will discuss in detail the various options that are before the Commission in relation to the implementation of a new contribution methodology, and I look forward to hearing their testimony and views. The time is now to start this process and it is critical we have a clearly delineated timetable for the completion of deliberation and *action.*

In the meantime, let me say I find it somewhat ironic that we are here today, in part to discuss how the fund to implement the E-Rate can be used to stabilize the *overall* universal service fund in the short-term, given the tooth-and-nail fight we had to put up to get the E-Rate in the first place. And it is the issue of the E-Rate I want to focus on today.

First, I commend Commissioners Copps and Martin for their commitment to allowing undisbursed E-Rate funds from one year to be used to toward mitigating unmet demand in the following years. Considering that the estimated demand for E-Rate funds for FY2002 is $5.7 billion—more than *double* the level of funding afforded by the $2.25 billion per year cap—using previously undisbursed monies could play a vital role in realizing our goal of wiring 100 percent of America's classrooms to the Internet.

In that light, I would be deeply concerned by any effort to keep open—in perpetuity—the option of using E-Rate monies to stabilize the overall fund. Moreover—and perhaps most importantly—taking that tack could be a serious disincentive to rolling up our sleeves and addressing the bigger picture of how we're going to change the contribution methodology so as to ensure the long-term viability of the entire fund.

In other words, we can keep taking the policy equivalent of "aspirin", and treat the symptoms while masking and ignoring the root cause...or we can actually *diagnosis* the problem and start *treating* it with a new contribution methodology that both reflects today's realities with regard to telecommunications usage, and remains sensitive to the service line-item costs to consumers. Mr. Chairman, it is the latter approach that I advocate today—and that the FCC recognized in their proceeding last week.

I believe that a commitment from the Commission that there is *no intention* to use E-Rate money to stabilize the overall fund after April 2003 is critical to spurring the kind of speedy action required to ensure that the entire universal service fund remains sufficiently funded. The bottom line is that, in the long term, *all* of the very important programs, including the E-Rate, encompassed under the universal service umbrella will be affected by any future shortfalls in the fund. A short term fix at the expense of a lasting solution would be a terrible abrogation of our oversight responsibilities.

Therefore, I look forward to working closely with the FCC over the next ten months, and am confident that we can sure up the overall fund and end the reliance on unused schools and libraries money by April of next year. Again, thank you Mr. Chairman.

PREPARED STATEMENT OF VINCENT R. SANDUSKY, PRESIDENT, AMERICAN PUBLIC COMMUNICATIONS COUNCIL

The American Public Communications Council ("APCC") is a national trade association of over 1,300 independent (non-telephone company) providers of payphone equipment, services and facilities. Of the approximately 1.9 million payphones deployed nationwide, about 550,000 payphones are operated by independent providers with the remaining 1.35 million payphones operated by the incumbent telephone companies.

This statement explains the role that payphones have played to date in contributing to universal service and describes how the Federal Communications Commission's recent proposal for a connection-based universal service assessment system, unless modified, would dramatically and adversely impact that role. This statement also offers thoughts on the future relationship between payphone service and the Universal Service Fund.

The Unique Role of Payphones in our Communications Network

Payphone service is an "on demand dial-tone/per use" wireline, high-quality service available to all members of the public twenty-four hours a day, seven days a week, 365 days a year. Users are not required to make an initial investment in equipment, await activation of the service or pay recurring monthly charges. Any member of the public can place a call anywhere at any time. Users have the option of paying for calls with coins or by use of calling cards, prepaid cards or other access code arrangements.

In many instances, payphones provide access to the communications network at no cost to the consumer. For example, Emergency 911 calls are available at all the payphones in the country free of charge to the caller. Users can also place calls to 800 subscribers at no charge to the caller. These numbers provide a variety of services to callers including access to public services such as: Social Security; Women, Infants, and Children Nutrition (WIC) programs; the Internal Revenue Service; Veterans Benefits hotlines; and domestic violence hotlines.[1] By providing all Americans, no matter what their income level, with readily available, affordable and reliable access to the telephone network, payphone service is a vital contributor to universal service.

As Congress recognized in mandating the FCC to encourage widespread deployment of payphone service, payphones are important to all Americans regardless of their income or where they reside. Users of wireless service need ready access to payphones when their wireless phones are out of a service area (such as in many rural areas), lose battery power or are not otherwise available for use. Of greater urgency, the victims of domestic violence and abused children generally cannot use their home or wireless phones and must rely on payphones to make calls to shelters.

All of these payphone users exist in every strata of society in every neighborhood and region of the country. They rely on widespread access to payphones to meet critical needs. In addition, payphone service is vitally important to low income Americans, particularly the more than five and a half million without a home phone. Payphones are also critical in rural areas where a significant number of poor Americans lack basic home telephone service. Not only is the percentage of poor rural Americans without phones greater than in other areas but fewer citizens in rural America own cellular phones, increasing the need for readily available access to payphones. Those without home or cellular phones need access to payphones not only in the communities in which they live but also in the many communities in which they commute to work each day.

The value of readily available, reliable, high-quality wireline service cannot be underestimated as the events of September 11 clearly demonstrate. New Yorkers were lined up twenty deep to access payphones when their usual forms of communication were unavailable. On a typical Tuesday, many of the New Yorkers lined up might not have had need to use a payphone, but on September 11th they were certainly glad payphones were readily accessible. In the days and weeks following the tragedy, as systems providers were struggling to bring their services up to full capacity, payphone service providers provided free payphone service in the affected areas of Manhattan.

The Current Situation: Decreasing Payphone Deployment

Today, because of the rapid expansion of wireless, and because delays in resolving regulatory uncertainties have negatively affected payphone service providers' costs

[1] Social Service agencies, recognizing the importance of ready access to payphones by their constituents, have contacted the FCC to emphasize the need for Commission action in various payphone proceedings.

and revenues, payphone deployment is eroding. The expansion of wireless services since 1998 has had a dramatic effect in reducing the overall volume of calls made at payphones. As call volume has declined, payphone service providers have been under pressure to remove payphones from locations where payphones are still needed by the public but no longer attract a sufficient number of calls to offset costs. In a 1999 order, the FCC found that a payphone with less than 439 calls a month was not economically viable. If a payphone with 439 calls a month is removed, callers must find some other way, or place, to connect to our communications network to make these calls. The announcement last year by BellSouth, which at the time operated 143,000 payphones throughout the southeast, that it plans to exit the payphone market soon and focus on its wireless business is a precursor of an even higher rate of decrease in 2002 and 2003. As wireless continues to grow rapidly, payphone call volume is almost certain to continue to decline, which will increase the pressure on payphone service providers to remove marginally performing payphones.

In addition, delay in resolving regulatory issues has resulted in PSPs bearing excessive line costs and suffering from an inability to collect much of the dial-around compensation to which the Commission has found they are entitled. The Commission recently has acted to address some of these issues. However, the Commission's actions, which do not fully resolve the issues, are still subject to a lengthy review process with the potential for years of additional delay before the issues are finally put to rest. While these lengthy delays are problematic for all businesses, they are particularly difficult for the many small businesses that comprise a significant portion of the independent payphone service provider industry.

Current Universal Service Fund Payphone Assessments and the FCC's Proposed Connections-Based System

Under the current revenue-based system, payphone service providers are assessed by the Fund on the basis of their revenues from interstate coin calls. Although calling patterns vary from phone to phone, the average monthly payphone universal service assessment is significantly less than a dollar per payphone line. Given declining payphone deployment, even that amount is excessive; yet under the FCC's recent proposal for a "connections-based" system of assessments, payphone lines would be improperly grouped with multi-line business lines; the result will be assessments that would be several times higher than the current level applicable to payphones.

APCC is participating in the FCC's rulemaking proceeding on the connections-based approach. APCC neither supports nor opposes the proposed connections-based system of assessments. Instead, APCC has pointed out that payphone service is a valuable component of universal service; that the number of payphones is rapidly declining; that the proposed multi-line business line rate, if applied to payphone lines, would greatly accelerate the removal of payphones; and that to help stabilize the deployment of payphones, the FCC can and should refrain altogether from burdening payphone service providers with these per-line charges.

It has never made sense to require payphone service providers to make payments to the Fund. Payphones have always been a form of universal service, and payphone service providers simply do not fit the FCC's mold as a payor into the Fund. Unlike other payors to the Fund, who pass-through their Fund-related costs by a line item charge on the customer's bill, payphone service providers have no rational way of passing on such costs. Moreover, in the 1996 Act, Congress did not include payphone service providers as mandatory "telecommunications carrier" contributors to the Fund. The independent payphone service provider industry has always believed that the FCC overreached to find that the public interest required that payphone service providers be payors into the Fund. The industry believes that the FCC incorrectly classified LEC payphone service as service provided by telecommunications carriers and thus subject to mandatory universal service payments. To retain "competitive neutrality," the FCC also required independent payphone service providers to make universal service payments. In short, the FCC need not—and, because of the decline in payphone deployment, should not—require payphone service providers to make payments to universal service.

To Stabilize Payphone Deployment, Payphone Service Should Be A Universal Service Fund Recipient

Rather than requiring payphone service providers to pay into the Fund, to help preserve ready, affordable access to the network through payphones, the FCC should use the Fund to provide support for payphones. APCC has submitted a proposal to the Joint Board that would provide both general support for all payphones and special support for payphones in high cost/rural areas. The total cost of APCC's

proposal would be $169 million annually, or about 3 percent of the total size of the Universal Service Fund. The level of support for all payphones would be equal to the subscriber line charge assessed on (or imputed to) payphone lines. Additionally, payphones located in high cost/rural areas would receive an additional $5.00 per payphone line per month in supplemental support (as well as current local switching and long term support) from the Commission's High Cost Fund. Although there are services other than payphone service that are worthy candidates for universal service support (e.g., toll services, expanded area service, prepaid services, which the FCC has charged the Joint Board to consider), there is one characteristic of payphone service that distinguishes it from the others. Unlike these other services, where the Joint Board is being asked to support increased levels or additional services through the Fund, *consumers face a diminution* in the level of payphone service they have received until now. Universal service support is thus being asked to help ensure continuation of an existing service, a service that provides a vital communications link for all Americans.

PREPARED STATEMENT OF WESLEY E. CARSON, PRESIDENT AND CHIEF OPERATING OFFICER, ALASKA COMMUNICATIONS SYSTEMS HOLDINGS, INC.

Introduction

On behalf of Alaska Communications Systems Holdings, Inc. ("ACS"), I would like to offer the following written testimony to the Senate Commerce Committee and its Communications Subcommittee on the critically important topic of the future of Universal Service and the ultimate viability of the federal Universal Service Fund. ACS regrets that it was not invited to present this testimony in person and to respond directly to questions of the Subcommittee Members. I hope that these written comments will prove both valuable and provocative. ACS stands ready to respond to any follow up inquiry that the Subcommittee Members might have.

ACS is a holding company with several operating units doing business in the diverse Alaska market. In addition to its wireless, Internet and long distance affiliates, ACS offers local service and exchange access services via four separate local exchange companies operating in the largest urban and some of the smallest rural communities in Alaska.[1] While new technologies and competition continue to prompt advances in products, services and the efficiencies of service delivery, the practical reality of serving rural America—and rural Alaska in particular—cannot be overlooked. ACS' testimony today will focus on this reality and the need for Congress, the FCC and state policy makers to remain vigilant in protecting universal service objectives and resources.

We must not lose sight of the ultimate goal of this program. The desire to enhance opportunities for competitive market entry may be laudable, but must never take precedence over the need to ensure the ongoing availability of reliable and affordable basic telecommunications services for consumers throughout the country. ACS has repeatedly advanced the caveat that continued growth of the federal Universal Service Fund ("USF") cannot be sustained. While periodically adjusting the "cap" on the fund to reflect changes over time is sound policy, the idea that the fund can grow exponentially is doomed to failure.

Recent additions of new categories of support have already stretched the limits of the USF to respond. These additions have generated a multiplicity of end user fees. Compounding this, the proliferation of new or expanded categories of support eligibility can be expected to immediately be translated into yet other increases in customer surcharges. When viewed together with other significant increases reflected on the customer's bill, like the recent changes in the Subscriber Line Charge, the whole process is likely to crumble under its own weight. Sooner or later, consumers will rise up and declare, "We're mad as hell and we're not going take it any more." Representatives from densely populated "payer" states have already drawn a line in the sand arguing that they can no longer shoulder the ever increasing burden. Congress, the FCC and state policy makers must recognize this reality and take steps to properly manage USF resources or face the dire consequences of failing to do so. ACS offers some specific examples and suggestions in response.

Universal Service in Alaska

ACS serves numerous rural communities in Alaska. USF funding is essential to ensure that rural subscribers have affordable telecommunications services that are

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[1] ACS of Anchorage, Inc., ACS of Fairbanks, Inc., ACS of Alaska, Inc., and ACS of the Northland, Inc.

comparable to the services provided in urban areas. Consequently, ACS has a strong interest in the integrity and continued availability of USF.

Unfortunately, existing Federal Communications Commission ("FCC") rules allow USF to be distributed in ways that are inconsistent with the purposes of universal service support set forth in Section 254 of the Telecommunications Act of 1996. We believe Congress should be interested in the misuse of USF. Such improper use results in increased pressure on limited resources and creates "perverse incentives" to compete for subsidies. In addition to the direct threat to rural consumers, misuse of USF resources creates an impediment to investment and service improvements (including both basic telephone and broadband) in rural areas.

Section 254(e) of the Telecommunications Act of 1996 requires, in pertinent part, that a carrier that receives federal universal service support use that support only for the provision, maintenance and upgrading of facilities and services for which that support is intended.[2] The FCC has identified the high cost carriers entitled to support from the High Cost Fund as those with embedded loop costs in excess of 115 percent of the national average loop cost. In other words, eligibility for high cost support is directly related to the degree to which a provider's costs per loop exceed the national average cost per loop. Under current rules, that means a local loop costing in excess of $23 per line per month is eligible for high cost support.[3]

The misuse of funds and inefficient competition for subsidies stems from Section 54.307(a) of the FCC rules.[4] Under 54.307(a), a competitive eligible telecommunications carrier ("CETC"), including wireline CLECs in Alaska, receives federal high-cost loop support ("HCLS")[5] for each line it serves based on the support the ILEC would be entitled to receive for each line regardless of the competitors' costs for providing that service.

The situation confronted in Fairbanks, Alaska offers a vivid example of the problem. In Fairbanks, ACS is eligible for approximately $10 per line per month of high-cost loop support based on its per-line costs of $33.51 per month. Alaska's state commission, the Regulatory Commission of Alaska ("RCA"), however, has required ACS to lease the same Fairbanks loop to its competitor, General Communication, Inc. ("GCI"), at the deeply discounted rate of $19.19 per month.[6] Despite the low cost of the loop to GCI, a cost substantially less than the $23 per line per month threshold otherwise required to be eligible for any cost support, current rules appear to entitle GCI to the same $10 per line per month support that ACS receives.

In Alaska, then, allowing the CETC to receive the same support as the ILEC is a rule that can and does produce absurd and improper results. Because GCI does not *have* high cost loops, as defined by the FCC, any high cost loop support received by GCI will necessarily be for a purpose other than to purchase, maintain or upgrade high-cost loops as required by the Act. Furthermore, Section 54.307(a) can and does result in huge windfalls for CETCs, which, by definition, also means the funds are not being used for the purposes for which they were intended. Such misuse violates the principle of competitive neutrality[7] and rather than promote effi-

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[2] 47 U.S.C. § 254(e).

[3] 47 CFR § 36.631. The Commission decided to freeze the "national average loop cost" for this purpose at $240 per year for the duration of the five-year plan, which became effective on July 1, 2001. Accordingly, a rural ILEC, whose embedded loop costs exceed 115 percent of $240 (approximately $276 per line, per year, or $23 per month) generally is eligible for financial support.

[4] 47 C.F.R. § 54.307(a) provides, "A [CETC] shall receive universal service support to the extent that the [CETC] captures the subscriber lines of an [ILEC] or serves new subscriber lines in the [ILEC's] service area." Subsection (1) of this rule further provides, in pertinent part, "[a CETC] serving loops in the service area of a rural [ILEC] shall receive support for each line it serves in a particular service area based on the support the [ILEC] would receive for each such line, disaggregated by cost zone if disaggregation zones have been established within the service."

[5] *As used in this Petition,* "High-Cost Loop Support" or "HCLS" refers to: (1) high-cost loop support (formerly known as "universal services fund"); (2) Long Term Support ("LTS"); and (3) Interstate Common Line Support ("ICLS").

[6] *See Petition by GCI Communications Corp. d/b/a General Communication, Inc., and d/b/a GCI for Arbitration with PTI Communications of Alaska, Inc., under 47 U.S.C. §§251 and 252 for the Purpose of Instituting Local Competition, Petition by GCI Communications Corp. d/b/a General Communication, Inc., and d/b/a GCI for Arbitration with Telephone Utilities of Alaska, Inc., under 47 U.S.C. §§251 and 252 for the Purpose of Instituting Local Competition, Petition by GCI Communications Corp. d/b/a General Communication, Inc., and d/b/a GCI for Arbitration with Telephone Utilities of the Northland, Inc., under* 47 U.S.C. §§*251 and 252 for the Purpose of Instituting Local Competition,* Docket No. U–99–141, Order No. 9 (Regulatory Comm'n of Alaska 2000).

[7] In Fairbanks, ACS has a post-USF cost of approximately $23.50. Gd, on the other hand, will have a post-USF cost of approximately $9.00. This is not a competitively neutral result and it

Continued

cient competition instead allows inefficient carriers to enter the market and compete based on these unlawful subsidies. Perhaps more importantly, such misuse puts continued stress on finite USF resources, ultimately threatening the very viability of a program that has for many years served the interests of consumers in high cost rural markets.

Congress should be concerned that its policies, as set forth in the Telecommunications Act of 1996, are not being implemented as intended. Where a CETC's loop costs are known and documented, such as when the CETC purchases UNEs at a state-sanctioned rate, USF support should be based on the CETC's own per-line costs, not on the costs of the ILEC.[8] When the CETC certifies to the state and the FCC that it is using the support for the purpose for which it was intended, it should be required to justify the level of support it receives. The CETC should be compelled to substantiate that its loop costs meet the threshold standard for high-cost loop support established by the FCC and justify the level of support it receives.

While most of the blame for allowing USF to be used as a regulatory crutch to prop up an otherwise inefficient competitor lies with the FCC, state commissions, including the RCA, could but have failed to prevent this misguided policy. Under Section 214(e) of the Communications Act of 1934, state commissions are responsible for designating competing carriers as eligible to receive USF. However, the Act provides that, "Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission *shall find that the designation is in the public interest.*"[9] (emphasis added.)

In the Fairbanks case, the RCA conducted no such analysis and offered no basis, in the record or otherwise, to support an affirmative public interest finding. Rather, reflecting a profound misunderstanding of the issues, the RCA summarily concluded:

> We found no evidence that GCI plans to use 2002 federal universal service funds in an inappropriate matter [sic]. We also note that GCI's local rates in competitive areas remain comparable to or lower than the incumbents', further suggesting 2002 federal funds will be used appropriately.[10]

Conclusion

In conclusion, Congress should be concerned that its legislative intent is being ignored or misdirected. ACS is prepared to suggest fair and impartial remedies. Although it did not have an opportunity to interact directly with the Subcommittee in this instance, ACS looks forward to the continuing dialogue on this important matter and stands ready to assist Congress and the regulatory agencies in righting the course of this critical consumer support mechanism. Please let us know if you how we might assist you in your further pursuit of these issues.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO THE FEDERAL COMMUNICATIONS COMMISSION

Question 1. The current regulatory scheme at the FCC is one of "stovepiping," or segregating oversight by the means by which communications services are delivered. As you know, there has been somewhat of a convergence in communications so that once separate industries are offering services of other industries. How do you see this convergence affecting payments into the universal service fund?

Do you see this nation's pricing system moving more towards a cost based system?

Answer. Changes in the telecommunications marketplace, including the migration of traditional voice services to wireless and other new technologies, and the bundling of telecommunications services with equipment and information services, are making it increasingly difficult to identify carriers' interstate telecommunications revenues, the basis upon which universal service contributions are currently as-

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should be no surprise that GCI can offer its services at a lower price when it has a significantly lower cost of goods sold than ACS strictly as a result of regulatory decisions.

[8] ACS acknowledges the Joint Statement of the Independent Telephone and Telecommunications Alliance, the National Rural Telecom Association, the National Telecommunications Cooperative Association, the Organization for the Promotion and Advancement of small Telecommunications Companies and the Western Alliance. ACS believes that the entire question of the designation of wireless providers as CETCs needs to be closely examined. However, in those instances where CETC designation is genuinely in the public interest, ACS believes that the wireless provider's own costs must form the basis for any support eligibility and actual high cost support received.

[9] Section 214(e)(2) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996.

[10] RCA Order U–01–90(2) dated November 13, 2001 at 6.

sessed. These changes, coupled with increased price competition, could erode the universal service contribution base over time. Accordingly, the Commission has initiated a thorough review of its universal service contribution methodology. The Commission is currently considering whether to retain or modify the current revenues-based system or to replace it with an assessment system based on the number and capacity of connections to a public network. The Commission, with participation by the Federal-State Joint Board on Universal Service, recently held a public meeting for industry and interested parties to present various options for consideration. In addition, the Commission is examining in a separate proceeding whether to broaden the base of contributors to include facilities-based broadband Internet access providers.

With regard to your second question, it is worth noting that the vast majority of consumers nationwide have access to multiple options for wireless services and, in some cases, for wireline services. Given the presence and expected growth of competition in the marketplace, it is expected that market forces will, over time, require providers to set prices for their services in an efficient, cost-based manner. In the meanwhile, Congress granted to the states the authority to set cost-based rates for the inputs that competitors use to compete. There is no reason to believe that states are generally moving away from setting those rates on the basis of cost as Congress has directed.

Question 2. As you know, companies must be deemed an eligible telecommunications carrier (ETC) to receive USF funds. Reports indicate that more people will use their wireless phones as their primary phone and forego a traditional home line, but these companies do not receive USF payments. Do you believe there should be changes to the means of determining who is an eligible telecommunications carrier?

Answer. Currently, wireless carriers may be designated as eligible telecommunications carriers if they meet the statutory requirements set forth in section 214, so no changes to the process are necessary to ensure the availability of universal service funds for wireless carriers. In fact, there are a number of wireless carriers that are currently receiving universal service support. Although the states have primary jurisdiction to designate entities as eligible telecommunications carriers, in the absence of state jurisdiction, this Commission has designated several wireless companies as eligible telecommunications carriers.

Question 3. Universal Service reform is quite an undertaking. I do believe that we can achieve some type of reform of the system, but I believe any reform considered must examine the long term affects on the solvency of the system. Could you address the potential long term affects on the system of some of the proposals?

Answer. As discussed above, the Commission has sought comment on ways to ensure that the universal service contribution methodology remains consistent with the Act as the marketplace continues to evolve. Among other things, the Commission sought comment on a proposal to assess universal service contributions based on the number and capacity of connections to a public network. Because the number of connections historically has been more stable than interstate revenues, a connection-based assessment may provide a more predictable funding source for universal service. A connection-based system also may eliminate the need for contributors to identify interstate and intrastate telecommunications revenues, distinctions that may become more difficult to make as the marketplace continues to change. On the other hand, some parties have raised concerns that a connection-based system would disadvantage low-volume users.

The Commission also invited commenters to supplement the record with proposals to retain or modify the existing, revenue-based system. The Commission specifically sought comment on proposals to assess contributions on projected or current, instead of historical, revenues. These proposals would address concerns that the current methodology may provide competitive advantages to contributors with increasing interstate telecommunications revenues while disadvantaging carriers with declining revenues. Certain commenters point out, however, that neither of these proposals would eliminate the need for contributors to distinguish between interstate and intrastate revenues, or telecommunications and non-telecommunications services. The Commission is also concerned that these proposals also may increase administrative burdens for contributors and lead to increased fluctuations in the contribution factor, the set percentage that carriers pay to support universal service.

The Commission is actively considering these issues, and welcomes input from all interested parties. Please be assured that the Commission will continue to balance concerns such as these as it acts to ensure the long-term sufficiency and solvency of the fund.

Question 4. Georgia receives a great deal of funds from the universal service fund. We are the largest state east of the Mississippi and has many rural areas. I need

to be able to tell my constituents that they will have universal service support. Can I, in good faith, tell my constituents that universal service support will be available at the same levels in Georgia as it has been in the past?

Answer. Beginning in 1998, through the second quarter of 2002, Georgia has received more than $740 million in support from the various universal service support mechanisms, thereby benefiting consumers in the State of Georgia. There is no specific reason to believe that universal service support to Georgia will decrease in the next few years.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO THE FEDERAL COMMUNICATIONS COMMISSION

Question 1. One problem often cited by critics of the current contribution mechanism is the "lag" between prior reported revenues, which are six months old, and current revenues, which are assessed based on the contribution factor.

Is it possible to eliminate this lag, but retain a revenue-based assessment mechanism? Are there ways to minimize the competitive distortion between carriers with rising revenues (such as the RBOCs) and carriers with falling revenues (such as the IXCs)? How would the adoption of "collect-and-remit" proposals advanced by some carriers affect the administration and stability of the fund?

Answer. Several commenters have proposed that the Commission assess contributions on projected or current, instead of historical, revenues. Because this would eliminate the current six-month interval between reported revenues and assessment of contributions based on those revenues, commenters assert these proposals would eliminate the lag of the current system, thereby minimizing competitive distortions between carriers with rising and falling revenues.

The Commission also sought comment on a "collect-and-remit" proposal. Under a collect-and-remit system, carriers would be required to remit to the fund administrator, Universal Service Administrative Company (USAC), only those contribution amounts actually collected from enduser customers. Accordingly, a collect-and-remit system would relieve carriers of any risk associated with the recovery of universal service contributions and eliminate the need for contributors to mark-up universal service line items to reflect uncollectibles. Some parties argue, however, that because USAC would not be able to predict with complete accuracy the amount of assessments actually collected in a given period, a collect-and-remit system would create the possibility of shortfalls in the universal service fund, which may necessitate directing USAC to establish a reserve funded through increases in assessment rates. Certain commenters note that fluctuations in uncollectible rates also could impact the predictability and stability of the universal service fund.

The Commission is actively considering these issues, and welcomes input from all interested parties.

Question 2. One of the items currently under review by the Federal-State Joint Board is the effectiveness of the certain federal low income support programs (Lifeline and Link Up Programs). Often, the success of these programs varies widely from state to state due to differences in state eligibility requirements and in the administration of these programs. California, for example, received over half of all federal low income support dollars in 2001.

What are the major reasons behind the relative successes or failures of these programs in certain states? Should there be more direct federal involvement in establishing eligibility requirements for these programs? Should certain minimum outreach efforts be required to ensure that low income residents have access to these programs?

Answer. The federal Lifeline/Link-Up programs have yielded the highest participation rates where states have provided matching funds and engaged in proactive targeted efforts such as aggressive outreach and multi-agency cooperation. Certain states whose eligibility criteria capture fewer low-income subscribers than the federal eligibility criteria may have lower take rates. In addition, the take rate is low where there is lack of knowledge or information about the Lifeline and Link-Up programs.

The FCC has initiated a proceeding to examine the Lifeline and Link-Up programs and has referred the issue to the Federal-State Joint Board on Universal Service. The Joint Board is currently reviewing the low-income programs. Issues under consideration with respect to eligibility include modification of the existing federal eligibility criteria, as well as whether to require all states to include the federal eligibility criteria in their respective programs. The Joint Board has also sought comment generally on outreach issues, including whether to adopt specific outreach requirements for all carriers. Thus if the record shows that either more direct Fed-

eral involvement or certain minimum outreach efforts are warranted the Commission will not hesitate to implement these proposed changes.

Question 3. As defined in the statute, "universal service" represents "an evolving level of telecommunications services." One of the items currently under review by the Federal-State Joint Board is whether to add broadband or other items to the list of supported services.

Should broadband be designated as a supported service? If not, what test should guide future determinations as to when broadband should be included? To the extent that the Commission defines broadband services as an "information service," would such a ruling preclude the Joint Board and FCC from later finding that broadband is a "telecommunications service" eligible for universal service support?

Answer. On July 10, 2002, the Federal-State Joint Board on Universal Service (Joint Board) issued its Recommended Decision regarding the definition of supported services. As required by statute, the Joint Board utilized the principles and criteria in section 254(b) and (c) to guide its recommendations, including those regarding advanced services. Those criteria include whether the service is (1) essential to education, public health, or public safety; (2) subscribed to by a substantial majority of residential consumers; (3) being deployed by telecommunications carriers in public telecommunications networks; and (4) consistent with the public interest, convenience and necessity. The Joint Board, applying these criteria, concluded that advanced or high-speed services should not be added to the definition of universal service at this time. The Joint Board did, however, fully support the Commission's prior conclusion that universal service policies should not inadvertently create barriers to the provision of or access to advanced services and that the current universal service system does not create such barriers. The Joint Board stated in its Recommended Decision that if the Commission concludes that wireline broadband Internet access service is an "information service" and that the transmission component of that service is "telecommunications," it believes that broadband Internet access services could not be included within the definition of supported services because section 254(c) limits the definition of supported services to telecommunications services.

The Recommended Decision is now before the Commission. The Commission will address this issue, consistent with the governing statutory framework.

Question 4. Under the President's Budget, the size of the Universal Service Fund is expected to grow from $5.3 Billion in 2001 to $7.1 Billion in 2007.

Since the Schools & Libraries Fund is currently capped at $2.25 Billion per year, how much of this growth is attributable to expansion in the High Cost Support Mechanism? Are there any further pending changes to universal service programs that might place further upward pressure on the size of the fund?

Answer. Most of the projected growth in the universal service fund in the President's Budget is attributable to increased support to carriers serving customers in high-cost areas. It is expected that universal service will grow over time due to inflation, line growth, and increased participation, even if no major programmatic changes are implemented. Moreover, because the high-cost program is significantly larger than the low-income and rural health care programs, it would be expected that most of the growth is associated with the high-cost programs.

Several proposals currently before the Commission could impact the size of the universal service support mechanisms. It is difficult, however, to determine at this time whether these decisions will increase or decrease the size of the fund. For example, the Commission, in consultation with the Joint Board, is considering whether to modify the forward-looking high-cost support mechanism for non-rural carriers in light of a recent ruling by the United States Court of Appeals for the 10th Circuit. In addition, the Commission is considering modifications to the rural health care support mechanism that could bolster the availability of telemedicine and telehealth and increase current levels of demand, subject to the existing cap. Finally, the Commission has indicated its intent to initiate a proceeding to evaluate the way portable high-cost support is calculated for competitive eligible telecommunications carriers.

Question 5. In *Qwest v. FCC,* the 10th Circuit found that the federal, statutory mandate stating that rural and urban rates be "reasonably comparable" requires the FCC, where necessary, to induce states to meet federal principles.

In light of the 10th Circuit's decision in *Qwest*, what "inducements" should the federal government use to ensure that the federal statutory goal of ensuring reasonably comparable rates between urban and rural areas is met?

Answer. In response to the *Qwest v. FCC* decision, the Commission issued a *Notice of Proposed Rulemaking* seeking comment on how states should be induced to assist in implementing the statutory goal of reasonable comparability, and on other

issues remanded by the court. The Commission asked about conditioning federal support on some form of state action, entering into a binding cooperative agreement with the states, and other possible inducements. It referred these and other issues, as well as the record developed in response to the *Notice,* to the Federal-State Joint Board on Universal Service for a recommended decision. The official comment period closed on April 25, 2002, and the Joint Board is now developing its recommendations.

Examination of the record developed so far indicates a range of opinion as to what inducements the federal government should use. A number of commenters maintain that, based on the states' long history of advancing universal service goals, and evidence that urban and rural rates nationwide are reasonably comparable, the Commission should monitor state policies and use inducements only where a need arises. Other commenters have proposed possible inducements, including requiring states to certify that their urban and rural rates are reasonably comparable, payment of additional federal support for states that take specified action, and non-payment of federal support for states that fail to take specified action. Some commenters also have proposed specific actions that states should be induced to undertake beyond setting reasonably comparable rates, such as establishing explicit universal service support mechanisms.

The Commission is actively considering these issues, and welcomes input from all interested parties. Please be assured that the Commission will continue to balance concerns such as these as it acts to ensure the long-term sufficiency and solvency of the fund.

Question 6. Proponents of changing the existing universal service contribution mechanism often cite recent declines in total interstate telecommunications revenues as evidence that the current assessment mechanism is flawed.

Has the FCC made any attempts to quantify how much of the decline in total interstate revenues is due to declining economic conditions and how much is due to structural changes in the marketplace. Or put another way, if economic times were better, would total interstate telecommunications revenues still be expected to decline? Is the growing use of Internet telephony having a quantifiable effect on interstate revenues?

Answer. The cause of the decline in revenues is a complex matter. Declines in total interstate end-user telecommunications revenues began in the second half of 1999. The record in the Commission's ongoing contribution methodology proceeding suggests that the universal service contribution base is declining, in part, due to changes in the telecommunications marketplace, including migration of customers to wireless services and other new technologies that are difficult to categorize by jurisdiction, increased bundling of interstate/intrastate and telecommunications/non-telecommunications products and services, local exchange carrier entry into the long distance market, and related price competition. It is difficult, however, to quantify the precise impact of any one of these factors, or to quantify the impact of overall economic trends.

Commission rules do not currently require contributors to identify Internet protocol telephony revenues when reporting revenues for purposes of calculating universal service contribution obligations. However, some commenters believe migration to Internet telephony will significantly erode the contribution base. At this time, migration does not appear to have greatly impacted the contribution base, but concerns regarding this issue may increase in the future.

Question 7. In an effort to keep universal service charges from rising, the Commission voted to borrow unused funds in the Schools and Libraries account in order to keep the contribution factor level for the next three quarters. In so doing, the Commission also stated its intention to have completed and implemented rules changing the current contribution methodology by April 1, 2003.

How much will have to be borrowed from the Schools & Libraries Fund over the next 3 quarters?

Answer. The Commission directed the Universal Service Administrative Company to apply sufficient unused funds from the schools and libraries program to maintain the third quarter 2002 contribution factor at 7.2805 percent. Commission calculations indicate that about $255.4 million in unused funds were necessary to stabilize the contribution factor for the third quarter of 2002. Should carrier interstate end-user telecommunications revenues and demand for universal service support remain about the same, approximately the same amount of unused funds would be necessary to keep the contribution factors stable for the fourth quarter of 2002 and the first quarter of 2003.

Question 8. To the extent that the Commission is unable to meet its April 1st deadline, what would be the expected effect on future contribution factors if interstate revenues continue to decline?

Answer. The universal service contribution factor is calculated by dividing total quarterly program collection or demand by the quarterly contribution base. If the universal service contribution base declines and program demand remains constant or increases, the universal service contribution factor will increase. It is difficult to predict future contribution factors due to the large number of variables at play. While events may change these estimates, we project the contribution factor could be over 9 percent in the coming year, assuming current trends continue.

Question 9. Given that some parties have advocated expanding the base of contributors to include all broadband providers, does the Commission expect to conclude its related items regarding the regulatory classification of broadband by that date?

Answer. The Commission is currently examining the complex record in this proceeding and hopes to resolve the regulatory classification of wireline, broadband Internet access by that date. Comments in the broadband proceeding were submitted on May 3, 2002 and reply comments on July 1, 2002. The Commission received approximately 150 comments and reply comments and over 800 e-mailed responses.

FCC STAFF COMMENT:

The Federal Communications Commission in partnership with our state public utility commissions, has had a program for auditing common carriers for several decades, beginning in the late 1930's or early 1940's. After divestiture of AT&T in 1984, and prior to the passage of the 1996 Act, the audit work of this Commission largely focused on proper regulation of interstate rates charged to long distance companies by price cap and rate of return incumbent local exchange carriers. This audit program operated, and continues today pursuant to section 220 and various other sections of the Communications Act of 1934, as amended. *See* 47 U.S.C. § 220.

More recently, with the passage of the 1996 Act and the growth of competition, the Commission's audit program has correspondingly evolved. Audit staff has been tasked beyond its traditional regulatory accounting role, to review compliance with other Commission policies and requirements including, among other things, Bell Operating Company (BOC) section 272 separate affiliate rules that govern after their long distance entry, carrier numbering resource utilization rules, as well as carrier obligations in connection with universal service, which was the topic of the hearing, and the specific focus of your question.

In particular, consistent with its oversight obligations over the administration of the universal service fund, the Common Carrier Bureau began in the fall of 2000 a review of the universal service line items charged by the three largest long distance carriers, AT&T, WorldCom and Sprint, under our authority set forth in sections 218 and 220(c) of the Communications Act. Specifically, the review focused on the carriers' support and explanation for the universal service line charge in customer bills that exceeded the contribution factor established by the Commission.

The review was performed by audit staff, who conducted field interviews with representatives of each company, issued data requests to obtain information from these companies, examined tariff filings and billing records, and examined the FCC Forms 457 and 499 filed by these companies with the Universal Service Administrative Company (USAC) reporting aggregate interstate end user revenues. Through this review, staff sought to establish the underlying components of each carrier's universal service fee charged to consumers to determine whether those fees were consistent with the Commission's rules and applicable law.

This investigation, which concluded in 2001, ultimately revealed a need to consider structural reform to our existing approach to universal service assessment and recovery. Indeed, our review confirmed the carriers' explanations for *what* composed the rate elements of the carriers' universal service fee. For example, although the Commission set a uniform contribution percentage, carriers chose to boost this in order to account for a variety of market factors including, among other things, uncollectible revenues, a declining revenue base, overhead expense and unbilled revenues.

What we found far more difficult to answer, however, was the question of *whether* these additional rate components violated our existing rules. The Commission does not prescribe specific rates or ratemaking methodology for the long distance companies, as they operate in a competitive marketplace. Nevertheless, section 201 of the Communications Act generally requires that charges be "just and reasonable." More-

over, although the Commission's rules give carriers flexibility in how they recover the costs of contributing to support universal service from their customers, they also require that carriers not shift more than an equitable share of their contributions to any customer or group of customers. The Commission's rules also require that bills contain a full and non-misleading description of charges on those bills.

Under these standards, whether the carriers' line item practices and rate components, confirmed by the audit staff in its review, were in fact unreasonable or contrary to our rules, reflected an inherently subjective judgment, and would be susceptible to differing interpretations and disputed by the carriers. This lack of clarity in turn would make any specific enforcement action more difficult. Thus, we concluded that a more effective long term solution was to focus on a comprehensive examination of the framework for carrier assessment and recovery of universal service contribution amounts. For that reason, and as an outgrowth of the line item investigation, the staff chose to direct its principal efforts toward a rulemaking examining in a comprehensive fashion how to modify the current system to ensure long term stability, fairness and administrative efficiency in a dynamic marketplace. The rulemaking commenced with a request for comments to reform the system in May of 2001. In that order, the Commission expressly highlighted the need for changing its rules. *See Federal State Joint Board on Universal Service,* CC Docket No. 96–45, Notice of Proposed Rulemaking, 16 FCC Red 9892, ¶¶ 3, 5, 6 (2001).

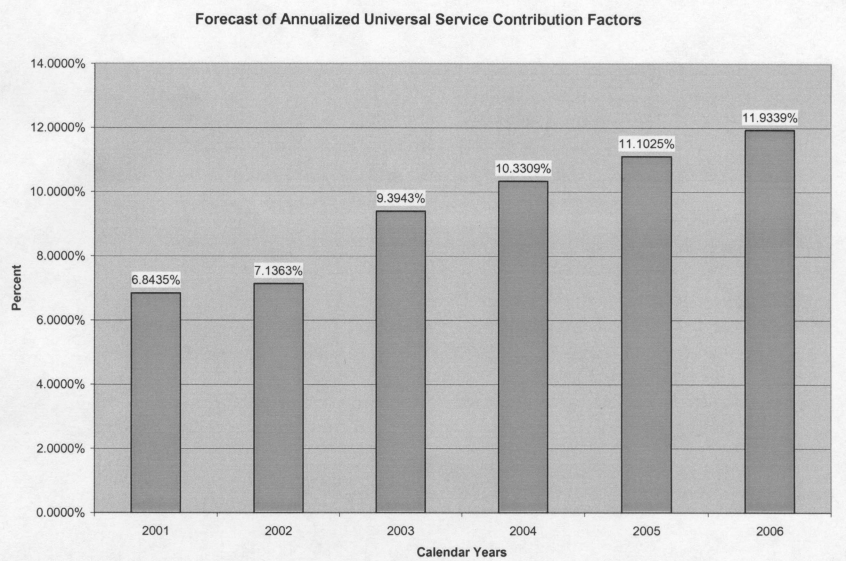
Since then, as you know, in February of this year, the Commission issued a further round of comments on a specific connection-based proposal that would eliminate carrier discretion altogether in the amount charged to its customers. Once again, the Commission made clear its concern over the existing carrier line item practices:

> Some carriers also employ different recovery methods for different customer groups, imposing universal service line-item charges on certain categories for different customer groups, but recovering an undisclosed amount from other customers through per-minute service rates. For example, some carriers do not recover universal service contributions form certain categories of customers, such as dial-around customers. In addition, universal service line-item percentages for residential customers often are higher than those for business customers. Other carriers charge customers large, up-front universal service fees that are unrelated to their revenues from a customer. Such practices may be inexplicable to the casual observer, and may shift a disproportionate share of the cost of contributions onto certain customer classes. In this Further Notice, therefore, we seek comment on how to modif' our rules to ensure that carriers that elect to recover their universal service obligations from their customers do so in a manner that is reasonable, fair and understandable.

See Federal State Joint Board on Universal Service, Further Notice of Proposed Rulemaking, CC Docket No. 96–45, FCC 02–43, ¶¶ 19, 20 (rel. Feb. 26, 2002) (citations omitted).

Finally, after your hearing on universal service issues, the Commission held a public forum on these proposals that included the federal and state members of the Joint Board on Universal Service. Staff is actively working to analyze the record and make a recommendation to the Commission in the near future on these issues.

The attached information provides a projection for the annualized universal service factor for calendar years 2002–2006. To develop this projection, the FCC's Wireline Competition Bureau utilized the following assumptions: (1) interstate end user telecommunications revenues would continue to decline at the past eight quarters' annualized rate (3.8 percent per year); (2) program demand would continue to grow consistent with historical growth rates, subject to existing program caps (more details regarding program demand projections follow below); and (3) unused funds from the schools and libraries program would be applied to reduce the contribution factor for the third quarter 2002 through the first quarter 2003. Annualized projected contribution factors were calculated by dividing total projected annual program costs by projected annual interstate end user telecommunications revenues.



Baseline - Projected ($ 000)

	C1=C3/C2	C2 (growth)	C3 (growth)
	Contribution Factor	Contribution Base	Support Collections
2001	6.8435%	$79,901.1	$5,468.0
2002	7.1363%	$73,434.6	$5,240.5
2003	9.3943%	$66,498.6	$6,247.1
2004	10.3309%	$64,104.6	$6,622.6
2005	11.1025%	$61,796.9	$6,861.0
2006	11.9339%	$59,572.2	$7,109.3

The above information is based on the following assumptions:

1) Based on historical annual average decline (third quarter 2000-second quarter 2002), assumed contribution base would decline 0.9 percent each quarter;

2) Based on historical growth rates (fourth quarter 1998-third quarter 2002), assumed demand for low-income program would increase by 7 percent each year;

3) Based on staff estimates guided by historical take rates, assumed demand for rural health care program would increase by 5 percent each year;

4) The 2.6 percent growth rate per year for the high cost support mechanisms is a weighted average of the projected growth rates for the individual programs. Each program's projected growth was based on historical growth in lines, inflation, and regulatory caps, where applicable. Projected growth for ICLS was based on the historical growth of the commonline revenue requirement and long term support, and scheduled increases in subscriber line charges. Projected growth for payments to competitive ETCs was based on historical growth for 2001;

5) Assumed demand for schools and libraries program would remain at the cap ($2.25 billion) each year; and

6) Utilized USAC projection of unused schools and libraries funds to reduce the contribution factor for third quarter 2002, fourth quarter 2002 and first quarter 2003.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO G. NANETTE THOMPSON

Question 1. Do you see this nation's pricing system moving more towards a cost-based system?

Answer. Yes. The 1996 Telecommunications Act laid out a plan to transition the nation's telecommunications industry from monopoly to competitive markets. As competitive forces come to bear in any market, prices migrate towards costs. It is the responsibility of state regulators and the FCC to insure that the policy goal of universal service is accommodated during that migration. The universal service programs are designed to insure that all Americans can remain connected to the national network by paying reasonably comparable local rates.

Question 2. As you know, companies must be deemed an eligible telecommunications carrier (ETC) to receive USF funds. Reports indicate that more people will use their wireless phones as their primary phone and forego a traditional home line, but these companies do not receive USF payments. Do you believe there should be changes to the means of determining who is an eligible telecommunications carrier?

Answer. No. The current system allows cellular carriers to obtain ETC status and a number of cellular carriers now receive USF. I agree however that the regulatory scheme should keep abreast of technological changes in the telecommunications world, and facilitate the delivery of services to consumers in the most cost-efficient manner possible. Especially where consumers across the nation are supporting delivery of services to high cost areas through the universal service fund, we need to insure that those funds are being wisely expended. Wireless technology may provide service in some rural areas at lower cost than wireline technology. Whatever technology can most cost efficiently deliver services should be eligible to receive federal universal service support.

Question 3. Universal service reform is quite an undertaking. I do believe that we can achieve some type of reform of the system, but I believe any reform considered must examine the long-term effects on the solvency of the system. Could you address the potential long-term effects on the system of some of the proposals?

Answer. I agree that universal service reform is quite an undertaking. I also agree that any reforms should be made mindful of the long-term effects. The goal should be a fund that accomplishes its policy objectives and is sustainable in the long term. That goal can be achieved only if the recent dynamic changes in the telecommunications industry are accommodated. Modifications to the contribution mechanism need to reflect the realities of the manner in which telecommunications services are delivered to consumers. The current contribution mechanism inequitably spreads the burden and benefits of universal service. The best long term solution is to modify the contribution mechanism to insure that all providers of telecommunications services contribute, and all who provide essential telecommunications services to customers in high cost areas are eligible for support.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO G. NANETTE THOMPSON

Question 1. One problem often cited by critics of the current contribution mechanism is the "lag" between prior reported revenues, which are six months old, and current revenues, which are assessed based on the contribution factor. Is it possible to eliminate this lag, but retain a revenue-based assessment mechanism? Are there ways to minimize the competitive distortion between carriers with rising revenues (such as RBOCs) and carriers with falling revenues (such as IXCs)? How would the adoption of "collect-and-remit" proposals advanced by some carriers affect the administration and stability of the fund?

Answer. Any revenue based system will have some lag because of differences in market share of companies over time. It is possible, however, to accommodate that lag with reconciliation process. The complexity and cost of that reconciliation should be weighed against a contribution mechanism based on some other standard. The most oft debated alternative is a contribution standard based on connections.

Any system presents inequities and opportunities for gaming. The best alternative is administratively simple for both the companies and USAC, clear in its application to eliminate incentives to distort reports, and equitable across all segments of industry that provide telecommunications services and benefit from the fund.

The "collect and remit" proposal might resolve the inequities created by changes in carriers' market shares, but would be more administratively complex than the current system. It would shift the burden of accommodating over and under collec-

tions to the fund itself from individual carriers. USAC would be able to best estimate the cost and administrative issues associated with that shift.

Question 2. One of the items currently under review by the Federal-State Joint Board is the effectiveness of certain federal low income support programs (Lifeline and Link-Up Programs). Often, the success of these programs varies widely from state to state due to differences in state eligibility requirements and in the administration of these programs. California, for example, received over half of all federal low income support dollars in 2001. What are the major reasons behind the relative successes or failures of these programs in certain states?

Answer. The FCC referred this issue to the Federal-State Universal Service Joint Board and we will issue a recommended decision before the end of this year. There are several reasons for the differences between states. Among the most significant factors causing the differences between states is how they have set the eligibility criteria and how they perform customer outreach. More funding under these programs goes to states that allow automatic enrollment to persons receiving benefits under another program that supports low income consumers. How the programs are advertised, and the complexity of administering the programs from the perspective of the consumer and telecommunications provider also affect the disparate levels of enrollment between states. For example, United Utilities, Inc. in Alaska managed to substantially increase its Lifeline subscribership by going to remote villages with an interpreter and explaining the program to the citizens.

To evaluate success and failure, those terms must first be defined. The programs are designed to allow people with low-incomes to be connected to the national network. The joint board is examining the correlation between the states that have low income populations, those who receive a large percentage of the funds distributed under this program and the programs designed by the individual states to make recommendations to the FCC on how the program should be modified to better achieve its policy goals and be more equitable between states.

Question 3. Should there be more direct federal involvement in establishing eligibility requirements for these programs? Should certain minimum outreach efforts be required to ensure that low income residents have access to these programs?

The balance between state and federal responsibility for eligibility needs to be carefully struck to insure that states retain enough flexibility to accommodate their unique needs. For example, national guidelines that target Native American populations based on their residency on reservations do not reach those populations in Alaska with only one small reservation (Metlakatla) and a large native community that lives throughout the state. The federal government should encourage outreach efforts to insure that all eligible consumers are aware of the programs.

Question 4. As defined in the statute, "universal service" represents "an evolving level of telecommunications services." One of the items currently under review by the Federal-State Joint Board is whether to add broadband or other items to the list of supported services. Should broadband be designated as a supported service? If not, what test should guide future determinations as to when broadband should be included?

Answer. The Joint Board recently released a Recommended Decision which recommended that broadband not yet be added to the list of supported services. We found that broadband services did not meet the criteria in the 1996 Telecommunications Act for an eligible supported service because nationally only ten percent of consumers now purchase broadband services. We will re-examine this issue over time.

Question 5. To the extent that the Commission defines broadband services as an "information service," would such a ruling preclude the Joint Board and FCC from later finding that broadband is a "telecommunications service" eligible for universal service support?

Answer. The recent ruling is potentially problematic. In paragraph 19 of the Recommended Decision of July 9, 2002, the Joint Board identified the problems that would be created by an FCC determination that broadband is an "information service" rather than a "telecommunications service." If broadband is determined to be an "information service," it could not be included in the definition of universal service, which is limited to telecommunications services. It should also be noted that Section 254(d) only allows the FCC to require universal service contributions from telecommunications providers, which would exclude broadband providers if the service were deemed an information service. Broadband services could become a larger segment of the market with no obligations to contribute towards universal service.

Question 6. Under the President's Budget, the size of the Universal Service Fund is expected to grow from $5.3 billion to $7.1 billion in 2007. Since the Schools & Libraries Fund is currently capped at $2.25 billion per year, how much of this

growth is attributable to expansion of the High Cost Support Mechanism? Are there any further pending changes to universal service programs that might place further upward pressure on the size of the fund?

Answer. Most of the fund's growth in recent years is attributable to the expansion of the portion of the High Cost Fund associated with FCC access charge reform (CALLs and MAGs plans). In the future, the amount of non-access related funding might change as the FCC decides a case remanded last year by from the 10th circuit court of appeals concerning the non-rural cost support system. (Qwest v. FCC) That court held that the FCC's rules for universal service program did not assure that consumers across the nation were paying reasonable comparable rates, nor demonstrate that the funding provided was sufficient. The court was also critical of how the FCC assured state involvement in the administration and achievement of the goals of the universal service programs. The Joint Board is now working on a recommended decision to the FCC that will detail remedies for the problems and concerns raised by the court. The Joint Board was asked to complete its recommendation by August 2002.

Question 7. In *Qwest v. FCC*, the 10th Circuit found that the federal, statutory mandate stating that rural and urban rates be "reasonably comparable" requires the FCC, where necessary, to induce states to meet federal principles. In light of the 10th Circuit's decision in *Qwest*, what "inducements" should the federal government use to ensure that the federal statutory goal of ensuring reasonably comparable rates between urban and rural areas is met?

Answer. The FCC should clearly define its expectations regarding use of federal universal service funds and objectives states must strive towards if they desire continued support. State commissions use different methods to set rates, depending on how competitive the market is, the type of providers, and limitations placed on them by their state legislature. Even within their borders, rates are often set differently in different parts of the state as necessary to reflect market conditions. Therefore, the goal of comparable rates requires state involvement. The FCC should set standards, and require reporting of data from each state so that it can monitor national trends.

Question 8. In the original Senate version of the 1996 Telecommunications Act, universal service contributions were to be assessed on all telecommunications carriers based on an equitable and non-discriminatory basis. In the conference committee, however, this requirement was limited to telecommunications carriers providing interstate services . . . "

Given the shrinking contribution base for interstate revenues and the increasing difficulty of accounting between interstate and interstate revenues in bundled service offerings, does it make sense to change the statute and return to the broader language originally passed by the Senate?

Answer. Yes. Since the Act was passed the manner in which telecommunications services are delivered and the way the industry is regulated has changed. The distinction between interstate and intrastate revenues is not as clear as it was in 1996. In the case of wireless providers whose share of the market has increased, they may not be able to accurately distinguish the revenues without incurring substantial administrative costs.

Question 9. What effects, if any, will changes made to the federal contribution mechanism have on state universal service programs. What measures, if any, should be made to strengthen the Federal-State partnership in ensuring that all Americans have access to basic telecommunications services?

Answer. State programs are all different, so the answer to the first question depends on the state at issue. Generally, the states are likely to have increasing responsibility in the future to monitoring the use and sufficiency of the fund. The states best understand their own markets and the companies operating within their boundaries. The states can most effectively monitor the proper use of the fund and insure that it is achieving the national policy goals of sufficient, predictable support and reasonably comparable rural and urban rates. In 2001, the FCC required states to certify that all companies receiving universal service funds in their states were using the funds appropriately. The federal state partnership can be enhanced by a clear enumeration of the relative responsibilities of state and federal regulators. States need to be able to adapt programs to meet their unique needs. States can design their own state universal service programs to fund particular policy goals or supplement the federal programs. For example, in Alaska our state fund supports public interest payphones because keeping operable payphones in remote communities that do not otherwise generate enough revenue to justify the expense is a public safety issue.

SUPPLEMENTAL TESTIMONY OF LILA A. JABER, CHAIRMAN, FLORIDA PUBLIC SERVICE COMMISSION

We thought it would be helpful to provide greater detail to the Committee on a couple of points from my testimony. First, the Florida Public Service Commission (FPSC) has reason to urge that the overall Universal Service Fund grow no bigger than it currently is, and that the administration of the funds be subject to greater accountability standards. Florida has already taken steps, with state funds, to develop initiatives on funding for access to advanced services to schools and libraries. Second, we have additional suggestions for accountability of the disbursement of the funds. To the extent that Congress does not see the need to open up Section 254 for revision, we urge Congress to use its oversight role of the FCC to direct such changes. If Congress does pursue revisions to Section 254, we have included suggested language to limit the size of the overall fund.

Florida's Efforts to Provide Access to Advanced Services

In 1995, the Florida Legislature enacted a major overhaul of the Florida telecommunications law. That included the creation of Part II of Chapter 364, Florida Statutes, which created the Education Facilities Infrastructure Improvement Act. The Legislature found that it is in the interest of the State to assure its citizens access to advanced telecommunications services since such access will complement the provision of educational and health care services.

The law requires that advanced telecommunications services be provided to eligible facilities. A program was set out in which eligible facilities submitted a technology-needs request to the Department of Management Services. "Eligible facilities" includes campuses or instructional facilities, public community colleges, area technical centers, public elementary schools, middle schools, and high schools, as well as teaching hospitals and rural public hospitals.

Thus, a year prior to the Federal Telecommunications Act, the Florida Legislature enacted its own "E-rate" program. Florida also appropriated monies to rewire schools prior to its 1995 law. From 1992–1996, the Florida legislature appropriated $680 million for schools and library systems for technology initiatives. By the time the 1996 Telecommunications Act was passed, a considerable amount of the wiring of Florida schools had already been completed. Practically 100 percent of the classrooms in Florida today have Internet connections.

In addition, through programs like NetDay (a public/private partnership established to connect schools to the Internet) and the Florida Information Resource Network (FIRN, an organization of education information specialists with the goal of networking all of Florida's educational institutions), it is estimated that fully one-half of the schools in Florida were already wired before the Federal Schools and Libraries program began in 1997.

Indeed, Florida has good reason to be concerned about the size of the Federal Universal Service programs, when Florida is the largest net contributor and is almost "penalized" for its early success in wiring our schools for advanced services, paid for by Florida citizens. As a net contributor, Florida citizens are now paying for other states to achieve similar access to advanced services.

Accountability

The second topic I would like to address is accountability. The FPSC has consistently suggested that the Universal Service Funds need to have an increased level of accountability in an effort to ensure that funds are being disbursed in a manner that truly addresses the intended goal of the statute. To that end, we would suggest a number of possible steps that could be taken to achieve increased accountability.

First, the Congress, in its oversight role, might urge that the FCC conduct biennial or triennial reviews of its rules and guidelines governing each of the universal service programs to make sure the rules are not inadvertently creating incentives for gaming and abuse.

Second, the Universal Service Administrative Company (USAC) should be directed to implement a process to increase the number of independent audits of the recipients of universal service funding. The audits should be conducted in proportion to the relative size of the programs and the relative amounts of support received such that more audits would be conducted on large recipients versus small, and more audits would be conducted on the recipients of high cost support versus recipients of Lifeline and Linkup support. If Congress opens up Section 254 of the Act for review, language might be added for state commissions to conduct these audits if necessary. In the alternative, state commissions could be required, as part of the annual ETC certification review, to better ensure that recipients of universal service funding have used the funds as intended. The FCC could establish stronger national criteria for that review to make sure that there is consistency from state to state.

The concept is not to burden USAC, the FCC, state commissions or the industry with unreasonable regulatory oversight but to provide some incentive for carriers and states to reduce gaming and potential abuse.

In the recent FCC Inspector General's report, issued June 11, 2002, the Inspector General continued to focus on the Universal Service Fund activities because of continuing allegations of waste and fraud. According to the Inspector General, the size and scope of the Schools and Libraries program by itself makes it a major program for the FCC and a significant area for risk of fraud, waste, and abuse. "This, coupled with the results of various oversight activities performed to date, gives the Office of Inspector General a great deal of concern about this program." The report says, "It is our opinion that the scope of USAC's program, conducting a very small number of audits in a program with in excess of 30,000 applications (for Schools and Libraries alone) per year, does not provide the FCC with adequate insight on program-level compliance by program beneficiaries." The Inspector General also acknowledges that a systematic program of oversight has not yet been established.

Thus, we are concerned about the lack of audit resources, but we are glad to see the problem recognized. Especially as a net contributor state, with our schools wired for access to advanced services prior to the 1996 Telecommunications Act, we have good reason to want greater accountability in the program.

Revisions to Section 254

My last topic addresses possible legislative revisions to Section 254. If it is the Congress' desire to proceed with revising Section 254, then the Congress should cap the overall Universal Service Fund for three years following the effective date of any revisions to the Act. A provision for a triennial review could then take place. Standards for accountability and sufficiency should be included for the purposes of the review. We suggest the following provision:

> LIMITATION OF Universal Service Support. (i) Notwithstanding subsection 254(b)(5), universal service support shall be capped for three years following the effective date of this Act. Every three years thereafter, the Commission shall review the need to lift the caps, applying standards of accountability and sufficiency. If the Commission makes a finding that additional funds are necessary to meet subsection 254(b)(5), then the limitation shall be lifted for the subsequent three-year period.

In conclusion, the Florida Commission urges greater accountability in the Universal Service programs and offers the above suggestions for consideration.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO LILA A. JABER

Question 1. Do you see this nation's pricing system moving more towards a cost based system?

Answer. In the context that robust competitive markets will ultimately lead to rates which are closely aligned with cost, I believe telecommunications pricing will be driven toward a more cost-based approach as time goes on. That is the end result that all of us are shooting for. Basic local service rates have historically been priced to maximize customer connectivity without total reliance on cost recovery. Aligning price to underlying cost for these services is not something that can be achieved overnight without adverse impacts on some consumers. Many states, however, are already considering or have considered local service rate rebalancing and UNE pricing as ways to inject a more rational pricing structure into the local service market The Universal Service Fund is a key factor in ensuring that segments of society are not left behind by the resulting price/cost relationship of a more market-based pricing regime. Without a safety net for consumers and high-cost service providers the results of market-based pricing may be detrimental to some consumers in some areas.

Question 2. As you know, companies must be deemed an eligible telecommunications carrier (ETC) to receive USF funds. Reports indicate that more people will use their wireless phones as their primary phone and forego a traditional home line, but these companies do not receive USF payments. Do you believe there should be changes to the means of determining who is an eligible telecommunications carrier?

Answer. No. Wireless carriers can and have become ETCs. For example, Western Wireless was designated as an ETC for service to tribal members on the Pine Ridge Reservation in South Dakota (FCC Docket No. CC–96–45, Released 10/5/0 1). Many wireless carriers have chosen not to seek ETC status because of the requirements

to provide certain services (such as offering Lifeline services) associated with being an ETC.

Question 3. Universal Service reform is quite an undertaking. I do believe that we can achieve some type of reform of the system, but I believe any reform considered must examine the long term effects on the solvency of the system. Could you address the potential long term effects on the system of some of the proposals?

Answer. It is difficult to predict long term effects of any proposed changes; however, it appears that the current funding mechanism seems unable to cope with the changing marketplace dynamics in the telecommunications industry. Specifically, there is increasing difficulty in assessing the exact quantity of interstate services, and that difficulty varies according to the type of carrier. In addition, the size of the fund is ever changing, requiring constant adjustment in collection factors. Thus, it is intuitive that certain changes need to be made. The proposal put forth by AT&T based on the number of connections served has the benefit of simplicity, certainty, and ease of administration. However, I am concerned, that in the final analysis it will appear as yet another end-user rate increase to some customers. I do believe that some change is necessary in order to add some stability to the collection mechanism and the fund itself. I applaud the FCC for its current review of the contribution methodology.

In addition, I believe it is appropriate to address accountability of the administration of the fund at both the federal and state level and to establish a mechanism for measuring the effectiveness of the fund. By that, I am really asking everyone involved to re-evaluate the purpose of the funds and determine whether the current programs, and the eligible services covered by a fund, match what we believe should be the goals of the fund. Then, we can more effectively answer questions such as sufficiency and stability. That is the primary reason I have suggested capping the fund for a period of time to permit that type of assessment to take place.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO LILA A. JABER

Question 1. One problem often cited by critics of the current contribution mechanism is the "lag" between prior reported revenues, which are six months old, and current revenues, which are assessed based on the contribution factor.

Is it possible to eliminate this lag, but retain a revenue-based assessment mechanism? Are their ways to minimize the competitive distortion between carriers with rising revenues (such as the RBOCs) and carriers with falling revenues (such as the IXCs)?

How would the adoption of "collect-and-remit" proposals advanced by some carriers affect the administration and stability of the fund?

Is it possible to eliminate this lag, but retain a revenue-based assessment mechanism?

Answer. I believe that it may be possible to eliminate the lag if forecasted or estimated revenues are used. However, this presents regulators with the problem that carriers may intentionally underestimate their expected interstate or international revenues to minimize their financial exposure. It appears there should be a penalty for materially underestimating revenues. In addition, a true-up mechanism could be developed if revenues are underestimated. I would note, however, that the FCC recently denied AT&T's petition for waiver filed in December, to assess its contributions to universal service on projected, rather than historical, revenues (FCC Order DA02–1419).

Question 2. Are there ways to minimize the competitive distortion between carriers with rising revenues (such as the RBOCs) and carriers with falling revenues (such as the IXCs)?

Answer. Several proposals have been suggested that purport to address these differences, such as a collect-and-remit mechanism, or moving from revenues to a per connection assessment mechanism.

Question 3. How would the adoption of "collect-and-remit" proposals advanced by some carriers affect the administration and stability of the fund?

Answer. Moving to a collect-and-remit program would shift the risk of under or over recovery of universal service support from the carriers to the administrator of the fund. Specifically, under the collect-and-remit proposal, the administrator would have to estimate the amount of uncollectible support and factor that into the assessment. This would be true under either a revenue or a per-connection basis.

Question 4. One of the items currently under review by the Federal-State Joint Board is the effectiveness of certain federal low-income support programs (Lifeline

and Link-Up Programs). Often, the success of these programs varies widely from state to state due to differences in state eligibility requirements and in the administration of these programs. California, for example, received over half of all federal low-income support dollars in 2001.

What are the major reasons behind the relative successes or failures of these programs in certain states? Should there be more direct federal involvement in establishing eligibility requirements for these programs? Should certain minimum outreach efforts be required to ensure that low-income residents have access to these programs?

What are the major reasons behind the relative successes or failures of these programs in certain states?

Answer. I believe that there are a number of reasons for the relative successes or failures of these programs in states. Specifically, under the current federal rules, states that mandate state lifeline support can determine what the qualification criteria are. Hence, states can affect their pool of eligible participants. Certification and verification procedures, if conducted at all, also vary, not only from state to state, but from carrier to carrier. These differences affect participation.

Question 5. Should there be more direct federal involvement in establishing eligibility requirements for these programs?

Answer. I believe that there should be a balance between the ability of a state to expand the eligibility criteria and federal oversight of the program. Specifically, to the extent that a state wishes to use their intrastate Lifeline criteria as eligibility for the federal program, the FCC should thoroughly examine the criteria to ensure that the program is properly providing support to consumers that need the support. I have also suggested that the FCC increase its audit frequency of these programs.

Question 6. Should certain minimum outreach efforts be required to ensure that low-income residents have access to these programs?

Answer. Yes, we recommended increased promotion of the program through more frequent bill inserts and requiring all ETCs to post application information about their Lifeline service on the Lifeline Support website. The Florida PSC has worked with the FCC, other state agencies, and the Florida AARP organization to promote Lifeline availability.

More recently, in fiscal year 2001—2002, the Florida Legislature approved an appropriation of $500,000 to be transferred from the Florida Public Service Commission Regulatory Trust Fund to the Department of Children and Families to fund that agency's implementation of an automatic enrollment system for its clients eligible for Lifeline and Linkup. it is expected that this automatic enrollment system will increase participation in these programs, so that those needing assistance will be able to afford telephone service. We will continue to monitor efforts to develop and implement an automatic enrollment program for Lifeline and Linkup.

Question 7. As defined in the statute, "universal service" represents "an evolving level of telecommunications services." One of the items currently under review by the Federal-State Joint Board is whether to add broadband or other items to the list of supported services.

Should broadband be designated as a supported service? If not, what test should guide future determinations as to when broadband should be included? To the extent that the Commission defines broadband services as an "information service," would such a ruling preclude the Joint Board and FCC from later finding that broadband is a "telecommunications service" eligible for universal service support?

Should broadband be designated as a supported service? If not, what test should guide future determinations as to when broadband should be included?

Answer. The Joint Board issued its recommended decision on July 10th. The Joint Board concluded that advanced and high-speed services currently do not meet the Act's criteria for inclusion in the list of supported services. Therefore, the Joint Board did not recommend that the FCC expand the definition of supported services to include advanced or high-speed services at this time. I support this decision.

Adding advanced or high-speed services to the list could also jeopardize support currently provided to some carriers. For example, some carriers, such as wireless carriers and some small wireline Local Exchange Carriers, would no longer be eligible for universal service support because a significant number are not now capable of providing advanced or high-speed services or do not do so throughout their service areas. This would reduce the number of providers eligible for universal service support and might reduce consumer choice in rural and high-cost areas. Accordingly, the Joint Board indicated that the inclusion of advanced or high-speed services in the list of core services could stifle competition among various types of eligible telecommunications carriers and would not serve the public interest.

The Joint Board shares the FCC's and Congress's commitment to ensuring that appropriate policies are in place to encourage the successful deployment of advanced services. Even though advanced services are not directly supported by federal universal service, I do not believe that the FCC's policies impede the deployment of modern plant capable of providing access to advanced services. I believe that such a policy is more appropriate than directly supporting such services at this time. As a result, I agree that it is appropriate to make clear that the facilities installed by carriers should not create barriers to the future deployment of advanced services, and that the actual deployment of advanced services should be monitored, along with possible universal service implications.

Question 8. To the extent that the Commission defines broadband services as an "information service," would such a ruling preclude the Joint Board and FCC from later finding that broadband is a "telecommunications service" eligible for universal service support?

Answer. The classification of broadband services as information services by the FCC may result in an inconsistency if the FCC and the Joint Board sought to include broadband services as a supported service. However, it may well be that support of facilities used in the provision of broadband services could be included and not be contrary to the classification of an "information service." In the final analysis, if it were the will of the Congress or the FCC to do so, I believe the list of supported services could ultimately be expanded to cover facilities necessary to provide high-speed data transport.

Question 9. Under the President's Budget, the size of the Universal Service Fund is expected to grow from $5.3 Billion in 2001 to $7.1 Billion in 2007.

Since the Schools & Libraries Fund is currently capped at $2.25 Billion per year, how much of this growth is attributable to expansion in the High Cost Support Mechanism?

Are there any further pending changes to universal service programs that might place further upward pressure on the size of the fund?

Since the Schools & Libraries Fund is currently capped at $2.25 Billion per year, how much of this growth is attributable to expansion in the High Cost Support Mechanism?

Answer. I would preface my remarks to clarify that I am not intimately familiar with the assumptions made within the President's Budget. Barring any changes in the cap on the schools and library program or the rural health care program, I believe almost all of the increases would be associated with the high cost fund and Lifeline/Linkup. I should note that the FPSC has not done an independent analysis on this question and thus we do not know the answers.

Question 10. Are there any further pending changes to universal service programs that might place further upward pressure on the size of the fund?

Answer. The Joint Board is presently reviewing proposals to respond to the remand from the 10th Circuit Court of Appeals. This remand deals in part with the sufficiency of the fund in fulfilling the goals of the Telecommunications Act. The outcome of this proceeding could affect the size of the fund. As I have stated in my supplemental testimony, if Congress desires to proceed with revising Section 254, the Congress should cap the overall Universal Service Fund for three years following the effective date of any revisions to the Act. A provision for a triennial review could then be put in place. Standards for accountability and sufficiency should be included for the purposes of the review.

Question 11. In *Qwest v. FCC,* the 10th Circuit found that the federal, statutory mandate stating that rural and urban rates be "reasonably comparable" requires the FCC, where necessary, to induce states to meet federal principles.

In light of the 10th Circuit's decision in *Qwest*, what "inducements" should the federal government use to ensure that the federal statutory goal of ensuring reasonably comparable rates between urban and rural areas is met?

Answer. The FPSC has suggested that there is a way to induce states to take actions to alleviate the burden that particular states are causing on the federal high-cost universal service support mechanism for non-rural carriers. The FCC should not, however, dictate the method that states take to address high-cost support. The FPSC does see a benefit to injecting more accountability into the program as to the individual states' need for high-cost support. The FCC could require that state commissions provide notification of the steps their state has taken to achieve this rate comparability. States should be allowed to verify rate comparability within the state by showing either:

(1) that its rates in urban and rural areas are within two standard deviations of each other; or

(2) that its rates in rural areas are within two standard deviations of the nationwide average urban rate.

This information will shine a spotlight on those states that are not taking sufficient steps to address their own state needs.

Question 12. In the original Senate version of the 1996 Telecommunications Act, universal service contributions were to be assessed on all telecommunications carriers based on an equitable and non-discriminatory basis. In the conference committee, however, this requirement was limited to telecommunications carriers providing interstate services . . . "

Given the shrinking contribution base for interstate revenues and the increasing difficulty of accounting between interstate and intrastate revenues in bundled service offerings, does it make sense to change the statute and return to the broader language originally passed by the Senate?

Answer. While I cannot speak for the other members of the FPSC on this matter, I believe that it may be appropriate to consider such a change at this time given the current market conditions. However, such changes could open-up a new round of major litigation. I believe that it may be beneficial to consult with the FCC regarding such a statutory change.

Question 13. What effects, if any, will changes made to the federal contribution mechanism have on state universal service programs? What measures, if any, should be made to strengthen the Federal-State partnership in ensuring that all Americans have access to basic telecommunications services?

What effects, if any, will changes made to the federal contribution mechanism have on state universal service programs?

Answer. I think it depends on what changes are actually adopted by the FCC. The biggest change that could affect the programs relates to the collect-and-remit proposal. If the program administrator can effectively estimate uncollectibles, the proposal would have no detrimental effect on the program. Under this proposal, the program would only be adversely impacted if the administrator underestimated uncollectibles in any given quarter. This burden currently falls on the carriers.

Question 14. What measures, if any, should be made to strengthen the Federal-State partnership in ensuring that all Americans have access to basic telecommunications services?

Answer. I do not believe additional programs are necessary to meet the goal of universal access to basic telecommunications services. I do believe, however, that making some clarifications and adjustments to add more accountability to the existing programs will make the programs more effective and efficient.

The FCC has been reaching out to the state commissions in several significant ways. The FCC has held some Federal-State workshops on performance metrics, actively sought the input of State Commissioners on the Federal-State Joint Board on Universal Service and on the Section 706 Joint Conference on Advanced Services. We see great improvements in the Federal-State partnership and do not see the need for additional measures at this time.

I hope that my answers to these questions have been responsive. If you need further explanation or additional information to any of these questions, please do not hesitate to contact me.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MAX CLELAND TO BILLY JACK GREGG

Question 1. Do you see this nation's pricing system moving more towards a cost-based system?

Answer. Yes. The introduction of competition into any area of economic endeavor always tends to drive prices toward cost. Telecommunications is no exception. Prior to the introduction of competition, rates in urban areas were generally above cost while rates in rural areas were below cost. Although competition will likely result in lower prices and a better variety of products and services in urban areas, the challenge for universal service is to ensure that the advent of competition does not result in rates in rural areas rising to unacceptably high levels.

Question 2. As you know, companies must be deemed an eligible telecommunications carrier (ETC) to receive USF funds. Reports indicate that more people will use their wireless phones as their primary phone and forego a traditional home line, but these companies do not receive USF payments. Do you believe there should be changes to the means of determining who is an eligible telecommunications carrier?

Answer. No. Under the 5th Circuit's decision in *TOPUC v. FCC,* [1] states have primary responsibility for determining ETC status, and may impose additional reasonable criteria beyond the minimum requirements set forth in Section 214(e) of the Act. Wireless carriers are achieving ETC status throughout the nation under current regulations, and are receiving an increasing share of universal service support. As discussed in paragraph 84 of the Joint Board's Recommended Decision of July 9, 2002, [2] wireless carriers in seventeen states are now receiving $64 million in annual high-cost support from the federal fund. These numbers are expected to increase over time.

Question 3. Universal service reform is quite an undertaking. I do believe that we can achieve some type of reform of the system, but I believe any reform considered must examine the long-term effects on the solvency of the system. Could you address the potential long-term effects on the system of some of the proposals?

Answer. The two basic proposals for funding universal service are a revenue-based system or a connection-based system. I believe the most sustainable long-term funding will be produced by a connection-based system. A revenue-based system has the advantage of equitably spreading the responsibility for universal service based on relative usage of the telecommunications network. However, the current USF funding system based on interstate and international revenues is not sustainable over the long-term. Even if safe harbor provisions for wireless carriers and pagers are modified, the long-term trend for interstate revenues will continue downward as more traditional circuit-switched communications move to IP-based systems which are exempt from universal service contributions. [3] On the other hand, a connection-based system based on the capacity of the connection should be sustainable over the long-term. A connection-based system has the advantage of being indifferent to how the connection is used, whether for traditional voice calls or for internet traffic. Moreover, it is expected that the *capacity* of connections to the public switched network will continue to grow even if the total *number* of connections stabilizes in the future.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO BILLY JACK GREGG

Question 1. One problem often cited by critics of the current contribution mechanism is the "lag" between prior reported revenues, which are six months old, and current revenues, which are assessed based on the contribution factor. Is it possible to eliminate this lag, but retain a revenue-based assessment mechanism? Are there ways to minimize the competitive distortion between carriers with rising revenues (such as RBOCs) and carriers with falling revenues (such as IXC5)?

How would the adoption of "collect-and-remit" proposals advanced by some carriers affect the administration and stability of the fund?

Answer. There are several ways to address the problem of lag in a revenue-based system. However, any mechanism adopted will have to deal with the fact that expected revenue and actual revenue will never exactly match. As mentioned in the question, one method would be a "collect and remit" system, whereby carriers would be authorized to charge customers the prescribed assessment factor and remit to Universal Service Administrative Company ("USAC") whatever was collected. The advantage of such a system is that it would affect all carriers equally, regardless of whether their revenues were increasing or declining. The disadvantage of a collect and remit system is that USAC would have to carry a reserve fund on its books to guard against unexpected shortfalls in revenue. [4] Another option would be use of a system based on projected revenues, subject to future true-up. The disadvantage of such a system is that it would increase administrative intrusion and expense to ensure that projections revenues were reasonable and were actually trued-up. Moreover, use of projected revenues would perpetuate the current wide disparity in as-

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[1] *Texas Office of Public Utility Counsel et al v. FCC*, 183 F.3d 393 (1999) at 418.

[2] *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96–45, Recommended Decision, FCC 02J–1(July 9, 2002) at ¶ 84.

[3] An assessment system based on total revenues, both interstate and intrastate, would be more sustainable. However, use of intrastate revenues to support federal universal service was prohibited by the 5th Circuit in *TOPUC v. FCC*, 183 F.3d at 447–448. In addition, any revenue-based system would be subject to erosion from future migration to IP-based telephony.

[4] It has been estimated that USAC would have to carry a $500 million reserve if a collect and remit system was adopted. However, it should be noted that USAC was carrying a cash balance in excess of $2 billion at the beginning of 2002. Most of this reserve related to the schools and libraries fund. A portion of these excess funds were tapped by the FCC on June 13, 2002, to stabilize the universal service fund through the first quarter of 2003.

sessment factors charged to customers, while adding a new element of uncertainty to the universal service assessment system.

Question 2. One of the items currently under review by the Federal-State Joint Board is the effectiveness of certain federal low income support programs (Lifeline and Link-Up Programs). Often, the success of these programs varies widely from state to state due to differences in state eligibility requirements and in the administration of these programs. California, for example, received over half of all federal low income support dollars in 2001. What are the major reasons behind the relative successes or failures of these programs in certain states?

Answer. The essential reason for the disparity among the states is our federal system of government. Unless the Congress decides to preempt the states and mandate a federal low-income support system, there will continue to be differences in the size and efficacy of state Lifeline and Link-Up ("Lifeline") programs. The principal differences among states occur in the size of benefits available, in the applicability of benefits available, in the administrative procedures for application and certification of eligibility for Lifeline benefits, and in the promotion and advertising of the Lifeline program.

First, under the current Lifeline program the FCC has established a basic monthly federal benefit of $5.25 to $7.75 per customer, with additional federal benefits totaling $1.75 per customer per month available based on the level of state matching funds. As can be seen by review of Attachment 1, not all states offer the matching funds necessary to achieve the maximum Lifeline benefit.[5]

Second, beyond the level of benefits, there are also great differences in the services to which the benefits apply. Some states place no limit on the type of service to which the discount applies, while others limit Lifeline to the lowest level of service available, typically a measured or message service. Since such usage-based services are generally not as popular with customers as flat-rate services, participation in these types of Lifeline programs is also low.

Third, there are great disparities in state application and certification procedures. States with high participation rates like California have very simple self-certification procedures for Lifeline applicants, while states with low participation rates typically require a multi-step process to verify participation in eligible welfare programs.[6] Complicating matters, many of the roadblocks to wider participation mentioned above are enshrined in state statutes, and cannot be easily changed.

Fourth, the attitude of different states and telecommunications companies in promoting and advertising the Lifeline program varies widely. Some companies view Lifeline as an effective way to keep as many customers on the network as possible, and actively promote the program. Other companies seem to perceive Lifeline as a necessary evil, and try to limit its availability. These differences in perspective obviously affect the enthusiasm with which Lifeline programs are advertised and promoted.

Finally, increasing participation in the Lifeline program has implications for the overall size of the Universal Service Fund. The Low-Income Support mechanism disbursed over $600 million during 2001, with over half of that amount going to California. If every state had the same participation rate as California, the size of the Low-Income Support mechanism would grow by approximately $1 billion to a total of $1.6 billion.

Question 3. Should there be more direct federal involvement in establishing eligibility requirements for these programs? Should certain minimum outreach efforts be required to ensure that low income residents have access to these programs?

Answer. FCC regulations currently establish minimum eligibility requirements for the Lifeline program. A telecommunications carrier cannot maintain ETC status unless it offers Lifeline benefits in compliance with the federal standards, as certified by the individual states. As mentioned in the predicate to the question, the Joint Board is currently considering various proposals to modify the Lifeline program. An expansion of the eligibility criteria would have to be implemented by the individual states in order for the phone companies within their borders to maintain ETC status. One change that would ensure minimum outreach programs nationwide would

[5] Attachment 1 is Appendix LI0l from USAC's *Federal Universal Service Support Mechanisms Fund Size Projections for the Third Quarter 2002* (May 2, 2002). It should be noted that the maximum Tier 1 Basic Support was increased to $6.00 on July 1, 2002, when the cap on subscriber line charges was increased to that level.

[6] Current federal Lifeline rules base eligibility on participation in any of a number of income-based welfare programs, such as SSI, Medicaid, food stamps or TANF. With the enactment of welfare reform the period of time an individual can qualify for welfare benefits has been limited. Thus, it appears that some modification of eligibility standards will have to be made to accommodate individuals who have exhausted their welfare benefits but are nonetheless eligible for Lifeline based on their level of income.

be to empower USAC to engage in outreach and education programs related to the Lifeline and Link-Up programs.

Question 4. As defined in the statute, "universal service" represents "an evolving level of telecommunications services." One of the items currently under review by the Federal-State Joint Board is whether to add broadband or other items to the list of supported services. Should broadband be designated as a supported service? If not, what test should guide future determinations as to when broadband should be included?

Answer. The Joint Board released its Recommended Decision on July 9, 2002, which recommended that broadband not be added to the list of supported services at this time.[7] I agree with that decision. Although broadband is available to the vast majority of residential customers (estimates vary between 70 percent and 85 percent), only 10 percent of these customers have actually subscribed to such broadband services. One of the principal criteria to be considered by the Joint Board in determining which services should be included in the definition of universal service, is whether the service is subscribed to by a substantial majority of residential customers. While I believe broadband will ultimately be included in the list of supported services, such inclusion is not appropriate at this early stage of the development of the market for broadband.

Question 5. To the extent that the Commission defines broadband services as an "information service," would such as ruling preclude the Joint Board and FCC from later finding that broadband is a "telecommunications service" eligible for universal service support?

Answer. In paragraph 19 of the Recommended Decision of July 9, 2002, the Joint Board noted the potential problems that would be created by an FCC determination that broadband is an "information service" rather than a "telecommunications service." If broadband is determined to be an "information service," it could not be included in the definition of universal service, which is limited to telecommunications services. However, it should be noted that even if broadband services were not eligible for universal service support, Section 254(d) empowers the FCC to require universal service contributions from any other telecommunications provider, including broadband providers, "if the public interest so requires."

Question 6. Under the President's Budget, the size of the Universal Service Fund is expected to grow from $5.3 billion to $7.1 billion in 2007. Since the Schools & Libraries Fund is currently capped at $2.25 billion per year, how much of this growth is attributable to expansion of the High Cost Support Mechanism? Are there any further pending changes to universal service programs that might place further upward pressure on the size of the fund?

Answer. Attached hereto as Attachment 2 is my estimate of growth of each of the support mechanisms and in the total fund through 2007. Based on my evaluation of known changes in each of the support mechanisms over the next five years, I estimate that the total fund will be $6.9 billion in 2007, slightly less than estimated by this year's budget forecast. As can be seen on Attachment 1, the majority of the expected growth in the total Universal Service Fund between now and 2007 can be attributed to growth in the High Cost Support Mechanism. High Cost Support currently totals approximately $3 billion, with $2 billion going to rural companies and $1 billion going to non-rural companies. Most of the growth in High Cost Support through 2007 is expected to be in support for rural companies. Support for non-rural companies will stay at approximately $1 billion throughout this period as growth in High Cost Model Support is offset by the phase-out of interim Hold Harmless Support. Low-Income Support will continue to grow through this period as more effective advertising and easier enrollment procedures lead to increasing participation. The Schools and Libraries Fund will continue to be capped at $2.25 billion, while the Rural Health Fund will not grow appreciably.

Question 7. In *Qwest v. FCC*, the 10th Circuit found that the federal, statutory mandate stating that rural and urban rates be "reasonably comparable" requires the FCC, where necessary, to induce states to meet federal principles. In light of the 10th Circuit's decision in *Qwest*, what "inducements" should the federal government use to ensure that the federal statutory goal of ensuring reasonably comparable rates between urban and rural areas is met?

Answer. The Joint Board is currently considering what type of state inducements are appropriate under the Act and 10th Circuit's ruling. The Joint Board is also considering other elements of Court's ruling relating to defining key terms in Section 254: reasonable comparability of rates and sufficiency of the fund. I believe each of these elements is interrelated, and must be considered together in order to reach

[7] 7. Recommended Decision at ¶¶ 9–19.

a reasonable outcome. As to state inducements, I favor an expanded state certification process under Section 254(e) to gain information on state rates, on uses of federal support, and on actions taken or to be taken by each state to ensure that rates in rural areas are comparable to those in urban areas. This expanded certification process should induce states to identify aberrant rates and use state resources to bring these rates within the range of comparability. In the limited circumstance where existing federal support and state actions are not sufficient to enable comparable rates, additional targeted federal support may be warranted. However, at this point data is simply inadequate to make any finding about the level of rates, state actions to support rates, or the need for additional federal support.

Question 8. Under the current revenue-based system, percentage assessments charged to consumers may vary widely depending on whether interstate revenues are declining or increasing. In your view, does the current contribution mechanism cause unnecessary customer confusion? Should the FCC adopt uniform "labeling" requirements for carriers choosing to put a universal service line-item on customer bills? What further action should be taken to make universal service charges more understandable to consumers?

Answer. Under the current system carriers are allowed to recover their universal service assessment from customers in any "equitable and non-discriminatory" manner the carrier deems appropriate. There is no doubt that the flexibility presently afforded to carriers has led to widespread customer confusion and frustration. Some carriers recover the USF assessment by means of a percentage mark-up on customers' bills. Even though the percentage assessment on all carriers is the same, the level of the percentage mark-up on customers' bills varies wildly, and is usually substantially above the FCC-prescribed assessment rate. For example, the current FCC-mandated 7.2 percent USF assessment on carriers is recovered by AT&T using an 11.5 percent assessment on customers' bills, and by MCI using a 9.9 percent assessment.[8] Other carriers, such as the RBOCs, recover the USF assessment by means of a monthly per line charge on local phone bills. These per line charges also vary greatly, from 280 to 600 per line. Other carriers do not impose a separate surcharge and simply recover the USF assessment in the cost of the service they sell.

In addition to the variation in how the USF assessment is recovered, there is variation in how the USF surcharge is labeled. For example, different carriers call the charge "Federal Universal Service Surcharge," "Universal Access Charge," or "National Line Charge." Explanations of these charges also vary by carrier. Thus, a typical residential customer with a single landline phone, $30 in long distance service, and a wireless phone could be charged 500 on his local bill for a "Federal Universal Service Surcharge," $3.45 (11.5 percent) on his long distance bill for a "Universal Access Charge," and 310 on his wireless bill for a "Universal Connectivity Charge." The customer will likely be unaware that each of these charges is the same, and is based on exactly the same USF assessment rate on interstate revenues.

Most importantly, use of varying percentage surcharges makes it virtually impossible for a customer to accurately compare rates, or to even know the actual rate he or she will be paying. For example, an advertised rate of 100 per minute from a carrier with an 11 percent USF surcharge would actually amount to an effective rate in excess of 110 per minute.

I believe that regardless of the contribution methodology adopted to support universal service, the FCC should mandate uniform labeling of any USF surcharges and should prescribe allowable end-user surcharges under a collect and remit system. While any surcharges are distasteful, adoption of a uniform system should at least reduce customer confusion and eliminate any opportunity for carriers to over-recover universal service obligations from customers.

[8] Because the percentage surcharges imposed by carriers are so far above the prescribed USF assessment rate, many have charged that some IXC's are using the surcharges to generate additional revenues. To date, the FCC has not performed any audits of IXC recoveries of USF assessments.

LOW INCOME SUPPORT AVAILABLE STATE-BY-STATE

Attachment 2

STATE	TIER 1 BASIC	TIER 2 OPTIONAL	TIER 3		TOTAL FEDERAL SUPPORT*
			STATE MATCHING	FEDERAL MATCHING	
ALABAMA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
ALASKA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
AMERICAN SAMOA	$3.50/$5.00	$1.75	No		$5.25/$6.75
ARIZONA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
ARKANSAS	$3.50/$5.00	$1.75	No		$5.25/$6.75
CALIFORNIA	$3.50/$5.00	$1.75	Varies By Co. By Exchange	Will Vary	
COLORADO	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
CONNECTICUT	$3.50/$5.00	$1.75	$1.17	$0.58	$7.00/$8.50
DELAWARE	$3.50/$5.00	$1.75	No		$5.25/$6.75
DISTRICT OF COLUMBIA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
FLORIDA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
GEORGIA	$3.50/$5.00	$1.75	$3.50 (Bell South/ Alltel)	$1.75	$7.00/$8.50
GUAM	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
HAWAII	$3.50/$5.00	$1.75	No		$5.25/$6.75
IDAHO	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
ILLINOIS	$3.50/$5.00	$1.75	$1.50	$0.75	$6.00/$7.50
INDIANA	$3.50/$5.00	$1.75	No		$5.25/$6.75
IOWA	$3.50/$5.00	$1.75	No		$5.25/$6.75
KANSAS	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
KENTUCKY	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
LOUISIANA	$3.50/$5.00	$1.75	No		$5.25/$6.75
MAINE	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
MARYLAND	$3.50/$5.00	$1.75	$3.50(Verizon)	$1.75	$7.00/$8.50
MASSACHUSE1TS	$3.50/$5.00	$1.75	$6.00	$1.75	$7.00/$8.50
MICHIGAN	$3.50/$5.00	$1.75	$2.00	$1.00	$6.25/$7.75
MINNESOTA	$3.50/$5.00	$1.75	No		$5.25/$6.75
MISSISSIPPI	$3.50/$5.00	$1.75	$3.50 (Bell South)	$1.75	$7.00/$8.50
MISSOURI	$3.50/$5.00	$1.75	No		$5.25/$6.75
MONTANA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
NEBRASKA	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
NEVADA	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
NEW HAMPSHIRE	$3.50/$5.00	$1.75	No		$5.25/$6.75

LOW INCOME SUPPORT AVAILABLE STATE-BY-STATE

Attachment 2—Continued

STATE	TIER 1 BASIC	TIER 2 OPTIONAL	TIER 3		TOTAL FEDERAL SUPPORT*
			STATE MATCHING	FEDERAL MATCHING	
NEW JERSEY	$3.50/$5.00	$1.75	No		$5.25/$6.75
NEW MEXICO	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
NEW YORK	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
NORTH CAROLINA	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
NORTH DAKOTA	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
NORTHERN MARIANA IS.	$3.50/$5.00	$1.75	No		$5.25/$6.75
OHIO	$3.50/$5.00	$1.75	No		$5.25/$6.75
OKLAHOMA	$3.50/$5.00	$1.75	$1.17	$0.58	$5.83/$7.33
OREGON	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
PENNSYLVANIA	$3.50/$5.00	$1.75	$2.50 (Verizon)	$1.25	$6.50/$8.00
PUERTO RICO	$3.50/$5.00	$1.75	No		$5.25/$6.75
RHODE ISLAND	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
SOUTH CAROLINA	$3.50/$5.00	$1.75	$3.50 (eff.—10/1/01)	$1.75	$7.00/$8.50
SOUTH DAKOTA	$3.50/$5.00	$1.75	No		$5.25/$6.75
TENNESSEE	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
TEXAS	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
UTAH	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
VERMONT	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50
VIRGINIA	$3.50/$5.00	$1.75	$1.75/$3.50	$.88/$1.75	$6.13/$7.00 $7.63/$8.50
VIRGIN ISLANDS	$3.50/$5.00	$1.75	$7.05	$1.75	$7.00/$8.50
WASHINGTON	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
WEST VIRGINIA	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
WISCONSIN**	$3.50/$5.00	$1.75	Varies By Co.	Will Vary	
WYOMING	$3.50/$5.00	$1.75	$3.50	$1.75	$7.00/$8.50

*Cap for SLC for all companies was increased to $5.00 effective 1/02 and to $6.00 on 7/02.
**Low income customers in Wisconsin cannot be charged over $15.00.

USF BILLINGS 1997–2007 $ Millions

Attachment 2

Fund	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
High Cost	1,614	1,691	1,746	2,115	2,741	2,900	3,200	3,300	3,400	3,500	3,600
Low Income	148	464	501	537	578	666	740	820	890	950	1,000
Schools & Libraries	0	1,250	1,698	1,865	2,139	2,250	2,250	2,250	2,250	2,250	2,250
Rural Health	0	8	0	9	11	23	24	25	25	25	25
Subtotal	1,762	3,413	3,945	4,526	5,469	5,839	6,214	6,395	6,565	6,725	6,875
Unused Funds						-480	-240				
TOTAL USF	1,762	3,413	3,945	4,526	5,469	5,359	5,974	6,395	6,595	6,795	6,875

Years 2003–2007 are estimates.

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