THE FUTURE OF UNIVERSAL SERVICE

HEARING

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS AND THE INTERNET

OF THE

COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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THE FUTURE OF UNIVERSAL SERVICE

WEDNESDAY, SEPTEMBER 24, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON TELECOMMUNICATIONS
AND THE INTERNET,
Washington, DC.

The subcommittee met, pursuant to notice, at 1 p.m., in room 2123, Rayburn House Office Building, Hon. Fred Upton (chairman) presiding.

Members present: Representatives Upton, Gillmor, Cox, Deal, Whitfield, Shimkus, Wilson, Pickering, Bass, Bono, Walden, Terry, Tauzin (ex officio), Markey, Rush, Boucher, Gordon, Deutsch, Stupak, Wynn, Green, and Dingell (ex officio).

Staff present: Dan Brouillette, staff director; Howard Waltzman, majority counsel; Will Nordwind, majority counsel and policy coordinator; William Carty, legislative clerk; Greg Rothschild, minority counsel; and Jessica McNiece, minority staff assistant.

Mr. UPTON. Sorry for the delay. We had a number of votes on the floor. And I understand that we are going to have votes about every hour. A couple of votes will not be able to roll this like we are able to do from time to time.

So good afternoon. Today's hearing is entitled "The Future of Universal Service." We have before us a very distinguished and very large panel of witnesses. So I am going to keep my opening remarks brief.

At the outset, I want to offer a special welcome to one of our witnesses, Sid Shank of Bloomingdale Telephone Company, which is located in my district. Over the years, I have made many visits to Bloomingdale and Paw Paw, where she lives, with its one four-way blinking traffic light; yellow, by the way—I think it's yellow anyway—and have seen what a terrific difference the nearly 100-year-old Bloomingdale Telephone Company has made in the lives of the 2,000 customers that it currently serves. As a result, I have witnessed firsthand the valuable byproduct of universal service.

Universal service is a cherished principle of our Nation's telecommunications system, which has been and continues to be a vital link for rural America and those most in need. However, coming from Michigan, the auto State, I would say that while the car is still running, the engine light has come on, suggesting that the universal service engine needs an overhaul if we are going to keep it running for another 100,000 miles and beyond. Today we are lifting up the hood and checking things out.

We know that competitive forces, which have evolved since the Telecommunications Act of 1996, are putting great strain on the universal service engine.

On the contribution side, trends suggest that the amount of money coming into universal service is declining. CLECs are competing for business and urban residential customers, which is an implicit source of universal service funding for the ILECs serving rural customers.

Also, different technologies are competing against one another. So, instead of making traditional land line long distance calls an explicit source of universal service funding, people are using e-mail, wireless phones, voice over internet protocols, which currently contribute less or nothing to the universal service relative to traditional land line long distance calls.

Meanwhile, on the demand side, trends suggest that it is increasing at a rapid pace as more and more wireless companies are seeking universal service funding in rural areas where rural ILECs aren't currently serving and receiving universal service. Many rural carriers are also seeking to use universal service funds to build the infrastructure to provide advanced services.

Of course, every one of our constituents shoulders the burden of universal service on their phone bills. So we need to be ever mindful about our responsibility to them and their family budgets.

All of these pressures suggest that the current system is unsustainable. And it is our job to make sure that it is fixed, not only for today but also for whatever the telecommunications future may bring.

Today we are going to hear about the problems and some of the proposed solutions. I suspect that there will be some difference with respect to the solutions, but I certainly look forward to working with every member of this subcommittee as we take stock of today's testimonies and answers to our questions so that we can best prepare ourselves for the job ahead of us in the coming days.

At this point, I will remind all members that if they waive their opening statement, they will get an extra 3 minutes on their first round of questions. And with that inducement, that will raise to my friend Mr. Gordon from Tennessee.

Mr. GORDON. It sounds like "Let's Make a Deal" here.

Mr. UPTON. Yes.

Mr. GORDON. You are right. We have a lot of witnesses. We need to get on with this. I will just briefly say that my district is well-represented by BellSouth. And, Ms. Greene, you do a good job with that organization.

And, as you know, I represent the wealthiest part of Tennessee, the suburbs of Nashville, and the poorest part, there in the root of the Appalachian part of Tennessee. So it's interesting how you are able to serve both of these well. And I hope the panel as we go through today will talk a little bit about whether there should be standards and how we should go about assessing and having standards for people or for organizations that have to serve this diverse type of groups, from the wealthiest to the poorest. I think that that is something that we need to be looking at, and I hope that you will address it.

Thank you.

Mr. UPTON. I would yield for an opening statement from Mr. Gillmor.

Mr. GILLMOR. Thank you very much, Mr. Chairman. I have a very profound and insightful statement that is on the way from my office. It's not here, but I will enter it into the record when it gets here. I do want to commend you for going forward with these hearings.

This is a very important subject area where the changes in the marketplace are making a significant difference in how we take care of a universal service fund. There are also some serious questions of fairness in the way the burden is mapped. And I'm glad that we're taking a look at it. I hope that we will continue to do it in even more depth.

Thank you.

[The prepared statement of Hon. Paul Gillmor follows:]

PREPARED STATEMENT OF HON. PAUL E. GILLMOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

I thank the Chairman for the opportunity to address the future of Universal Service, a critical issue in states with rural, high-cost areas, such as mine. Although the goals and performance of this program have been successful, a majority of the telecommunications sector and many Members here today recognize the fund's current situation, in which competition and technology have begun to wear away at the Universal Service system. More specifically, the cost of the fund continues to grow and revenues diminish as consumers have migrated to data services such as email and voice-over Internet.

Furthermore, the current formula has flaws that in some cases have led to unfair results. For example, under the existing system, larger carriers that serve rural customers often shortchange millions of rural Americans, as carriers in a few states currently receive up to 80 percent of the funding. In my home state of Ohio, residents pay almost $7 million into the fund for non-rural carriers, but none of this funding actually reaches rural Ohio. As a consequence, rural Ohioans are subsidizing the telephone service of rural residents in other states.

While certainly a worthy issue to address, I also look forward to hearing from the well-balanced panel of witnesses concerning a comprehensive approach to ensuring the continued viability of Universal Service in addition to other immediate and long-term solutions.

Again, I thank the Chairman for holding this timely hearing and yield back the remainder of my time.

Mr. UPTON. I yield to Mr. Dingell, the ranking member of the full committee.

Mr. DINGELL. Mr. Chairman, I thank you for your courtesy and commend you for holding these hearings. This is a great opportunity, and it is one that I hope this committee will take advantage of.

I am pleased that we are examining this very important issue of universal service and its future because I am becoming increasingly concerned about the future stability of universal service support mechanisms. Providing high-quality telecommunications services at affordable rates to all Americans has long been a cornerstone of our Nation's telecommunications policy and was enacted into law in the Telecommunications Act of 1996.

As this committee embarks on critical examination of the universal service and how to ensure that it is sustained in the future, we must be willing to ask tough questions of those companies who have benefited handsomely from deregulation and make sure that the players are all asked to contribute in an equitable manner.

In 1996, the Congress believed that universal service programs could be supported by assessing a charge against interstate telecommunications services.

As we all know, much has changed in the telecommunications landscape since 1996. And these changes now demand a thorough reexamination of the manner in which we support universal service.

The explosive growth in the use of e-mail and wireless services has replaced traditional long distance voice service for many Americans, and has dramatically slowed the growth of wire line interstate minutes. At the same time, cost per minute has fallen. These events have dramatically decreased the pool of revenue available to support universal service and caused the assessment on consumers' bills to rise to 9.5 percent.

Also important, as networks become digital and capable of offering multiple types of service, carriers have begun to bundle products to consumers in attractive commercial offerings. In many regions, the consumer can purchase local and long distance voice service, high-speed internet service, and wireless service from a single carrier at a single price. This is wonderful for consumers, who are realizing the savings and convenience of real competition, but it is beginning to wreak havoc on those who must determine which portion of that bundled rate is for interstate service and can, thus, be assessed for purchased purposes of universal service.

Finally, the present system also leads to several marketplace inequities. For example, though cable companies and phone companies offer comparable broadband products to consumers, only telco DSL service offered by the phone companies must support universal service.

As the Federal Communications Commission and our committee contemplate action to address these issues, I suggest that we begin to adhere to certain principles. First, all providers—and I mean all, A-L-L, providers—of telecommunications should provide equitably for contributions to support universal service. There is absolutely no reason to exempt certain products offered by particular industries simply because those industries have traditionally provided video rather than common carrier services.

Next, all communications and not simply interstate communications should be assessed. In a world of packeted networks and bundled service offerings, it is simply nonsense for the FCC to determine which communications are interstate, rather than intrastate, in nature.

Finally, as new services come on line, such as voice over the internet protocol, we should be careful not to play favorites for the so-called new technologies. Contrary to what some might say, we are not stifling the growth of new services by asking them to play by exactly the same rules as their competitors play and to confront the same challenges and difficulties that they confront. Rather, if we allow carriers to evade universal service requirements simply because of the technology or type of technology of their network, then not only will we be shortchanging universal service support mechanisms, but we will be picking winners and the losers in the marketplace. And, worse, we will be stacking the deck unfairly against certain participants in the industry.

Mr. Chairman, I look forward to working with you and with Chairman Tauzin on the issue. We must stand ready to make tough choices to ensure the continued service of the telecommunications industry to our people and the continued success of that service. I thank you for your courtesy to me.

Mr. UPTON. Thank you, Mr. Dingell.

I recognize Mr. Cox for an opening statement.

Mr. COX. Thank you, Mr. Chairman. I welcome our witnesses here. I thank you for holding this hearing on an issue that is of great import to many of us who are determined not to repeat the disastrous history of overregulation in the traditional telephone market.

When we debated in this committee the 1996 act, there was a consideration at that time of an amendment that I proposed that would have limited universal service to voice-grade telephony. The truth is that we are living in a world right now where voice and data are merging, where, indeed, what we call data is very difficult to define. And the kinds of telecommunications services that consumers can avail themselves of are expanding very rapidly.

One of the reasons that this program is in trouble is that demand for funds has been growing while the support base has not been growing with it. We need to look at ways to limit what might otherwise be an inexorable expansion of a program that would at that point be in search of a purpose.

I think the fundamental purposes that need to be maintained for universal service include making sure that everyone, whether they can afford it or not, has a lifeline. They ought to be able to call 911. People should not be so shut out from the rest of society that they can't get an ambulance to take them to the emergency room. But at the same time, we ought not ask most consumers to pay taxes to subsidize people getting video conferencing or getting all of the services that might someday be available in the form of data over what used to be telephone lines. We certainly don't want to be paying for movies on demand or any such thing. And I think it is time for us to take a very, very hard look at what is it that we are trying to accomplish with this program. And I would think that the lessons that we have learned since 1996 would be very instructive in this respect but that now because of the financial problems of this program would be a fine time to explicitly describe universal service as voice-grade telephony and use it as a lifeline program.

I thank the chairman. I yield back.

Mr. UPTON. Thank you.

Mr. Stupak?

Mr. STUPAK. Thank you, Mr. Chairman.

The Federal Universal Service Program is of critical importance to rural parts of America, including my district. Universal service ensures that households in all parts of America have access to basic telecommunications services, even in the most rural areas. But the FCC's program for non-rural carriers is no longer effectively meeting these goals. Overwhelmingly, the program benefits carriers and customers in three States, and millions of rural customers served by non-rural carriers receive no benefit at all. The FCC itself compiled a chart that illustrates this clearly.

According to the FCC, residents in Michigan pay more than $5 million into the non-rural part of USF Program. Yet, carriers and consumers in Michigan receive no money for the program in return. Similar cases exist in 42 other States as well.

And I would ask unanimous consent to submit this chart from the FCC into the record.

[The chart follows:]

USF Net Dollar Flow for High-Cost Rural Areas Served by Mixed Carriers: 2001

(Annual Payments and Contributions in Millions)

High-Cost, Non-Rural Fund ONLY

State	Contribs to USF*	Paymts from USF	Net Dollar Flow
Alabama	2,650,000.29	42,863,000.88	40,213,000.59
Alaska	497,000.70	0.00	-497,000.70
Arizona	4,074,000.18	0.00	-4,074,000.18
Arkansas	1,584,000.18	0.00	-1,584,000.18
California	19,405,000.93	0.00	-19,405,000.93
Colorado	3,997,000.10	0.00	-3,997,000.10
Connecticut	3,131,000.86	0.00	-3,131,000.86
Delaware	779,000.03	0.00	-779,000.03
Florida	13,334,000.32	0.00	-13,334,000.32
Georgia	6,483,000.90	0.00	-6,483,000.90
Hawaii	800,000.08	0.00	-800,000.08
Idaho	1,031,000.32	0.00	-1,031,000.32
Illinois	8,842,000.11	0.00	-8,842,000.11
Indiana	3,700,000.57	0.00	-3,700,000.57
Iowa	1,775,000.15	0.00	-1,775,000.15
Kansas	1,886,000.91	0.00	-1,886,000.91
Kentucky	2,468,000.49	0.00	-2,468,000.49
Louisiana	2,635,000.49	0.00	-2,635,000.49
Maine	937,000.83	6,629,000.32	5,691,000.50
Maryland	4,517,000.17	0.00	-4,517,000.17
Massachusetts	5,480,000.82	0.00	-5,480,000.82
Michigan	5,674,000.50	0.00	-5,674,000.50
Minnesota	3,503,000.19	0.00	-3,503,000.19
Mississippi	1,664,000.31	103,960,000.88	102,296,000.57
Missouri	3,801,000.38	0.00	-3,801,000.38
Montana	733,000.33	4,334,000.25	3,600,000.92
Nebraska	1,184,000.37	0.00	-1,184,000.37
Nevada	1,863,000.09	0.00	-1,863,000.09
New Hampshire	1,249,000.82	0.00	-1,249,000.82
New Jersey	8,371,000.35	0.00	-8,371,000.35
New Mexico	1,256,000.82	0.00	-1,256,000.82
New York	13,745,000.77	0.00	-13,745,000.77
North Carolina	5,804,000.34	0.00	-5,804,000.34
North Dakota	555,000.01	0.00	-555,000.01
Ohio	6,791,000.80	0.00	-6,791,000.80
Oklahoma	2,102,000.54	0.00	-2,102,000.54
Oregon	2,592,000.57	0.00	-2,592,000.57
Pennsylvania	8,344,000.42	0.00	-8,344,000.42
Rhode Island	857,000.75	0.00	-857,000.75
South Carolina	2,790,000.75	0.00	-2,790,000.75
South Dakota	584,000.43	0.00	-584,000.43
Tennessee	3,721,000.83	0.00	-3,721,000.83
Texas	12,880,000.80	0.00	-12,880,000.80
Utah	1,532,000.46	0.00	-1,532,000.46
Vermont	560,000.33	10,026,000.78	9,466,000.45
Virginia	6,038,000.66	0.00	-6,038,000.66
Washington	4,434,000.74	0.00	-4,434,000.74
West Virginia	1,161,000.21	25,894,000.38	24,733,000.17
Wisconsin	3,232,000.07	0.00	-3,232,000.07
Wyoming	463,000.12	6,138,000.62	5,675,000.51
TOTAL	199,848,000.13	199,848,000.13	0.00

Source: FCC Universal Service Monitoring Report, CC Docket No. 98-202, October 2002, Table 3.17, page 3-26.

Notes: Figures may not add due to rounding. Support payments do not include quarterly true-ups. USF is an abbreviation for the Universal Service Fund, which funds the high-cost support mechanisms.

* Carriers make payments into the fund based on end-user interstate telecom revenues. The estimates in this column are computed by multiplying the state's share of end-user revenue times the nationwide total at the bottom of this column. For the methodology used to derive the state's share, see the technical appendix to Chapter 1 of the source document.

Mr. UPTON. Without objection.

Mr. STUPAK. When I first learned about this, I was amazed. Apparently, the rationale that leads to this inequity is as follows: The FCC uses the average cost of the non-rural carriers serving the State and compares that with the National average cost of providing telephone service. If a State's average is more than 135 percent of the National average, the State is eligible for funding. If the State is below 135 percent, it is not eligible for funding.

On the face of it, this approach makes sense. However, it has flaws. First, the cost of providing service in a State is skewed downward if a non-rural carrier provides service to residents in a city in that State.

In addition, this method ignores the intent of Congress. Congress told the FCC to ensure comparable rates between urban and rural areas. Universal service is designed to ensure that rural residents in all parts of the country are afforded access to telephone service that is comparable in price and quality to service in cities. A scheme that sends 70 percent of the funds to two States does nothing to advance urban, rural rate compatibility in my State or most States in the Nation.

The Universal Service Fairness Act that Representative Terry and I have introduced would solve this problem by assessing each rural area independently. Each telephone company wire center is compared to a National benchmark. If the wire center is over the benchmark, it would receive support. If the wire center is below the benchmark, it would not. This method would enable residents, rural residents, across America to be treated fairly. And it ensures that lower-cost areas would not benefit.

Mr. Chairman, I share the view of many of the members of this subcommittee that we should undertake a review of the entire USF Program. The program has many challenges. However, I believe that we should consider moving to fix inequities that do rural customers a great disservice while we continue to grapple with the larger issues as well.

With that, I yield back the remaining 6 seconds of my time.

Mr. UPTON. The gentleman's time has expired. I recognize the gentleman from Nebraska, Mr. Terry, certainly.

Mr. TERRY. Thank you, Mr. Chairman, for holding this important hearing.

I would like to as well focus my comments on one aspect of universal service fund. And that's the high-cost, non-rural fund. Now, although the FCC calls it non-rural carriers, in fact, actually, this service serves more than 70 percent of rural Americans.

This program may be one of the most poorly targeted programs in the Federal Government. More than half of the program, $120 million out of $234 million, benefits one single State. Nearly 85 percent of this program goes to carriers in only three States. And only eight States receive any funding under this program. It's interesting to note that some of the rural States that do not benefit from this program include Texas, who donates over $12 million to this program, and receives nothing; Tennessee, $3.7 million and receives nothing. Nebraska receives nothing.

Ironically, the States that do benefit from this program, although rural and deserving of some support, are not the most rural States in America. For example, by almost every measure, my State, Nebraska, is considered rural. According to the cost and the most recent Census data, Nebraska is one-third as densely populated as Mississippi. Yet, carriers serving residents in Nebraska receive no support under this program.

I am proud to partner with Mr. Stupak in a bill that would correct this, as he has outlined in his opening statement. By using a different formula, 40 States, more than 40 States, will receive some degree of funding, as opposed to just 8.

Now, Mr. Chairman, you and I have discussed the necessity to review and work toward complete reform of the USF Program. And I want you to know, as I have told you on the floor, consider me a partner in that effort.

I do agree that we need to completely reform the Universal Service Program on the distribution, on the revenue side, but let's also recognize that that is going to be a very arduous, tedious, and lengthy process. And I would respectfully request that we not punish in that time States like mine, Nebraska. And let's resolve the inequities while we can now.

With that, I look forward to working with you on the Universal Service Fund and continue to plead that we at least do what we can and move the Terry-Stupak bill.

I yield back my 9 seconds.

Mr. UPTON. The gentleman yields back the balance of his time.

We recognize Mr. Green for an opening statement.

Mr. GREEN. Thank you, Mr. Chairman. I appreciate the offer of the extra 3 minutes, but I think I want to say what I have so it will get into the record now. And I thank you for calling the hearing on the future of universal service.

I expect that we will hear agreement from our panelists today and from many members that the universal service fund needs to be preserved. We may have different reasons for that. Mine is because I believe we must have a healthy fund to improve education through our schools and library funding known as the e-rate.

People who are talking about reducing claims on the fund should be warned that if they try to scale back or limit e-rate funding, I think we will see a tremendous outcry from our teachers and our parents and our school districts across the country. I don't want to get into the nuts and bolts of e-rate or some of its recent publicity, but I want to talk about what e-rate has done for the school children in my hometown in Houston.

With their recent receipt of over $50 million in year 6, the Houston Independent School District, very urban district, 200,000-plus children, has received approximately $200 million in universal service funding through e-rate.

Between 1998 and 2001, internet access in our minority classrooms jumped from 37 percent to 81 percent. And we were successful in bridging that digital divide because of the universal service fund. I believe these investments will be paid back many times over when these children fully enter our society and our workforce.

Ninety-five percent of all of our Houston public school classrooms are now connected, with over 90 percent using high-speed connections. Teachers are connected to their schools' resources at their homes. And hopefully students will also be able to connect through their homes.

Smaller districts also benefit. I have a number of districts other than Houston Independent School District. I have one small district that's 80 percent economically disadvantaged. And they received more than $1.5 million in e-rate funding. This low-income district is now scoring 90 percent on all their State achievement tests. And the school administrators say that it couldn't have happened without e-rate-provided funding from the universal service fund. So improving educational opportunities for these schools is my motivation for seeking solutions to the coming crunch for the universal service fund.

I don't know the solution on how to make the deposits and withdrawals on the fund match up. And I look forward to hearing from our distinguished panelists on how this may be accomplished. But I do know the approach should be comprehensive in considering all aspects of the universal service, both within and without the actual universal service fund.

Before we hear about potential solutions for universal service in general and the fund in particular, I will make one observation. If the FCC is going to continue to demand that the incumbent local exchange carriers subsidize their competitors to pick off their high-value customers through the UNE-P system and the TELRIC pricing mechanism behind it, the incumbents are going to become less and less able to have their business models support the majority of rural and high-cost customers, whom they now serve.

And if incumbents that do not draw much from the fund can no longer afford to serve these rural customers, then other companies will move in using the universal service fund dollars to serve these customers. If we think the fund is in trouble now, it may get a lot worse if action is not taken. It is a complicated relationship, but if balance were restored to this industry by eliminating UNE-P or the TELRIC pricing, we would retain the ability of the incumbents to provide universal service without causing increased burden on the fund.

If incumbents cannot serve their current rural customers, the burden on the fund is going to get bigger. And soon people are talking about making more folks pay into the fund, causing a lot more pain.

All the while, we have critical needs in our schools and our school children and need telecommunication investments. If these investments are hit because we would rather subsidize a few companies, I think that would be particularly a shame.

And, again, I'm glad the panel is here, Mr. Chairman. I am glad you are holding this hearing. Thank you.

Mr. UPTON. Thank you, Mr. Green.

Mr. Walden?

Mr. WALDEN. Mr. Chairman, I will waive an opening statement.

Mr. UPTON. Good for you.

Ms. Bono?

Ms. BONO. I'll waive also.

Mr. UPTON. Mr. Whitfield?

Mr. WHITFIELD. I'll waive also.

Mr. UPTON. Mr. Bass?

Mr. BASS. I'll waive.

Mr. UPTON. Ms. Wilson?

Mrs. WILSON. Enter it into the record.

Mr. UPTON. Without objection.

All members' statements will be a part of the record. So do you defer as well?

Mrs. WILSON. I'll waive.

Mr. UPTON. Mr. Pickering?

Mr. PICKERING. I will defer as well.

Mr. UPTON. Mr. Boucher?

Mr. BOUCHER. Well, thank you, Mr. Chairman. I do have something to say.

As a representative of a rural Virginia district, I have a very strong interest in assuring that the longstanding commitment our Nation has made to affordable telephone service for everyone remains at the core of our Federal telecommunications policy.

We have a telephone service penetration rate in the high 90 percentile Nationwide, an achievement that few Nations can claim. That sterling accomplishment is a consequence of and is directly attributable to this commitment to universal service, through which the residents of high-cost rural areas receive the basic local telephone service at the same monthly rate as the residents of the easier-to-serve metropolitan regions.

In the absence of our universal service policy, the high cost of stringing telephone lines over large distances and mountainous terrain would place the cost of telephone service beyond the reach of tens of thousands of my constituents and tens of millions of rural Americans.

And so, as we embark on these timely hearings—and I think they are timely—to survey the changes and the universal service funding and delivery mechanisms, which the arrival of competition in the telecommunications industry makes necessary, I will urge the members to retain our core basic universal service policy: affordable local telephone service for everyone with the same basic monthly rate for rural and urban residents alike. But changes must come in the mechanics by which we achieve that result.

In an era of highly competitive markets for both wired and wireless telephone service, the universal service policy is still based on the concept of a local telephone monopoly with a single wire line provider for all voice service. To a large extent, the policy is still based on the notion of a vertically integrated system with a single provider for both local and long distance service, a condition which has not prevailed in the United States for 20 years.

All universal service revenues, the system's money end, are derived from charges on interstate services while purely intrastate services escape any universal service charge. CLECs, who serve business customers only, take the cream off the top, depriving the universal service fund of much of its traditional revenue service resource, which leaving the incumbent CLEC with an even greater universal service funding responsibility.

Telephony offered by cable systems through the cable modem service in packaged switching format looks and feels exactly like local telephone service, but it escapes any universal service payment responsibility.

These matters only scratch the surface in a complex system for which changes must come. I want to commend the chairman for launching the committee's deliberations on universal service. I very much look forward to the witnesses who have joined us here today. And I want to join the chairman in thanking them for their participation. And I look forward to participating with the members as we make the changes which must be made while reserving our core principle of affordable service for everyone.

Thank you, Mr. Chairman.

Mr. UPTON. Thank you, Mr. Boucher.

Mr. Rush?

Mr. RUSH. Thank you, Mr. Chairman. Mr. Chairman, I join with my colleagues on the committee in applauding you for holding this hearing on universal services.

Oversight of universal service programs is critical for all parts of the country. And it is indeed important to residents of cities and suburbs. We contribute the lion's share of funding for this program. And it is important to rural America also to ensure that rural residents have access to quality affordable telephone services.

Seven years after the passage of the Telecommunications Act, the goals of the act remain the same to both reserve and advance universal services. However, the future of the fund is now in danger.

Mr. Chairman, since we passed the 1996 Telecommunications Act, the technological landscape has certainly drastically changed, never to return. We are now witnessing an explosion of wireless and internet technologies. And they're offering a bundle of services, which, in part, is great for the consumer but, on the other hand, has the potential to shrink the base of revenues for the universal service fund. This is, in part, due to the funding mechanism, which is totally reliant on interstate and international end user telecommunication revenues, thereby increasing the difficulty of identifying interstate revenues.

As we continue to fund notable programs, like the E-rate Program and the Rural Health Care Program, reform will be necessary to ensure the sustainability of the fund in the long term. That said, Mr. Chairman, I look forward to hearing the testimonies of our distinguished panelists, who offer proposals on how we can best restructure the universal service fund so that we can ensure that it is being used responsibly and fairly and that it indeed is fully funded.

Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. UPTON. Thank you, Mr. Rush. I know you are rooting for the Cubs tonight, too.

Mr. RUSH. I predict a victory, Mr. Chairman.

Mr. UPTON. For the Red Sox for Mr. Markey here. He will be here. He's at the health conference.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. BARBARA CUBIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WYOMING

Thank you, Mr. Chairman.

I would like to thank you for holding this hearing to examine the state of Universal Service, and jump-starting the effort to ensure the solvency of this important fund. We must make certain that the USF continues to assist rural and high cost communities—and low income Americans—stay connected in our modern world.

Being from a rural state, I can appreciate how difficult it is to provide ubiquitous, affordable phone service across states like Wyoming. Those who are fortunate enough to live in Wyoming, however, should not have the misfortune of exorbitant telephone rates. After all, a phone in New York City is worthless if there isn't anyone on the other end of the line.

We have come a long way from the initial concept of Universal Service, and the means of communication hardly resemble the rotary dial phone that I grew up with. With new and emerging technologies changing how we stay connected, there have also emerged new questions on how the USF should operate. For this to be an effective process, we need to assess the role of telecommunications providers regarding their obligations to the fund as well as examine who is receiving a subsidy from the fund. Spiraling contribution rates are not the sign of a balanced program. And no consumer wants to open his or her phone bill and see a regularly ballooning USF contribution.

I am certain that ensuring the solvency of the USF has as many different potential solutions as the witnesses we have testifying today—if not more. Hopefully, there are some common themes we can build upon and reach a consensus approach that will be widely supported throughout communities, the industry and Congress.

As a result of this hearing, I would like to learn from our panel just what changes they would propose to ensure the viability of Universal Service. I would also like to hear everyone's thoughts on how we arrived at this precipice . . . what went wrong?

We have a unique opportunity to take today's pending troubles with the fund and craft a common sense, dependable solution. One that had broad support and one that is rock-solid, so that we won't be holding a hearing a few more years down the road and asking, "What went wrong?" again.

Thank you Mr. Chairman, I yield back the balance of my time.

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Mr. Chairman, thank you for calling this hearing today. Universal service is a complicated, but important, topic, and this subcommittee needs to begin to understand its current status and what lies in its future.

Ensuring that all Americans have access to affordable telephone service has been an important public policy goal for more than fifty years. However, competitive forces created after the '96 Act have made the current system unsustainable. Unless key changes are made in the universal service regime, I fear that the fund will spiral out of control, and that many of our rural constituents, including those in my district in Louisiana, will be without affordable telephone service.

Competition has impacted universal service in three respects. First, competition among local exchange carriers for business and urban residential customers has eroded a primary source of implicit universal service funding for incumbent local exchange carriers (ILECs). Competition is great for consumers, but it requires changes in universal service policies.

Second, competition among technologies has begun to reduce the pot of money from which universal service derives its funding. People send emails rather than make long-distance phone calls. That drains revenues from interstate revenues. People use their wireless phones rather than wireline phones. And burgeoning technologies like Voice over Internet Protocol (VOIP) do not currently contribute to universal service funding.

Third, competition has begun among different services for universal service dollars. Wireless companies are beginning to use universal service funds to serve wireless carriers. And wireless companies are receiving universal service dollars even though a particular customer is still being served by a wireline company that uses universal service dollars. In addition, some people want to use universal service money to fund broadband in rural areas. This has greatly increased the demand on universal service money.

All of these competitive trends have put unprecedented pressure on the universal service program. The program needs to be modernized to reflect all of these trends.

I look forward to hearing the testimony of our witnesses today so that we can begin to educate members regarding different ideas for universal service reform. I hope this committee will engage in a vigorous debate about this issue and coalesce around a strategy for reform. I look forward to working with Chairman Upton, Mr. Dingell, and other interested parties to ensure that we bring long-term sustainability to the universal service program.

Mr. UPTON. We are delighted to have a distinguished panel with us this afternoon. And we are joined by Ms. Kathleen Abernathy, a commissioner of the FCC; Mr. Bob Rowe, Chairman of the Montana Public Service Commission; Mr. Billy Jack Gregg, Director of the Consumer Advocate Division, Public Service Commission of West Virginia; Ms. Margaret Greene, President of the Regulatory and External Affairs of BellSouth; Mr. Joel Lubin, Vice President of AT&T; Mr. Glen Post, Chairman and Chief Executive Officer of CenturyTel; Ms. Sid Shank, General Manager of Bloomingdale Telephone Company from the greatest city of Michigan; and Mr. John Stanton, Chairman and CEO of Western Wireless Corporation.

Ladies and gentlemen, your testimony has been made a part of the record in its entirety. We appreciate very much that you sent it up early so we had a chance to look at it last night, for me, my staff, and other members of the committee. It's made a part of the record.

We are going to try to limit your remarks to 5 minutes.

Ms. Commissioner Abernathy, we will start with you. Welcome back.

STATEMENTS OF KATHLEEN Q. ABERNATHY, COMMISSIONER, FEDERAL COMMUNICATIONS COMMISSION; BOB ROWE, CHAIRMAN, MONTANA PUBLIC SERVICE COMMISSION; BILLY JACK GREGG, DIRECTOR, CONSUMER ADVOCATE DIVISION, PUBLIC SERVICE COMMISSION OF WEST VIRGINIA; MARGARET H. GREENE, PRESIDENT, REGULATORY AND EXTERNAL AFFAIRS, BELLSOUTH CORPORATION; JOEL LUBIN, VICE PRESIDENT, AT&T CORPORATION; GLEN POST, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CENTURYTEL, INC.; SIDNEY SHANK, GENERAL MANAGER, BLOOMINGDALE TELEPHONE CO.; AND JOHN STANTON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, WESTERN WIRELESS CORPORATION

Ms. ABERNATHY. Thank you very much, Chairman Upton and distinguished members of the subcommittee. It is a pleasure to be here today. And I appreciate the opportunity to discuss the future of universal service. And I also applaud you for taking the time and energy to tackle this very difficult issue.

As pointed out by all of you, I think, the goal of providing high-quality telecommunications services to all Americans at affordable rates is a cherished principle in U.S. telecommunications policy and one of the cornerstones of the act. All too often, we forget that in the not too distant past, phone service was a luxury that few in rural America could afford. Today, however, universal service funding has guaranteed citizens throughout the country the ability to communicate at reasonable rates.

I know that every member of this subcommittee understands the importance of universal service. And as chair of the Federal-state joint board on universal service, I also make it a top priority.

My written statement provides details on the challenges confronting universal service and the various rulemaking proceedings that we have pending at the FCC. So what I thought I would do this afternoon is highlight two key issues identified in my written statement; first, the contribution methodology debate; and, second, the issues surrounding who qualifies for universal service support in areas served by rural telephone companies. I think everyone agrees that for universal service to remain vital, we must ensure that sufficient funds continue to flow into the system and that the funding burden is spread among contributors in an equitable and a nondiscriminatory manner.

The commission took some important steps last December to stabilize the universal service contribution factor in an effort to mitigate the growing funding burden on some consumers. But the existing regime remains in jeopardy for several reasons. And I believe that more fundamental reforms will be necessary to protect universal service in the long term.

I think, as anyone with a cell phone can attest, the telecom market has evolved away from reliance on traditional long distance service and toward new services, like wireless and e-mail and more recently voice over IP.

Since universal service funding comes only from interstate revenues and there is a Federal court decision that said the FCC is not permitted under section 254 of the act to assess intrastate revenues, then this continuing decline in interstate revenue base has forced the FCC to increase the contribution factor substantially to meet funding demands.

Another concern arises from the increasing prevalence of bundled service offerings. And I know a number of you mentioned that. While these bundles are great for consumers because they're convenient, they save us money, that's fine, but they also make it extremely difficult to identify that part of the bundle that is the interstate telecommunications piece.

Since the FCC's existing rules only allow us to assess contributions on the interstate minutes, somehow we have to try and isolate those revenues from the revenues that are generated from intrastate services or from other information services. At the same time, however, simple economics will likely lead carriers to attempt to minimize their contribution obligations by shifting revenues to categories of service that are not assessed USF obligations.

So how do we respond to these marketplace and technological changes? One option is for Congress to give the FCC the authority to assess contributions on both interstate and intrastate revenues. This total revenue assessment approach would be more predictable and would make it harder for carriers to shield some of their revenues in different categories.

In addition, however, the FCC is considering whether to adopt alternative contribution methodologies under our existing authority. So, for example, a system based on physical connections or assigned telephone numbers might be more stable than the revenue model we currently use. And proponents note that these alternatives would eliminate the need to consider this whole debate about interstate versus intrastate jurisdiction or telecom service versus information service monies. But these proposals, nevertheless, remain controversial, in large part, because they would shift contribution obligations away from long distance carriers and into the pockets of the LECs and the wireless carriers.

While universal service charges, as we all know, are ultimately passed through to consumers, industry segments, nevertheless, strive to minimize the charges on their own bills for competitive reasons.

Finally, the FCC has also sought comment on broadening the contribution base to include the telecom component of all broadband services, including both DSL and cable model services. Spreading the contribution burden across a broader base of services would necessarily drive down the USF charge imposed on any single service. Those are proposals that are currently in front of us.

Now, apart from the contribution methodology, the other primary source of instability in the universal service regime is the support mechanisms for those carriers that serve rural America. This component has grown substantially over time. And this increase in demand for funds when combined with the decreasing revenue base is responsible for the fact that we now have a contribution factor that is approaching double digits.

Another funding issue that has received particular attention is the intersection of competition and universal service in rural areas. While new competitors, including wireless providers, currently receive a very small percentage of overall USF support, their share has been growing rapidly along with a surge in applications to become eligible telecom carriers who were entitled to support.

This trend, together with the fact that incumbent carriers do not lose any support if a customer switches to a competitor's service, suggests that rule changes may be necessary to avoid placing unreasonable strains on the overall high-cost support mechanisms. And, therefore, the FCC has asked the USF joint board to consider a variety of issues relating to the designation of competitive ETCs and the manner in which all ETCs receive support.

In closing, while universal service is facing a number of challenges, I am confident that with your help and your guidance and the commitment of the FCC, that we will be able to ensure the sustainability of the various support mechanisms. We have initiated the necessary rulemaking proceedings. Together I think we can respond to the challenges ahead.

And I want to thank you for the opportunity to testify. And I look forward to answering any questions you may have. Thank you.

[The prepared statement of Kathleen Q. Abernathy follows:]

PREPARED STATEMENT OF HON. KATHLEEN Q. ABERNATHY, COMMISSIONER, FEDERAL COMMUNICATIONS COMMISSION

Good afternoon, Chairman Upton and distinguished members of the Subcommittee. I appreciate the opportunity to appear before you to discuss the challenges confronting universal service and the FCC's efforts to preserve and advance this critical policy objective.

The goal of providing high-quality telecommunications services to all Americans at affordable rates is a cherished principle in U.S. telecommunications policy and one of the cornerstones of the Telecommunications Act of 1996. I know that every member of this Subcommittee understands the importance of universal service, and, as Chair of the Federal-State Board on Universal Service, I make it a top priority to ensure that the federal support mechanisms fulfill their objectives.

The 1996 Act directed the FCC to promote two key goals that at times appear to be in tension with one another: opening local markets to competition and preserving universal service. The prior monopoly environment enabled regulators to promote universal service by building implicit subsidies into local and long distance rate structures. In a competitive environment, however, these implicit subsidies cannot be sustained, since the rates that provided surplus funds—such as business rates in urban areas—are undercut by new entrants and eventually driven down to a cost-based level. Congress accordingly directed the FCC to adopt explicit support mechanisms that would be sufficient to ensure that rates remain affordable and reasonably comparable throughout the nation. In response, the FCC developed several explicit support mechanisms for carriers that provide service in high-cost areas. High-cost support will total approximately $3.3 billion in 2003.

The 1996 Act also expanded the scope of universal service by directing the Commission to establish support mechanisms for schools and libraries and for rural health care facilities. The schools and libraries program (often called the E-Rate program) provides up to $2.25 billion in annual support and has enabled millions of school children and library patrons to gain access to advanced telecommunications and Internet services. While the rural health program generally has been underutilized, the FCC is considering a variety of measures to strengthen it, as discussed below.

In addition to the high-cost support mechanisms and the programs supporting schools, libraries, and rural health clinics, the FCC's Lifeline and LinkUp programs provide discounts off monthly service charges and connection fees to ensure that low-income consumers have access to basic telephone service. This year, these programs will provide approximately $691 million in support.

All of these programs promote the universal service goals set forth in section 254(b) of the Act, including the availability of quality services at affordable rates; access to advanced services in all regions of the Nation; comparable access to telecommunications services for all consumers, including low-income consumers and those living in rural, insular, and other high-cost areas; and access to advanced services for schools, libraries, and rural health care facilities. Shortly after Congress's enactment of the 1996 Act, the FCC adopted rules regarding the collection and distribution of universal service support. Now, with several years of experience under our belts, we are engaged in a reexamination of many aspects of the program to ensure that each component is administered as efficiently and effectively as possible and that the overall program remains sustainable. A host of marketplace and technological developments have already prompted some course corrections, and may ultimately cause us to reassess certain fundamental policy choices made in the initial implementation period. As we engage in this review, our commitment to preserving and advancing universal service remains unwavering.

I describe below some of the challenges confronting universal service and the efforts the FCC has underway to ensure that each component of the universal service program remains faithful to the principles set forth in section 254 of the Act. These proceedings aim to improve and strengthen all of our support mechanisms, and therefore will benefit consumers in high-cost areas, families with low income, and patrons of schools, libraries, and rural health care facilities. In my opinion, the FCC will soon need to revise its rules regarding the collection of funds and their distribution through the various support mechanisms. I will begin with the contribution methodology and then discuss issues pertaining to the distribution of support.

CONTRIBUTION METHODOLOGY

The Commission collects funds for the various universal service support programs pursuant to section 254(d) of the Communications Act. Service providers must pay a percentage of their revenues from interstate end-user telecommunications services to the Universal Service Fund. This percentage fee, called the contribution factor, changes on a quarterly basis depending on the demand for funding and the base of reported revenues. The current contribution factor is 9.5 percent.

Several trends have combined to put upward pressure on the contribution factor, which in turn has increased the funding burden on some consumers. While long distance revenues grew between 1984 and 1997, they have since been flat or in decline as a result of price competition and substitution of wireless services, e-mail, and, more recently, Voice Over Internet Protocol (VOIP) services. Because federal universal service contributions under existing rules are assessed only on *interstate* revenues from end-user *telecommunications services*, this shrinking of the applicable revenue base has contributed to a steady rise in the contribution factor over time—it has increased by more than six percentage points over the last six years. While the contribution factor for the fourth quarter of this year will be 9.2 percent, the slight reduction from the current factor likely represents a one-time reprieve resulting from an earlier over-collection, considering that the reported revenue base remains in decline.

Another important trend has been the increasing prevalence of bundled service plans. For years, wireless carriers have offered buckets of any-distance minutes at flat rates, and now wireline carriers are offering packages including local and long distance for a single price. In addition, many carriers offer business customers bundles that include local and long distance voice services, Internet access, and customer premises equipment. Such bundling has been a boon for consumers but has made it difficult to isolate revenues from interstate telecommunications services. And the problem is likely to get worse as bundling becomes more and more popular.

In December 2002, the Commission adopted a number of measures to stabilize the universal service contribution factor in an effort to mitigate the growing funding burden on consumers. For example, the Commission increased from 15% to 28.5% the safe harbor that wireless carriers may use to determine the interstate percentage of their revenues. The Commission also eliminated the lag between the reporting of revenues and the recovery of contribution costs, which lessened the competitive disadvantages facing long distance carriers with sharply declining revenues. And the Commission prohibited mark-ups of contribution costs on customers' bills to ensure that carriers cannot profit from inflated line charges.

While these were important steps, I believe that more fundamental reform will be necessary to ensure the sustainability of universal service funding in the long term. Bundling together interstate and intrastate services—and telecommunications and information services—gives carriers the opportunity and incentive to understate the portion of their revenues that are subject to assessment and increases the difficulty of identifying interstate revenues. Contribution factors therefore are likely to continue their ascent under a contribution methodology based on interstate telecommunications service revenues.

For this reason, the Federal-State Joint Board has recommended that Congress amend section 254 to provide the FCC with authority to assess intrastate revenues, in addition to interstate revenues. A total revenue assessment would be far lower and more stable than one based solely on interstate revenues, and, just as importantly, it would prevent carriers from avoiding their contribution obligations by allocating revenues to the intrastate jurisdiction.

In addition, the Commission has been considering whether to make substantial changes under its existing statutory authority. The Commission has sought comment on alternative methodologies based (in whole or in part) on end-user connections or assigned telephone numbers, because such approaches arguably would create a more sustainable model for funding universal service in the future. The number of end-user connections has been more stable than the pool of interstate revenues, and connection-based charges can be adjusted based on the capacity of each connection to ensure an equitable distribution of the funding burden among business and residential customers. Moreover, proponents of a contribution methodology based on telephone numbers (with connection-based charges for high-capacity business lines) argue that it would not only be more stable but also promote number conservation. Critics of these proposals—including carriers that would face increased assessments based on connections or telephone numbers—argue that reducing the contributions of long-distance carriers (which have very few assigned telephone numbers or end-user connections) would violate the statutory requirement that all carriers contribute on an equitable and nondiscriminatory basis.

Finally, the Commission also has sought comment, in the Wireline Broadband NPRM, on whether all facilities-based providers of broadband services should be subject to the same contribution obligations. While a total-revenue methodology or one based on end-user connections or telephone numbers would address problems arising from the blurring of the line between interstate and intrastate telecommunications services, such changes would *not* necessarily broaden the contribution base to include all broadband transmission services and new services such as VOIP. The Commission accordingly sought comment on whether or not to change the contribution pool to include new services that currently are not assessed. Regardless of whether such services are classified as telecommunications services or information services, section 254 gives the FCC permissive authority to assess contributions on "telecommunications," which underlies both types of services.

DISTRIBUTION OF SUPPORT

The steady increases in the contribution factor have resulted not only from the shrinking of the interstate revenue base, but also from the significant increases in the demand for funding. Much of the increased demand has resulted from the FCC's reform of interstate access charges: Many incumbent LECs now recover from the

Universal Service Fund costs that previously were recovered from long distance carriers. In addition, the increasing entry of wireless carriers and other competitors as eligible telecommunications carriers (ETCs) has raised questions about the long-term sustainability of the high-cost support mechanisms. Demand growth has been less of an issue with respect to the mechanisms that support schools and libraries, rural health clinics, and low-income consumers, but I describe below the FCC's recent initiatives to revise those programs to ensure that they remain efficient and effective.

HIGH-COST SUPPORT

1. ETC/Portability Issues

Before enactment of the 1996 Act, only incumbent LECs received universal service support. In recent years, however, wireless carriers and competitive LECs have been designated as ETCs. While competitive ETCs receive a very small percentage of high-cost funds overall, their share has been increasing dramatically in recent months along with a surge in the number of ETC applications. Competitive ETCs receive support under the "identical support" rule (also called "portable support"), which provides per-line support based on the incumbent ETC's costs. Incumbents do not lose support when a competitive ETC captures lines; rather, both carriers receive universal service funding. Rural LECs have argued that this regime creates uneconomic arbitrage opportunities and threatens the viability of universal service, while competitive ETCs generally contend that providing identical support—whether based on the incumbent LEC's embedded costs or based on forward-looking economic costs—is essential to competitive neutrality.

In November 2002, the Commission asked the Federal-State Joint Board to consider the intersection of competition and universal service in rural areas. The Joint Board subsequently sought comment on several key issues, including the manner in which competitive ETCs receive support and the impact of providing support to competitive ETCs on the growth of the universal service fund. The Joint Board also sought comment on the process for designating ETCs and whether the FCC should establish guidelines for consideration by the state commissions that make these determinations under section 214(e)(2). In July, the Joint Board held a public forum on these issues, and a wide range of industry representatives, consumer advocates, and state commissioners provided valuable insights.

Parties advanced a variety of proposals in their comments and at the public forum. Several groups of incumbent LECs argue that competitive ETCs should receive support based on their own embedded costs. Some competitive ETCs argue that incumbents and competitors should receive support based on forward-looking economic costs. To control growth, some parties advocate capping support upon entry of a competitor and dividing the funds pro-rata based on the percentage of lines each carrier serves; other parties advocate supporting only a single connection per household (current rules do not limit the number of wireline or wireless connections that are funded). Incumbent LECs generally oppose these proposals, arguing that reforming the ETC-designation process—in particular, making the public interest analysis more exacting—would suffice to keep the Universal Service Fund from growing too large.

The Joint Board is now considering the record and plans to provide a recommended decision to the FCC as expeditiously as possible.

2. Support for Non-Rural Carriers

While the rural high-cost support mechanism provides the lion's share of the funding—and correspondingly has received most of the attention—"non-rural" carriers (the Bell operating companies and other relatively large LECs) also receive high-cost support. Whereas rural carriers receive support based on their embedded costs, non-rural funding is determined based on forward-looking economic costs. Non-rural carriers receive support in a particular state if the statewide average cost per line, as determined by a computer cost model, exceeds the national average cost by a certain margin. Currently, non-rural carriers receive support in eight states (Alabama, Kentucky, Maine, Mississippi, Montana, Vermont, West Virginia, and Wyoming). While non-rural carriers in other states serve many high-cost wire centers, their *statewide average* costs are not sufficiently high to receive support. Moreover, rural carriers receive substantial support in each of the states for which non-rural support is unavailable.

I understand that this Subcommittee is considering legislation that would alter the distribution of non-rural support. The Commission is nearing completion of its own review of this support mechanism in response to a remand by the Tenth Circuit Court of Appeals. The court ruled that the Commission did not adequately explain how the non-rural support mechanism is sufficient to enable states to set affordable rates that are reasonably comparable in both rural and urban areas. In addition, the court directed the Commission to consider how to induce states to develop their own support mechanisms to fund high-cost areas within their borders, since the federal mechanism aims primarily to mitigate cost differentials among the states. The Joint Board issued its recommendations last October, and the Commission will complete its consideration of these issues next month.

LOW-INCOME SUPPORT

A separate component of the federal universal service program is the low-income support mechanism, Lifeline/LinkUp. These programs provide funding that enables low-income consumers to receive discounts on monthly service and installation charges. An additional layer of discounts is available for eligible consumers living on Indian tribal lands. Earlier this year, the Joint Board released a Recommended Decision on proposals to bolster the effectiveness of Lifeline and LinkUp. This Recommended Decision suggests new ways for low-income consumers to qualify for support and also addresses questions regarding states' efforts to engage in outreach and to verify program eligibility. The goal of the pending rulemaking is to remove impediments to beneficiaries' receiving support while simultaneously preserving the integrity and enhancing the efficiency of the program.

SCHOOLS AND LIBRARIES AND RURAL HEALTH CARE FACILITIES

Finally, the Schools and Libraries support mechanism (E-Rate) and the support mechanism for rural health care facilities provide additional support that enables these institutions to receive discounts on basic and advanced telecommunications services (as well as internal connections in the E-Rate program). Now that the Commission has had significant experience overseeing these programs, we are considering a variety of rule changes in pending rulemaking proceedings. These proceedings, like the Lifeline/LinkUp rulemaking, aim to eliminate red tape while ensuring continued program integrity.

In particular, the Commission will soon consider an Order that would modify the rural health care mechanism. This support mechanism has been underutilized, so the notice of proposed rulemaking sought comment on ways to alter eligibility requirements to eliminate obstacles to rural health clinics' receiving support, while remaining faithful to the statutory purposes. Facilitating telemedicine by connecting rural health clinics to regional hospitals and universities has always been an important goal, and it takes on added importance in light of the increased threat of bioterrorism.

Taken together, the reforms being considered by the Commission should ensure the continued vitality of the federal universal service support mechanisms. The Commission has no higher priority than delivering on the promise of ubiquitous, high-quality, and affordable services. I would like to thank you, Mr. Chairman, for calling this hearing, and I look forward to working with you and other members of the Subcommittee on these challenging and critical issues.

Mr. UPTON. Thank you very much.

Mr. Rowe, welcome.

STATEMENT OF BOB ROWE

Mr. ROWE. Thank you. Mr. Chairman, members of the committee, I am Bob Rowe. I am Chairman of the Montana Commission, also a member of the Federal-state board on universal service. I am speaking here today entirely in my own capacity.

I join in commending you for holding this terribly important hearing. I am very honored to be sitting here between two good friends of mine and with this very distinguished panel. I am going to speak fast, like a Yankee, to stay within my timeframe.

This program does face real crucial and time-sensitive challenges. All of you in your opening statements did a superb job laying out what those challenges are.

I am actually more optimistic now than I have been in years that we are going to really get at this and make progress. I am optimistic based on the experience we have had and the appreciation by industry and consumer groups, by the FCC, the joint board, and by Members of Congress that we have to act quickly and we have to act wisely because the risk of failure is so high. And, again, I think your thoughtful and intellectually diverse opening statements coupled with the great work being done on the Senate, led particularly by Senator Burns and Senator Dorgan, really can give us some optimism that we can get it right.

I start with two basic questions. The first question is, is universal service the problem or the solution as the saying goes? I would argue that section 254 may be the most successful part of the Telecommunications Act. And as I drive around Montana, as I visit other States every day, I appreciate the successes of all four elements of the Universal Service Program.

In my testimony, I describe, in particular, some of the good work being done by the rural independents and cooperatives in Montana, deploying really remarkable services in very tough-to-serve, very costly to serve areas. Consistent with Mr. Cox's point, most of the services, the advanced services they provide, aren't funded directly by universal service, but the network over which both basic and advanced services typically are provided is supported in part, the loop and the switch elements, by universal service. That's the no-barriers base approach.

There are good things happening in rural America. And those are very much associated with the success of the Universal Service Program.

The second basic question, are we more concerned about supporting individual customers or supporting a network? My answer is both. In my testimony, I discuss the key role of support to individuals, but I also describe the history of universal service coming out of the system that was put in place over the Twentieth Century to support the network with payments back and forth between carriers. This system was modified, became more complicated after the breakup of AT&T, and was again modified after the 1996 act, particularly through creation of the CALLS and MAG Programs. So, again, we're supporting both networks and being mindful to the needs of individual customers, who take service over those networks.

In terms of what is driving growth in the fund, I include some charts provided by NECA at the back of my testimony. Two key factors in recent years: first, again, the movement away from intercarrier payments or so-called implicit support to explicit support. An enormous amount of the growth in the fund is the result of the CALLS and MAG Programs putting money explicitly on universal service-type payments.

The second issue—it's a new issue in the last several years, but it's growing—is, of course, the relatively rapid uptake of competitive eligible telecommunications providers, particularly but not entirely, wireless. And, again, I go into that in more detail in my testimony.

What are the issues? In my written testimony, I describe in more detail issues in the contribution area. I think others will go into those in some detail, lay out the alternatives. I have been on record since actually 1996 in supporting an assessment on all telecommunications revenue. That's not the only solution, but it is a good solution.

Telecommunications revenues are increasing. Interstate revenues are declining. That is one solution. It is a solution addressed in a letter the joint board sent to Senator Burns earlier this year.

The second set of issues has to do with eligibility. The third set has to do with the cost basis for payment. Both of these complicated sets of issues are being addressed by the joint board right now. And I'm encouraged that we are going to make some progress.

In the large company area that a number of the members discussed,—and by "large company," I am referring to large companies, the Bell companies, that serve rural America—I have two concerns. The first has to do with the hybrid cost proxy model that is the basis for determining costs by these companies. There are fundamental problems with that model. I have certainly addressed it with the FCC. And they are issues that the FCC commissioners are mindful of.

The second is that the payment, the statute that you passed says rates and services in rural and urban America are to be reasonably comparable. The standard adopted by the FCC addressed by the court in the Tenth Circuit and then ultimately proposed for some modification by the joint board instead compares rural costs to a National average. And there is a very big difference between a National average and an urban average.

The final set of issues I address is whether there should be further modification of inter-carrier payments. I know a number of people on the panel will speak to that issue. My concern is that to the degree that issue was addressed, that the particular effects on the rural carriers be factored in. They are, if anything, more dependent upon so-called access revenue and have less ability to average that revenue somewhere else if it goes away. If it is replaced with universal service-type funds to some extent, that again puts more pressure on the funds. So you have to have a robust base. But we have to understand what we are doing there.

In my testimony, I recommend basically a three-part approach. The first, I do think focused legislation would be very helpful. And, again, both you and your colleagues in the Senate are looking at that. Second, I think the joint board with congressional oversight will make progress on the so-called portability issues having to do with contribution and eligibility. And, third, to the degree that we are going to address inter-carrier payments, I think we need a very structured, a very rigorous approach to do that.

We spend our days in the weeds, in the details of this. From your opening statements, you know the details very well as well. But ultimately your job is to basically provide a beacon to us to get us out of the woods and back on the path to making this program the success that you intended it to be.

Again, when I drive around Montana, look at the telemedicine facilities, the great facilities being deployed in schools and libraries as well as the basic high-cost fund programs, I am optimistic. And I recognize that this is an important program. Once you modify the program, I think we need to do so in light of its successes and in light of the critical place that you in passing the act gave it.

Thank you very much, Mr. Chairman.

[The prepared statement of Bob Rowe follows:]

PREPARED STATEMENT OF BOB ROWE, CHAIRMAN, MONTANA PUBLIC SERVICE COMMISSION

Mr. Chairman and Members of the Committee, I am Bob Rowe, Chairman of the Montana Public Service Commission, and a member of the Federal-State Joint Board on Universal Service. I am speaking only on my own behalf. I commend you for holding this important and timely hearing. I am truly honored to be here.

Real challenges face the federal universal system, as they do the entire telecommunications sector. However, I have perhaps more optimism now about the ability to address the challenges facing universal service than I have in quite some time.

Why am I optimistic? Experience and an appreciation of the risks of failure to act wisely have made the discussion of universal service issues more informed and constructive. I credit that to hard work among industry and consumer stakeholders, to an engaged and effective Joint Board and FCC, and to leadership by Congress. More on that later.

My testimony will briefly cover the following areas:

1. Several basic questions about universal service.
2. Factors driving the past and future growth in the fund.
3. Summary of current key issues in universal service.
4. Narrow versus broad approaches to issue resolution.
5. The critical role of Congress.

I will conclude by suggesting a combination of measures, including strong and continuing Congressional oversight. These suggestions build in part on approaches developed throughk the Universal Service Summits convened by Senators Burns and Dorgan, along with focused legislation in several areas, especially contributions to support universal service. I also suggest for consideration a possible approach to addressing difficult issues in intercarrier compensation.

A. SEVERAL BASIC QUESTIONS ABOUT UNIVERSAL SERVICE.

Two questions seem especially important to me, and help shape the solutions we craft:

1. Is universal service the problem or the solution?
2. Is universal service best understood mainly as a support system for customers or for networks that serve customers?

Is universal service the problem or the solution?

It is disturbingly easy to encounter those who believe that the universal service system is itself "the problem," especially the high cost fund portion. I believe that the programs embodied in Section 254 may perhaps be the Telecommunications Act's most tangible success. Each of the four programs—high cost fund, schools and libraries, rural telemedicine, and lifeline-link-up—has produced real achievements. In particular, the high cost support programs have allowed service providers to maintain their networks while keeping rates affordable.

Universal service really is working in Montana. The seventeen rural carriers have built high quality networks capable of supporting a wide range of services. They have deployed DSL in 183 rural communities, including remote, low income areas such as Crow Agency on the

Crow Reservation.[1] Rural carriers have formed consortia to provide switched ATM backbone and to provide at least 123 state-of-the-art video studios (Vision Net, Mid-Rivers and Range) for everything from distance learning to supporting local businesses. Every Native American Indian Reservation in Montana has, for example, at least one video studio operated by Vision Net. Most of these efforts are not supported by universal service,[2] but the high cost fund has helped pay for the critical local network facilities over which all these services originate and terminate, facili-

[1] All four of the Project exchanges on the Crow Reservation have DSL. Exchanges with as few as seventy lines have been provisioned with DSL.

[2] For example, universal service does not support transport, which can be a key cost driver for everything from connecting remote households [Joint Board Recommended Decision, Released July 10, 2002 (FCC 02J-1), Bob Rowe Separate Statement Concurring in Part Dissenting In Part (pp. 43-53)], to getting broadband traffic back to the Tier 1 Internet [Victor Glass, "NECA Rural Broadband Cost Study: Summary of Results," June 21, 2000; Victor Glass, "Rural Realities: Will rural dwellers be forgotten in the broadband boom?" July 15, 2002].

ties on which services such as DSL are directly deployed.[3] A map of facilities deployed by rural Montana carriers is attached to this testimony.

The other programs supported by universal service have also produced real successes.[4]

The very high level of service provided in some of the nation's most challenging areas shows that the program is successful and important. Essential reforms should be built upon this foundation.

Support for customers or for the network?

Many still argue that the existing high cost support system should be replaced with one that makes payments to individual customers, as does the current Lifeline program. Congress resolved this issue in the 1996 Act, saying that rates and services should be reasonably comparable between urban and rural or insular areas, not customers. It is worth noting, however, that factors such as small local calling areas in many rural areas (compared to the hundreds of thousands who may be within an urban local calling area make rural customers' total phone bills higher than urban customers' even where the nominal local exchange rate is lower. Moreover, non-metropolitan status correlates very closely with low per capita income. I offer two examples:

1. InterBel Telephone Cooperative serves about 3110 access lines in several small communities in Northwest Montana. The residential and business basic exchange rates, including the Subscriber Line Charge, are $18.50 and $26.20. Without universal service support, these figures would be $81 higher each month. The per capita income in Eureka is $12,619[5]. For the State of Montana as a whole the per capita income was $17, 151.
2. If it were not for universal service support, local rates on the Crow Reservation could be as high as $60 for residential customers and $70 for business customers. Per capita income on the Crow Reservation was $9,440 dollars in 1999, with 21.8 percent unemployment.

Getting services to customers at affordable and comparable rates is obviously a fundamental goal. However, we must also remember that existing universal service arrangements arose out of the system of payments created over the years to pay for building, maintaining, and operating the "network of networks" that served most telecommunications carriers and most of their customers. Initially, most of this occurred by the independent companies allocating some of their costs to the interstate jurisdiction. These costs were then recovered through the "settlements" between AT&T and the independent carriers.[6] With divestiture, this system was modified to incorporate "access payments" by the inter-exchange carriers to the local carriers, to support the local network required by IXC customers to originate and terminate long distance calls. This has been compared to "rent" paid for use of the local networks. The FCC created a variety of programs to support specific services, such as high-cost loops and switches deployed by smaller carriers. At the same time, a portion of the "non-traffic sensitive" costs were moved to end user payments, and the "subscriber line charge" (SLC) was created.

After passage of the 1996 Act, even more costs where shifted to end users, as the FCC tried to make "implicit" support explicit (at least as to interstate costs), to lower interstate access charges, and to move more "non-traffic sensitive" costs to end users. The CALLS (Coalition for Affordable Local and Long Distance Service) program for large companies and the MAG (Multi-Association Group) program for small companies are the prime examples.

As will be noted below, a network focus, in addition to a customer focus, helps provide analytical clarity, sheds additional light on one of the key cost drivers (further replacement of access by universal service type payments), and helps focus the discussion about what services should be covered by universal service. This history shows that one cannot understand universal service solely as a program for reducing customers' rates. Equally important, it has been used as a method of financing the construction of quality plant in high-cost areas.

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[3] .Support for the loop has also likely allowed carriers to allocate more resources for advanced services deployment than otherwise would have been the case.

[4] On June 9, 2003, the FCC issued a Notice of Proposed Rulemaking, requesting comments on a Joint Board recommendation concerning the Lifeline and Link-up programs.

[5] U.S. Census Bureau, 2000 Census.

[6] The initial "Ozark Plan," following out of the 1934 Act, was driven by the distance traffic had to be hauled and the hold time for interstate calls, and resulted in as much as 85 percent of costs being assigned to the interstate jurisdiction for some rural carriers. From 1981 to 1997, the interstate allocation of loop costs was gradually moved to a uniform 25 percent.

B. FACTORS DRIVING GROWTH IN THE FUND.

High cost loop support was capped by the FCC in 1994. The cap was intended to be temporary, while universal service was "reformed." Instead the cap has remained in place, although modified when the FCC adopted recommendations of the Rural Task Force. The attached tables and charts were provided by NECA [7] at my request.

Illustration 2 summarizes the current elements of universal service. Rural health care ($20 million per year), and the Lifeline and Link-up programs for low income customers ($741 million) are by far the smallest components. The Schools and Libraries program is substantial, but has been capped at $2.25 billion since 1997, and therefore is not a driver of current fund growth. Programs comprising the High Cost Fund are projected to total $3.4 billion for 2003. Illustration 3 shows the growth in total high cost fund support since 1998, roughly a doubling in size.

Illustration 4 shows growth in the High Cost Fund from 1998 through 2003, by components. The most significant increases in recent years, by far, have resulted from two similar decisions. First, the "CALLS" plan adopted by the FCC caused a roughly $650 million increase in the high cost fund. This new money limits how much SLC charges may increase in rural areas as a result of the decision to reduce access payments paid to price cap regulated (mainly large) ILECs. Then, the "MAG plan" as adopted by the FCC, created a similar support plan, the Interstate Common Line Support (ICLS) program for rate-of-return regulated (mainly small) ILECs. This program now costs about $425 million per year. These two programs, costing more than $1 billion per year, were designed to reduce interstate access charges.

Other factors have also caused costs to increase.[8] Illustration 5 shows estimated ILEC and Competitive Eligible Telecommunications Carrier (CETC) funding, annualized, based on third quarter, 2003, numbers. ILECs will receive $3.41 billion this year. CETCs will receive $251 million. Recent analysis indicates this figure may be exceeded.

Illustration 6 shows the growth in the number of CETCs and funding from the third quarter of 2002 to the third quarter of 2003. There were 30 CETCs in the third quarter of 2002, and 165 one year later. CETCs received $56 million (1.8 percent of the fund) in 2002 and $ 252 million (7.3 percent of the fund) one year later. It is generally agreed that there is substantial potential for further growth from CETC certification.

C. SUMMARY OF ISSUES IN UNIVERSAL SERVICE.

1. Contributions.[9] Currently, universal service is supported by an assessment on interstate revenue. The FCC has made several adjustments to the contribution base (most notably increasing the portion of wireless revenue assumed to be interstate and therefore subject to the assessment from 15% to 28.5% and basing assessments on prospective revenues). As a result, the assessment has temporarily stabilized at slightly above nine percent. However, most observers expect this to be a temporary reprieve from an increasing assessment on a decreasing base. Alternatives proposed by various parties include:

a. Per connection assessment;
b. Capacity based assessments;
c. Per-telephone number and number equivalent assessments; and
d. Modifications to the revenue-based approach either by:
   i. *broadening* the base to include more services (such as broadband services in addition to DSL), or by eliminating the wireless "safe harbor," or
   ii. *Deepening* the base to allow assessment for the federal fund to be based on intrastate as well as interstate revenue (with a similar modification for state funds).

[7] NECA operates the various intercarrier rate pools, conducts economic and technical analysis, and provides other services to the telecommunications industry. It does not take positions on policy issues. Use of this material does not constitute an endorsement by NECA for any position in this testimony. This information was derived by NECA from reports filed with USAC and other publicly-available information.

[8] Loop support increased due to regulatory changes resulting from MAG and RTF implementation, where the cap was increased and the payment calculation modified to incorporate growth in the number of loops and in DGP-CPI.

[9] The "contribution" issue was not referred by the FCC to the Joint Board. However, the Joint Board did hold a public meeting on the subject June 21, 2002, and state members did submit two sets of comments to the FCC, most recently on May 20, 2003.

Most of these proposals have been subjected to criticisms based on possible illegality under Section 254 as interpreted by the courts[10]; administrative workability, fairness, or other grounds. Most current attention is focusing either on the number and number-equivalent approaches (developed most thoughtfully by FCC Commissioner Martin), or on expanding the revenue base to include more telecoms revenue. Notably, the federal and state members of the Joint Board submitted a letter to Senator Burns stating that deepening the base to include intrastate revenue was a workable option.[11]

It has also been suggested that Congress clarify that any of the approaches are acceptable, based on a determination by the FCC, thereby eliminating any possible legal barrier to an approach determined most workable by the Commission.

2. Eligibility.[12] The Joint Board is currently examining numerous questions regarding carrier eligibility for universal service support. What standards should "competitive eligible telecommunications carriers" (CETCs) have to meet in order to be certified by a state commission or the FCC under Section 214, especially in areas served by rural carriers? Should the FCC adopt a set of standards applicable to currently-certified ETCs and CETCs alike? Should this issue continue to be left to the state commissions? Should the FCC set a floor, with state commissions able to build on this floor? Could a set of wireless-appropriate standards be developed? Could a "best practices" or model standards for state commission consideration be developed? Are there relevant differences between wireline CETC applicants (often rural overbuilders) and wireless CETC applicants? Is there a risk of diminished quality if one set of carriers faces a lower standard than does another? How should state commissions evaluate the "public interest" component of the current statutory standard, and should they consider the effect on the federal fund of multiple ETC designations?

3. Cost basis for payment. Currently, all "nonrural" companies, including all the Bell Companies, receive support based on forward looking costs, determined through the FCC's Hybrid Cost Proxy Model (HCPM). Small companies receive support based on embedded (historical) costs. CETCs receive support based on (and on a per-line basis identical to) the support of the incumbent for whose area the competitive carrier is granted ETC status. The Joint Board is currently considering a number of issues here as well. For example, should the CETC receive payment based on the incumbent's costs, or on its own costs, and should those be forward looking or embedded? Given concerns about the HCPM, should it ever be used for rural carriers, and should it continue to be used even for large carriers?

4. Large Company Issues. The 10th Circuit Court of Appeals remanded to the FCC its "large company" Ninth Report and Order.[13] In turn, the FCC referred this issue to the Joint Board, which issued a recommendation on October 16, 2002. The Joint Board suggested several modifications, which the FCC is now considering. The FCC's order is expected soon. In my opinion, the combination of an imperfect cost model[14] with the formula used to award support does result in significant under-

[10] See, *Texas Office of Public Utility Counsel v. FCC,* 183 F. ed 393 (5th Cir. 1999), prohibiting assessment of intrastate revenues to support the Schools and Libraries program. Others have suggested that a per-connection or per-telephone number approach would not comply with the statute that requires all interstate carriers to contribute, or would not be equitable and nondiscriminatory. See 47 U.S.C. Section 254(d).

[11] Letter dated May 19, 2003, Attachment 1. While the state members of the Joint Board endorsed this approach, it is likely to be strongly opposed by a number of state commissions.

[12] Eligibility-related and cost and payment issues were included in the "portability" referral from the FCC to the Joint Board. The Joint Board held a very productive en banc hearing in Denver on July 31, 2003, and is currently considering comments. This proceeding also concerns specific issues such as whether support should be limited to a "primary line," and how primary line would be defined.

[13] *Qwest Corp. v. FCC,* 258 F.3d 1191 (2001). The FCC's order was challenged by Maine, Vermont, and Montana, as well as by Qwest. The court held, inter alia, that the FCC did not provide an adequate explanation for its decision that the non-rural mechanism in the Ninth Report and Order achieved the statutory principles in Section 254; that the FCC failed to define the key statutory terms "reasonably comparable" and "sufficient"; that it did not adequately explain the 135 percent of national average funding benchmark.

[14] Montana, Maine, and Vermont have repeatedly urged the FCC to address problems with inputs, formulas and maintenance of the model, but have generally been frustrated in their attempts to obtain critical information about the model. See, letter to the FCC from counsel for the Vermont Public Service Board, September 12, 2003 (Attachment 2). Possible problems include but are not limited to assuming that cabling runs on straight compass lines, underweighting the cost of traveling over mountains or rivers; apparently ignoring physical barriers such as highways or railroads; apparently not accounting sufficiently for physical barriers such as shallow bedrock or rocky soil; not accounting for increased maintenance cost in snowy regions; inconsistently treating broadband facilities.

Continued

funding to areas served by the largest companies. This includes many states in the west, but also New England states such as Maine and Vermont (a rural state in which 85 percent of lines are served by Verizon).[15] In my dissent to the Joint Board recommendation, I argued that Section 254 requires that rates and services in rural and insular areas be "reasonably comparable" with rates and services in urban areas. Comparing rural rates[16] with a national average and then providing support only for costs exceeding 135 percent of the national average falls far short of this clear directive. A rural or insular area might be required to have rates or costs as high as 165 percent of the urban average cost before it would be eligible for support under the current system.

5. Covered services. The Joint Board is required periodically to review the list of services eligible for support, and recommend changes. "On July 10, 2002, the Joint Board recommended that the list remain unchanged on July 10, 2002 [Recommended Decision, Release Date (FCC 02J-1)]. The FCC issued an order adopting that recommendation on July 14, 2003. In that proceeding, I dissented in part, suggesting that a focus on support for the network over which most services are provided would be a more reasonable approach than attempting to evaluate specific services. For example, the primary requirement for DSL service (or similarly, high speed wireless service) is a robust network, with clean loops. This is consistent with the "no barriers" approach advocated by the Rural Task Force.[17]

6. Further modification of inter-carrier compensation systems. Many carriers, including but not limited to the largest ILECS and the IXCs, argue that further modification of inter-carrier compensation is required because of a variety of threats to the current system. The full scope of the problem is being identified only now, including through specific data requests by the FCC. It is abundantly clear, however, that rural carriers are much more dependent on access payments than the larger carriers. "Bill-and-keep" approaches are especially problematic for small carriers because they lack the ability to average costs over a larger area and the current pooling mechanisms function like high-cost support but are vulnerable if bill-and-keep is adopted. Also, intrastate access may eventually be as significant a concern as interstate access. If universal service support is further substituted for access payments, the upward pressure on the fund could be tremendous.

A. NARROW VERSUS BROAD APPROACHES TO ISSUE RESOLUTION.

Generally, one group of stakeholders prefers focusing on a particular issue, principally stabilizing the revenue base. Another group argues that a comprehensive approach is required, one that addresses all issues as part of the same package. The narrow approach is advocated based on feasibility, and the urgency of the contributions issue. The broader approach is advocated based on the desirability of addressing all related issues, especially including intercarrier payments, in a consistent manner, and that does not risk making decisions on narrower issues that may limit the ability to address the larger issues. Some have said that it is unwise to resolve contributions issues without also addressing eligibility issues at the same time.

A reasonable middle approach might be: 1. to move forward with a focused approach to the contributions issue, including legislation; 2. to address the portability issues through the ongoing Joint Board process, with Congressional oversight; and

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In the 10th Circuit litigation, Qwest mounted an unsuccessful general challenge to the use of forward looking cost models for universal service purposes. Based on several years of experience, one wonders how a court would view under Section 254 the model as implemented and maintained. The Congress could instruct the FCC, if it continues to use cost models, to adequately staff and maintain the model, and to document and publicly disclose all modifications to it.

[15] Only eight states receive high cost fund support under the large company program. Qwest serves fourteen states, including twelve of the fifteen least densely populated states, but receives high cost fund support for only two states: $10.307 million per year for Montana and $7.243 million per year for Wyoming. (It must be noted that many of the highest cost areas within those states are served by rural carriers.) Verizon will receive $9.259 million per year in high cost model support in Vermont and $5.529 million per year in Maine [based on 4th quarter 2003 projections by USAC].

[16] Or costs, as there are many variables in rate comparability, including but not limited to the size of the local calling area, how costs are assigned to different rate elements, the depreciation rates assumed, and so on.

[17] The Rural Task force recommended to the Joint Board and the FCC a "no barriers to advanced services" policy, including universal service support for plant that can (as built or with the addition of elements) provide access to advanced services; encouraging carriers to remove infrastructure barriers to such access; and, sizing the federal universal service fund so that it does not present barriers to investment in plant needed to provide access to advanced services. See, Joint Board's Recommended Decision concerning covered services, Separate Statement of Commissioner Rowe, Sections IV and V (July 10, 2002), pp. 47-52.

3. to address intercarrier payments through a rigorous, structured approach. For consideration, I suggest exploring a structured, analysis-based approach to resolving intercarrier payments concerns. We can learn some positive and negative lessons from "alternative dispute resolution" efforts such as CALLS, MAG, Rural Task Force, and the Qwest Multi-state Section 271 collaboratives. Such a process would require effective participation by all affected, especially the small carriers who are especially vulnerable to changes in access revenue. It would likely benefit from a high degree of transparency and independent facilitation; it should have access to sound and extensive analysis. Its decision rules and eventual deliverable product (e.g., a recommendation to the FCC, along with any dissents) should be clear. It would be difficult to achieve a rigorous outcome based purely on consensus. Therefore, it might be desirable for the facilitator to be charged as an arbitrator or decision-maker. As noted before, revision of intercarrier compensation has strong implications for universal service, and also potentially implicates the process of jurisdictional separations.[18]

B. THE CRUCIAL ROLE OF CONGRESS.

Throughout implementation of the Telecommunications Act, Congressional oversight has been valuable, and has been appreciated by all of us concerned with day-to-day implementation. It's easy for us to get lost in the forest, and Congress regularly provides a good beacon guiding us back to the main path.

I particularly commend to you the unique efforts of your Senate colleagues. As you know, Senators Burns and Dorgan, with strong support from Senators Stevens, Rockefeller, and others have convened two Summits. I was privileged to help moderate these two sessions. They were unique: The Senators sat at the table with a very broad spectrum of stakeholders, participating in a very lively give-and-take, furthering everyone's understanding,

and significantly clarifying the issues and options. No stakeholder perspective that asked to participate was excluded. (Reporters and investment analysts were not invited in until the end of the meeting, but were then free to talk to participants.) The Senators, of course, will decide what they do with this input. I commend this process to you, and urge you to discuss the results with your colleagues in the Senate. Specific options include formal oversight proceedings, a Sense of the Congress resolution on several key topics, and specific legislation, focused on issues including the contribution base.

C. CONCLUSION.

When I drive across Montana or other rural areas, when I see a rural telemedicine facility, when I'm in a school where students are learning on-line, I recognize universal service as a rip-roaring success. The programs included in universal service do face significant challenges. Some of those challenges are especially time-critical. All stakeholders desire a greater degree of certainty as they plan how to meet their customers' demands. Modifications should be designed to preserve what works, and to achieve Congress's vision in the remarkable language of Section 254.

[18] The separations process identifies and assigns costs to the interstate and intrastate jurisdictions, and matches those costs with cost recovery. A separations process of some sort is required when a provider of telecommunications service is regulated by two jurisdictions at once. Smith v. Illinois, 282 U.S. 133 (1930).

ILLUSTRATION 1

MONTANA RURAL CARRIER DEPLOYMENT

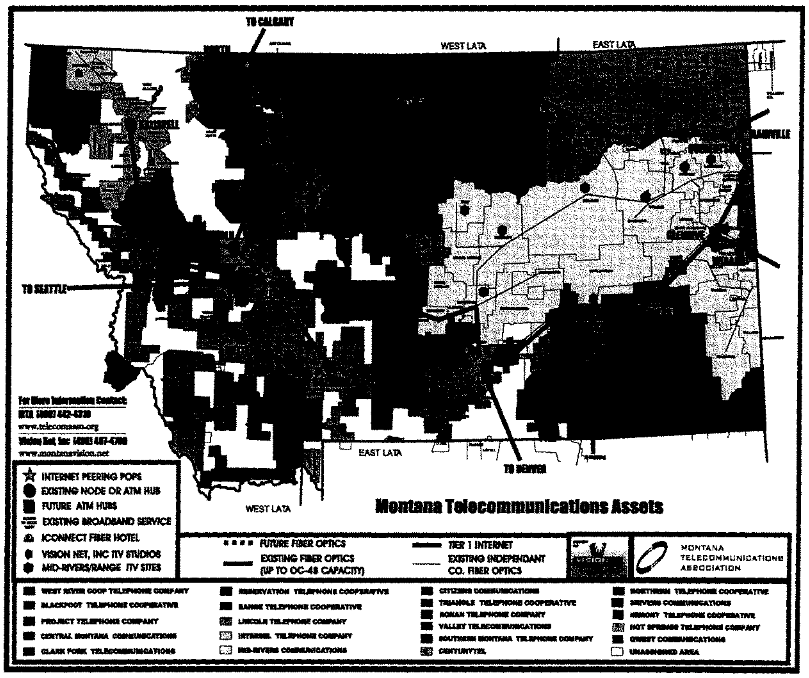


ILLUSTRATION 2

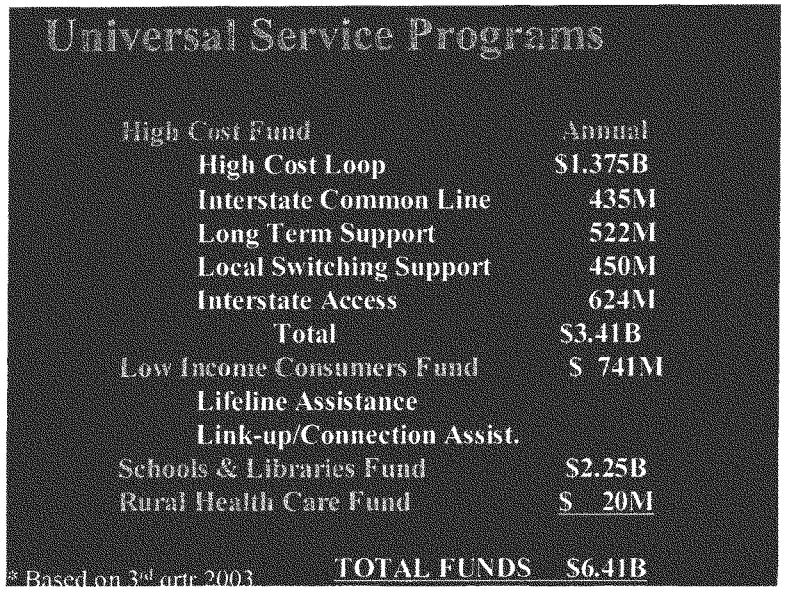


ILLUSTRATION 3

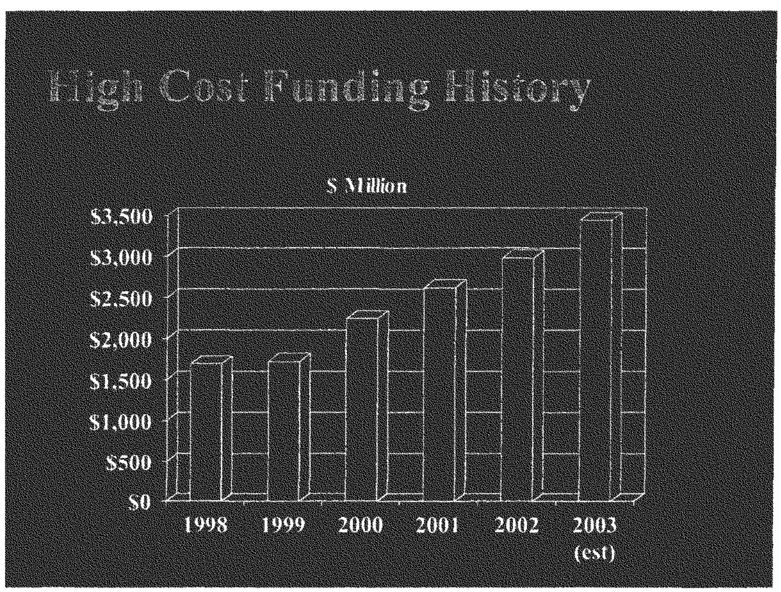


ILLUSTRATION 4

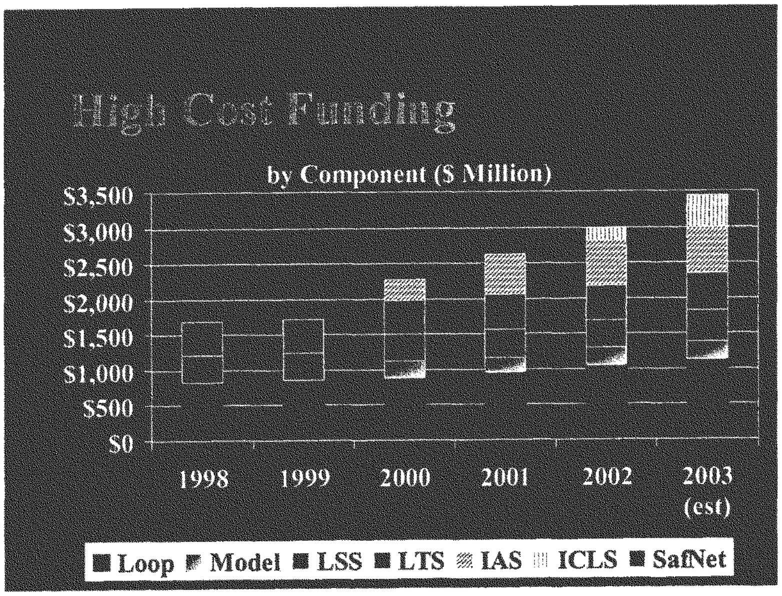


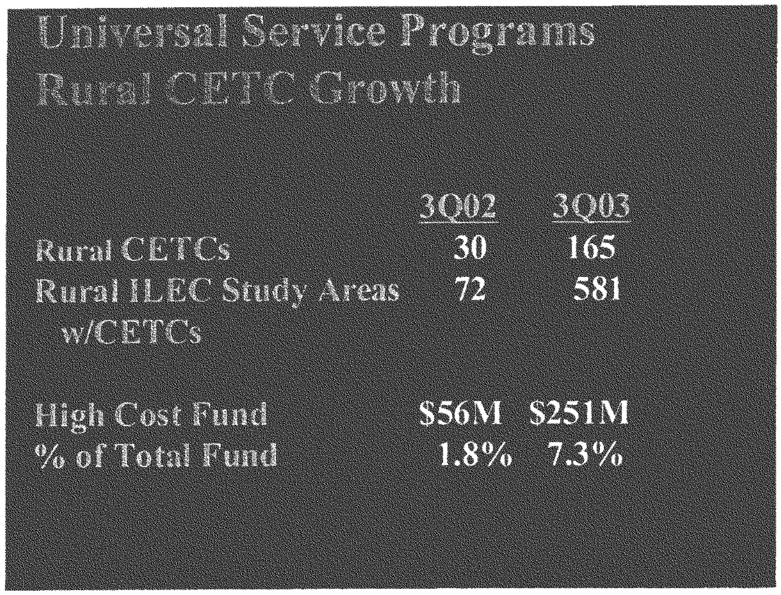
ILLUSTRATION 5

High Cost Fund ILEC/CETCs

High Cost Fund	ILEC	CETCs
High Cost Loop	$1.375B	$107M
Interstate Common Line	435M	$39M
Long Term Support	522M	$43M
Local Switching Support	450M	$39M
Interstate Access	624M	$22M
Total	$3.41B	$251M

* Based on 3rd qrtr 2003

ILLUSTRATION 6



Attachment 1
Joint Board Members Letter to Senator Conrad Burns Concerning Universal Service Support

FEDERAL STATE JOINT BOARD ON UNIVERSAL SERVICE
445 12TH STREET, S.W.
WASHINGTON, D.C. 20554

May 19, 2003

The Honorable Conrad Burns
187 Dirksen Senate Office Building
United States Senate
Washington, DC 20510

Dear Senator Burns:

The members of the Federal-State Joint Board on Universal Service greatly appreciate your taking time to meet with us on April 21, and we are writing in response to your request that we suggest legislative changes to strengthen the federal universal service support mechanisms. We also include a brief summary of ongoing efforts by the FCC and the Joint Board to use existing statutory authority to promote the goals you identified, including ensuring that support is distributed equitably, efficiently, and with adequate oversight. We share your commitment to preserving and advancing universal service, and we thank you for the opportunity to work with you on this critical public policy objective.

We are pleased to offer two informal legislative suggestions, but we note that the Joint Board has not had an opportunity to seek public comment on any proposals. And although three federal Commissioners serve on the Joint Board, the full Commission has not had a chance to provide its views on the issues we raise below.[19]

Our principal suggestion for your consideration concerns the FCC's authority to assess contributions for the federal universal service mechanisms. As you have recognized, universal service can be sustained over time only if a stable and broad contribution base is available. The FCC's limited authority to assess contributions presents a significant obstacle to achieving this goal. Although the FCC initially determined that it had jurisdiction to require contributions based on the provision of interstate *and* intrastate services, the U.S. Court of Appeals for the Fifth Circuit later held that the Commission may impose fees only based on *interstate* services.[20] In recent years, the pool of interstate revenues has been on the decline, and demands for high-

[19] In addition, while individual members of the Joint Board may have additional recommendations for legislative action, the Joint Board unanimously supports the two suggestions discussed below.
[20] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999).

cost support have steadily increased. As a result, the universal service contribution factor has climbed rapidly and now exceeds 9.1 percent. This percentage almost certainly will continue to rise going forward.

Granting the FCC explicit authority to assess contributions based on interstate *and* intrastate revenues would yield substantial benefits. Most importantly, the much broader contribution base would dramatically lower the contribution factor (from 9.1% to less than 3%, based on current funding needs). Consumers presumably would find the lower assessment rate less objectionable, even if overall contributions remain the same. Consumers also might find it less confusing to pay a USF surcharge on all revenues rather than on interstate revenues only, given the greater fluctuations in long-distance calling and the seeming arbitrariness of contributing based on some telecommunications services but not others. Moreover, as the marketplace continues to evolve towards bundled service offerings that include local and long-distance services at a flat rate, a total-revenue assessment would eliminate the difficult task of calculating the portion of such bundles that should be assigned to the interstate jurisdiction.

If Congress were inclined to adopt such a proposal, we believe it could be accomplished through minimal textual changes. Section 254(d) could be amended as follows:

> Section 254. Universal Service.
> * * *
> (d) Telecommunications carrier contribution
> **Notwithstanding the provisions of Section 152(b) of this Title**, ~~E~~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. 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.[21]

In addition, Congress might also wish to consider a minor modification to the Communications Act to address the Government in Sunshine restrictions as applied to the Joint Board. The Joint Board conducts numerous conference calls and meetings, and at least one of the three FCC commissioners must be absent at all times. As you witnessed at our April 21 meeting, this restriction makes it difficult for the Joint Board to conduct its business. We believe that the Joint Board could significantly improve its deliberative processes if Congress clarified that the Government in Sunshine restrictions were not intended to apply to the participation of the three FCC commissioners in the activities of the Joint Board. Specifically, the new language could specify that matters before the Joint Board do not become "official agency business" prior to the adoption of a Recommended Decision by the Joint Board, or that FCC commissioners

[21] Alternatively, the introductory clause could be omitted if Congress amended section 152(b) to include an exception cross-referencing section 254(d).

deliberating in their capacities as Joint Board members are not conducting or disposing of Commission business.

Finally, we wish to emphasize that, even if Congress chooses not to amend the statute, we remain firmly committed to doing everything in our power to advance the policies embodied in section 254. The Commission is considering changes to its contribution methodology under existing authority (the state members of the Joint Board have provided input in this proceeding, but the Joint Board has not been asked to provide a formal Recommended Decision). The Commission and Joint Board also are reviewing each of the support mechanisms to ensure that funds are disbursed in an equitable and efficient manner and to develop additional means of rooting out waste, fraud, and abuse. We briefly summarize these efforts below.

First, the Commission and Joint Board are reviewing the high-cost support mechanisms to ensure the sufficiency and sustainability of funding. The Joint Board has commenced a critical proceeding, in which we recently received opening comments, focusing on the intersection of competition and universal service in rural areas. Parties were asked to comment on several aspects of the process for designating competitive carriers as eligible telecommunications carriers ("ETCs"), including whether the FCC should establish guidelines for consideration by the state commissions, which generally make these determinations under section 214(e)(2) of the Act. The Joint Board's public notice also sought comment on the manner in which competitive ETCs receive support (often called the "portability" of support), the consequences of supporting multiple lines per household, and the overall impact of supporting multiple ETCs on the growth of the universal service fund. The Joint Board plans to hold a public forum on July 31, 2003, to hear more about portability from interested parties, including rural LECs, wireless carriers, competitive LECs, and others.

The Commission also is considering two Joint Board Recommended Decisions issued in 2002 pertaining to high-cost support.[22] One recommendation concerns the core services that are funded by the federal support mechanisms. Supported services include voice-grade local service, access to 911, access to interexchange services, and other basic local services. The Joint Board recommended preserving the status quo, and the FCC will release an order in response to that recommendation by mid-July. The other recommendation concerns the "non-rural" support mechanism, which provides funding to the Bell carriers and other large LECs to the extent they serve high-cost areas. In 2001, the U.S. Court of Appeals for the Tenth Circuit held that the FCC did not adequately explain how this support mechanism would ensure that states are able to set affordable rates that are reasonably comparable in both rural and urban areas. In particular, the court directed the Commission to consider how to induce states to develop their own support mechanisms to fund high-cost areas within their borders, since the federal mechanism aims primarily to equalize cost differentials *among* the states. The Joint Board suggested ways to respond to the court's concerns, and the Commission will complete its consideration of these issues by October.

Second, the FCC is taking steps to improve the efficiency, effectiveness, and

[22] We note that some members of the Joint Board have dissented from part or all of each Recommended Decision.

accountability of the support mechanisms for schools and libraries, rural health care facilities, and low-income consumers. On April 23, the Commission adopted an order that makes several important changes to the schools and libraries ("E-Rate") program. The Commission both eliminated unnecessary impediments to the flow of support to deserving applicants and complemented existing measures to combat waste, fraud, and abuse. The Commission also sought further comment on the waste, fraud, and abuse issues and held a public forum on May 8 to discuss concrete proposals to close any loopholes that may permit wasteful spending.

The Commission's pending rulemaking on the support mechanism for rural health care facilities likewise seeks to eliminate obstacles to legitimate funding requests without sacrificing cost-effectiveness. As the Notice of Proposed Rulemaking recognized, facilitating telemedicine by connecting rural health clinics to regional hospitals and universities takes on added importance in light of the increased threat of bioterrorism.

Lastly, the Commission is reviewing the low-income support mechanisms, Lifeline and LinkUp, with an eye toward cutting red tape and ensuring adequate oversight and accountability. The Joint Board released a Recommended Decision last month containing suggestions for modifying the eligibility rules and outreach mechanisms, as well as proposals to prevent waste, fraud, and abuse.

In closing, we reiterate our eagerness to work with you and the Telecommunications Subcommittee to strengthen universal service, including through the legislative process, where necessary. We look forward to continuing the dialogue we have started and welcome any questions about our legislative suggestions or ongoing rulemaking proceedings.

Sincerely,

Kathleen Q. Abernathy
FCC Commissioner

Nanette Thompson
Commissioner, Regulatory Commission of Chair of

Federal-State Joint Board Alaska

State Chair of Joint Board

Kevin J. Martin
FCC Commissioner

Thomas Dunleavy
Commissioner, New York Public Service Commission

Jonathan S. Adelstein
FCC Commissioner

Billy Jack Gregg
Director, Consumer Advocate Division
West Virginia Public Service Commission

Lila A. Jaber
Chairman, Florida Public Service Commission

Bob Rowe
Chairman, Montana Public Service Commission

ATTACHMENT 2
LETTER FROM COUNSEL FOR THE VERMONT PUBLIC SERVICE BOARD CONCERNING COST MODEL ISSUES

September 12, 2003

VIA ELECTRONIC FILING
Marlene H. Dortch, Secretary
Federal Communications Commission
Office of the Secretary
c/o Vistronix, Inc.
236 Massachusetts Avenue, N.E., Suite 110
Washington, D.C. 20002

Re: CC Docket No. 96-45

Dear Ms. Dortch:

On September 11, 2003, Joel Shifman, Senior Advisor to the Maine Public Utilities Commission (Maine PUC), Peter Bluhm, Director of Regulatory Policy of the Vermont Public Service Board (Vermont PSB), and I had a teleconference with Christopher Libertelli, Senior Legal Advisor to Chairman Powell, on issues related to universal service support for Vermont and Maine costumers.

In particular, Vermont and Maine complimented the Wireline Competition Bureau on its efforts to improve the model, document versions of changes, and move to a systematic change management system where all changes would be documented and published in releases. However, Vermont and Maine expressed concerns that the information that they had requested to identify all changes to the model structure and inputs made since the Staff began "updating" the model still had not been provided. Vermont and Maine stressed the importance of identifying each change made to the model so that they could evaluate the appropriateness of the change and determine the impact of the change on their customers' support levels. Without this information, they would not be able to assess whether the FCC's method for determining support was reasonable.

The FCC's recent request for comment on whether it should eliminate special access lines as inputs illustrated the problem. Vermont and Maine asked the Bureau to provide information that it had generated showing the impact of removing special access lines. The Bureau refused to provide this information. It was impossible for Maine and Vermont to calculate the impact themselves for several reasons. Outside parties do not have a model version that includes all the changes and "corrections" that the FCC staff has made. Also, parties have to run results for the whole country to determine a revised nationwide average before they can identify the impact on any one state. Running the model in this way takes several days and requires several banks of computers. When the Bureau refused to provide the information, Vermont and Maine asked several larger carriers for their results. While other carriers had the resources to run the model with the changed inputs, their results varied from carrier to carrier. In fact, the carriers' data runs inexplicably had produced widely different results, illustrating the instability of the model. Therefore, Vermont and Maine were unable to determine the impact and could not file comments. Unless the Bureau develops a model release that produces consistent and reliable results when run by all parties, it is impossible for parties to determine with any certainty what the results will be.

Vermont and Maine expressed continuing interest in working with the Bureau to make the USF support/model process more open and simpler. This would include advance notice and an opportunity for third parties to verify effects of changes before they were formally adopted. Overall, Vermont and Maine said they are interested in achieving: 1) a theoretically sound method of delivering support that is predictable and stable; 2) an open process that allows changes to the model and inputs to be objectively evaluated based on common assumptions; and 3) sufficient support so that rates charged in Vermont and Maine are reasonably comparable to rates charged in urban areas of the country. Vermont and Maine continued to express concern that their support has changed due to undocumented/unreasonable changes in the model, even though their costs have not changed materially.

Pursuant to Section 1.1206 of the Commission's rules, this letter is being electronically filed with your office. If you have any questions concerning this submission, please contact the undersigned.

Sincerely,

Elisabeth H. Ross
Attorney for the Vermont Public Service Board

Mr. UPTON. Thank you, Mr. Rowe.
Mr. Gregg?

STATEMENT OF BILLY JACK GREGG

Mr. GREGG. Thank you, Mr. Chairman. May it please the committee, I am Billy Jack Gregg. I am Director of the Consumer Advocate Division of the West Virginia Public Service Commission.

Prior to addressing issues related to the long-term sustainability of the universal service fund, I think it is important that we review where we are today with the universal service fund. Since 1996, when section 254 of the act was passed, the fund has grown from $1.8 billion to $6.2 billion for this year, 2003.

$6.2 billion sounds like a lot of money, and it is. But we have to put it in perspective. Last year the telecommunications industry had total revenues of over $230 billion. That means that by collecting and redistributing less than 3 percent of the total telecom revenues in this Nation, we have been able to keep phone service affordable in all areas of our Nation. We have allowed phone service to be affordable to low-income individuals. We have assisted rural health care providers. And we have wired all of our schools and classrooms to the internet. That is quite an accomplishment and something that all of us involved in universal service should be quite proud.

Moreover, every State and every territory of this Nation benefits from universal service. I have attached to my testimony as attachments 1 and 2 printouts from USAC's annual report for 2002, which shows payments under each support mechanism to each State on both a total basis and ranked by total receipts and on a per-line basis and ranked on a per-line basis.

In response to the statements from some of the members today, I think it is important to see that when you look at the high-cost fund, every State and every territory has received benefits from the high-cost fund alone except the District of Columbia because it does not have any high-cost areas. Otherwise, every State from the Northern Mariana Islands to Delaware to Montana to Wyoming to West Virginia all receive high-cost support.

The universal service fund has been one of the great public policy successes of this country for the last 100 years. The issues we are talking about today is, how do we sustain that success into the future? And, as has been mentioned by the members and the first two speakers, we have to look at both sides of the equation: the income for the fund and the outgo from the fund.

In terms of the contribution base, I would just ratify what my fellow members on the joint board, Ms. Abernathy and Mr. Rowe, said, we have to expand the base for universal service. The joint board has previously sent a letter, as Mr. Rowe said, to Senator Burns suggesting very targeted, very focused legislation that would give the FCC the authority to assess on all revenues and all services. Since all benefit from universal service, all should contribute. It's a very simple proposition.

On the outgo side, the most important thing we can do is target the high-cost support to fulfill the principles that are laid out in section 254. And I believe that there are three very basic measures that can be accomplished by the FCC to focus the support of the high-cost fund.

No. 1, we need to limit support to a single line per household. Right now under current rules, all lines supplied by all eligible telecommunications carriers are eligible for support. A household that has two land lines and three cell phone lines would receive support for each of those lines. I believe that that is excessive. If you limit it to a single line, we would get back to the original purpose, which was to provide comparable services at comparable rates.

Second, we need to reform the basis of per-line support to be based on each carrier's own cost. Right now they are based on the cost of the incumbent carrier. We believe that if you adopt this procedure, it should be capped at the incumbent's level of support to prevent any windfall to any competitor.

And, finally, we believe that the FCC should adopt guidelines for the States in making public interest determinations for eligible telecommunications carriers. I believe that those guidelines should be based on very simple support guidelines. Those areas that are truly costly to serve, where it makes no sense to have more than one subsidized carrier, are the ones that would be targeted.

I propose $20 and $30 guidelines. Above $20 per line per month, those study areas should be allowed one additional eligible telecommunications carrier, those eligible to receive universal service funding. Above $30 per line per month, only one eligible telecommunications carrier would be allowed.

About half of the rural study areas would be encompassed by those guidelines, but they only serve 1.7 percent of the access lines in this Nation. Yet, they receive 45 percent of total high-cost support. They are the truly small high-cost areas. And there should be some limitation on subsidization of competition in those areas.

I want to thank you again for the opportunity to appear here. And I look forward to the other statements.

[The prepared statement of Billy Jack 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 Utility Consumer Advocates (NASUCA), an organization of 43 state utility consumer advocate offices from 41 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.[1] 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 sustainability of the Federal Universal Service Fund (USF).

I. BACKGROUND

The most important issue facing the Federal Universal Service Fund is its long-term sustainability. We must ensure that the USF is sufficient, predictable and affordable for all parties involved: fund recipients, telecommunications providers and

[1] In most respects, my testimony reflects the positions taken by NASUCA, although there are some areas where NASUCA has not yet reached a consensus position.

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 Joint 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 $6.2 billion during 2003. 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 $230 billion. By annually collecting and redistributing less than 3% 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 Attachments 1 and 2.[2] 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.

II. THE FUNDING BASE

As I mentioned earlier, total funding for the USF has grown from $1.8 billion to $6.2 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 contribution base 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.[3]

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.[4] Since that time the contribution base for the USF has been limited to only interstate and international revenues. As the USF has grown in order to meet the Act's direction that support be sufficient and explicit, and as the interstate revenue base has leveled off, the assessment rate has increased rapidly.

Attachment 3 shows the change in USF funding since 1997, along with changes in the interstate revenue contribution base for the USF.[5] 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 $6.2 billion this year. 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

[2] Attachments 1 and 2 show actual disbursements to states during 2002 under each of the federal USF support mechanisms. Attachment 1 ranks the states based on total support received. Attachment 2 considers the number of access lines in each state, and ranks the states based on monthly support received per line.

[3] As a practical matter, virtually all telecommunications carriers provide some sort of interstate service.

[4] *Texas Office of Public Utility Counsel v. FCC,* 183 F.3d 393 (5th Cir. 1999) at 448.

[5] Through 2002 the interstate revenue base for a particular year represents revenues reported from the previous year. The USF assessment rate shown on Attachment 3 is not the actual rate used in any quarter, but is derived by dividing annual funding by the annual interstate revenue base. The interstate revenue base for years 1998-2003 comes from USAC reports. The interstate revenue base for 1997 is estimated. Beginning in the second quarter of 2003, assessments are based on projected collected revenues.

rate, from 5.7% in the fourth quarter of 2000 to 9.5% in the third quarter of 2003.[6] A universal service fund which cannot depend on the stability of its funding base is not predictable, is not sufficient, and is clearly not sustainable.

III. ALTERNATIVES FOR THE CONTRIBUTION BASE

There are several alternatives available in order to stabilize the USF contribution base. One alternative would be to retain the current system, but remove restrictions in current rules which artificially depress the existing interstate revenue contribution base. One such restriction is the so-called "safe harbors" which limit the contribution responsibility of certain classes of carriers. Beginning in the second quarter of 2003, the FCC raised the safe harbor for wireless carriers from 15% to 28.5%.[7] However, in spite of these changes the interstate revenue base continues to decline.

Another restriction limits the contributions from broadband providers, one of the fastest growing areas of telecommunications. Under current rules, providers of broadband by means of digital subscriber line (DSL) service must contribute to the fund, while cable modem service providers are exempt. It is obvious that such an inequitable and artificial system of assessment on similar services cannot be maintained. However, proposals to eliminate the inequity by eliminating contributions from DSL providers would only further shrink the interstate contribution base.

A second 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 4 is a comparison of changes in the universal service fund, the interstate revenue base, and total telecommunications revenues from 1997 to 2003.[8] As you can see, total telecommunications revenues would provide an adequate 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 discussing this issue today. The growth in the fund could have been accommodated while keeping the assessment rate below 3%.

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.[9] 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," currently exempt from USF assessment.[10] Finally, the impact of the use of total revenues on state universal service programs is unclear.

A third alternative would be to base assessments on connections to the public switched telephone network, or on assigned telephone numbers. The FCC is currently considering several such proposals. While these connection-based or numbers-based proposals do enlarge the base of the USF, and minimize problems with classification of services or revenues as information services, they do have several flaws: (1) each proposal radically shifts the funding of the USF among industry groups; (2) each proposal appears to exempt pure providers of interstate long distance from making any contribution to the fund in contravention of the plain wording of Section 254(d); (3) each proposal requires capacity-based connection equivalents for high-capacity customers; and (4) each proposal shifts responsibility for payment of USF charges from high-use to low-use customers.

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[6] These increases have been flowed through to most customers by means of line items. Beginning in the second quarter of 2003, carriers can no longer mark up these assessments, but can only flow through the assessment rate approved by the Commission.

[7] Under the "safe harbor" provisions, a wireless carrier can claim that 28.5% of its total revenues are interstate without further documentation. A wireless carrier claiming a smaller percentage of interstate revenues must have adequate documentation to back up such a claim.

[8] On Attachment 4 USF Funding and the Interstate Revenue Base are taken from USAC reports. The Total Revenue Base is taken from the FCC's Telecommunications Industry Revenues reports. The funding base for 1997 is estimated. Beginning in the second quarter of 2003, the USF funding base has been based on carriers' projected revenue collections.

[9] On May 19, 2003, the members of the Federal-State Joint Board on Universal Service sent a letter to Senator Conrad Burns of Montana suggesting legislative changes to enable the FCC to use a total revenue base for universal service contributions.

[10] It should be noted that the FCC already has the discretionary power under 254(d) to require contributions from any other provider of interstate telecommunications "if the public interest so requires."

A final alternative, which my office has proposed to the FCC, would be a hybrid of the proposals described above. For example, the Commission could continue to base 50% of the universal service assessment on interstate revenues, and assess the remaining 50% on end-user connections to the public switched network. Such a hybrid would not require a statutory change and would ensure that all providers of interstate services, even those that did not provide end-use connections, would continue to contribute to support universal service. In addition, this 50/50 hybrid approach would mitigate impacts on low-usage customers, and result in contributions from various industry sectors that are very close to those produced by use of total telecommunications revenues.

In finding a solution to the contribution base problem, I agree with Senator Stevens of Alaska who said last spring: "All companies that use the network, in my judgment, should contribute to universal service, regardless of the type of service they provide." [11] I believe we must expand contribution responsibility to encompass all revenues and all services that connect to the telecommunications network. Since all benefit, all should contribute.

IV. ISSUES RELATED TO PARTICULAR SUPPORT MECHANISMS

In looking at the long-term sustainability of the fund, we need to focus not only on broadening the contribution base, but also on controlling and focusing the funds paid out for the individual support mechanisms which make up the overall USF. Each of these support mechanisms presents unique issues which will have to be resolved. Even though many have argued that we must stabilize 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, amounting to $3.3 billion this year. Of this amount, approximately $800 million goes to non-rural companies, while $2.5 billion goes to rural carriers.[12]

As shown on Attachment 3, total high-cost support has grown by over $1 billion since 2000. Most of this increase is the result of three new mechanisms which have been added to the fund: high-cost model support, interstate access support, and interstate common line support. These new funds have helped adapt the USF to the introduction of competition by making support explicit and portable. However, the continued growth in the high-cost fund has added to the unrelenting pressure on the assessment rate which must be paid by all consumers.

Earlier this year, the FCC referred to the Joint Board a number of issues related to the growth of the high-cost fund. These issues include determination of how many lines to support, the cost basis of per line support, and whether guidelines should be adopted for state eligible telecommunications carrier (ETC) determinations.

1. Limitation of Support to a Single Line Per Household

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 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. However, rather than competing for universal service support, all ETCs that provide service receive support in equal per line amounts for all lines that they provide to a home or small business. 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.[13] As a result, the potential exists for a large increase in the high-

[11] TR Daily, March 26, 2003.

[12] The term "rural carrier" is defined at 47 U.S.C. 153(47). Generally, rural carriers are small carriers serving rural and high-cost areas, while non-rural carriers tend to be larger carriers, such as the regional Bell operating companies. There are approximately 80 non-rural carriers which serve 90% of the access lines in the nation, while the 1400 rural carriers serve the remaining 10%.

[13] Under the example provided above, if the per line support in the wire center was $10 per line per month, the incumbent ETC would receive $20 (2 X $10) per month in support. Once the wireless ETC began providing the three wireless "lines," the wireless carrier would receive $30 (3 X $10) per month for providing service to the same household. However, the incumbent's support would not be reduced. Thus, the USF would be obligated to pay out $50 per month in

cost fund as more and more carriers—especially wireless carriers—attain ETC status.

It is estimated that during 2002, support for secondary lines amounted to $336 million, or 11.5% of the entire high-cost fund. Moreover, support paid to wireless carriers represents the fastest growing component of secondary line support. As shown on Attachment 5, high-cost support for wireless carriers has grown from $500,000 in 1999 to approximately $120 million in 2003.

If the high-cost fund is going to continue to provide affordable access in all parts of the country, then it cannot continue to subsidize the unlimited desires of each individual. I believe that federal USF support should be limited to a single line for each household,[14] and that the choice of which carrier receives USF support should be left to each customer. This would mean that carriers would have to compete for the USF subsidy. This will increase customer benefits and stabilize the federal high-cost fund. Individual states should be free to subsidize additional lines if they so choose.

2. Determination of the Cost Basis of Per Line Support

As I previously mentioned, the current high-cost system bases per line support on the costs of the incumbent carrier, and offers this support to all ETCs serving the same area. This is true even when competitive carriers—such as wireless carriers—may have costs that are substantially less than the wireline incumbent. Another means of limiting the growth of the high-cost fund would be to use each carrier's own costs as the basis for per line support. In order to ensure that no carrier receives an unwarranted windfall from USF support, support to competitors should be capped at the per line support received by the incumbent.

3. Guidelines for ETC Public Interest Determinations

Under Section 214(e) of the Act, two different standards were adopted for designation of ETCs, depending on whether an area is served by a rural or non-rural incumbent carrier. For areas served by non-rural carriers, the Act mandates that states must designate additional carriers as ETCs if they can provide all of the supported services[15] and advertise the availability of those services throughout the service area. However, for areas served by rural carriers, states may designate additional ETCs, and must first find that it is in the public interest to do so.[16]

Unfortunately, there are currently no standards to guide states' determination of the "public interest" under Section 214(e) of the Act. As a result, state ETC determinations in rural study areas have varied widely in terms of conditions which must be met by carriers prior to and after ETC designation. In many states the obligations on competitive ETCs are less than those imposed on incumbent ETCs.

Almost every party agrees that one of the purposes behind Section 214(e) was to allow states to identify those areas where it was so costly to serve, that it made no sense to have more than one subsidized carrier. However, since states have no responsibility for funding the federal USF, and under current rules additional ETCs mean more federal USF money coming into the state, it is very difficult for states to find that it is not in the public interest to designate additional ETCs in rural areas. This is true regardless of the cost to serve any particular area.

I believe the FCC should establish guidelines for the public interest determination. The guidelines should allow states to level the playing field among ETCs by requiring all ETCs to offer an unlimited local calling plan, equal access to long distance carriers, and a comparable monthly price for local service. ETCs should also be required to follow the same consumer protection rules, including billing and collection rules, that apply to incumbents.

In order to provide guidance to the states in identifying those areas where there should be a limit on the number of subsidized carriers, I believe the FCC should also establish ETC guidelines based on the amount of per line support received by each study area. Under this approach, in rural study areas receiving an average of $30 or more per line in monthly support the guideline would state that it is presumed that it is not in the public interest to designate more than one subsidized

total support for this household, even though per line support for the wire center is only $10 per month.

[14] In order to mitigate the impact of this change on rural carriers, per line support should be redetermined based only on single lines. However, once an additional ETC enters the rural incumbent's service territory, per line support should be frozen. This will prevent an unwarranted spiraling of per line support which is possible under current rules.

[15] The complete list of supported services is found at 47 C.F.R. § 54.101(a).

[16] Section 214(e)(5) of the Act also requires any additional ETCs in a study served by a rural carrier serve the rural carrier's entire study area, unless the state and FCC concur that an area less than the entire study area is appropriate.

carrier, i.e., more than one ETC. In areas receiving more than $20 per line in monthly support, but less than $30 per line, it would be presumed that no more than one additional subsidized carrier should be designated. There would be no limitation on the number of ETCs in study areas receiving less than $20 per line in support. States would be able to overcome these presumptions by specific evidence about particular carriers or particular areas.

Establishing such presumptive benchmarks based on the amount of monthly per line support for each study area would be easy to administer, and would encompass the truly small study areas where it is especially costly to serve. Of the 1400 rural study areas, those study areas receiving over $20 per line in monthly high-cost support serve only 1.7% of the total access lines in the United States, but receive almost 45% of total high-cost support. In other words, these study areas represent the small, high-cost areas where presumably it makes no sense to have more than a limited number of subsidized carriers. Placing limitations on the number of ETCs in these truly high-cost areas will help ensure the long-term sustainability of the fund, and will help ensure that consumers in those areas continue to have high-quality access at affordable rates.

B. LOW-INCOME SUPPORT

The FCC greatly expanded the eligibility criteria and the size of the low-income support mechanism in 1997. Nevertheless, participation in the Lifeline and Link-Up programs varies widely among the states. As shown on Attachment 1, of the $673 million paid out for low-income support in 2002, almost half went to one state, California. This is not 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 more than double to $1.5 billion. The FCC currently has a proceeding open to review the operation of the low-income support mechanism. A Recommended Decision from the Joint Board was issued in April 2003 which endorsed expanding Lifeline and Link-Up eligibility to include customers with incomes at or below 135% of the federal poverty guidelines. NASUCA has supported the use of a benchmark based on 150% of the federal poverty guidelines, and has encouraged the use of automatic enrollment and self-certification to ensure that as many eligible customers as possible receive Lifeline benefits.

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, annual demand for e-rate funding 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 decision to allow unused schools and libraries funds to be rolled forward to increase future funding 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 to address allegations of fraud and abuse, and inefficiency in the administration of the program.

D. RURAL HEALTH CARE SUPPORT

Unlike the other support mechanisms, the rural health fund has had difficulty generating sufficient demand. The FCC originally anticipated a rural health fund sized at $400 million per year. However, in spite of repeated attempts to remake the fund, disbursements have remained low, only $16.4 million in 2002. Like the low-income program, benefits under the rural health care program are distributed unevenly. During 2002 Alaska received 72% of total USF rural health care funding.

Although the FCC is currently examining the operation of the rural health fund, it is clear that the root cause of the problems with the 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 stable and 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 of this structure. Issues related to the contribution base must be resolved. Since all benefit, all should contribute. In addition, the limited resources of the fund must be properly targeted to carry out the purposes of the Act. In order to continue the public policy success of the universal service fund, we must support access, not excess.

Attachment 1

FEDERAL UNIVERSAL SERVICE SUPPORT
RANKED BY SUPPORT IN EACH STATE
2002 DISBURSEMENTS IN MILLIONS

State	High Cost Support	Low Income Support	Rural Health Support	Schools & Libraries Support	Total Support
1 California	$65.4	$313.6	$0.1	$266.6	$645.7
2 Texas	$187.8	$45.6	$0.1	$171.8	$405.3
3 New York	$49.0	$53.2	$0.0	$300.5	$402.7
4 Mississippi	$199.7	$2.4	$0.0	$24.8	$226.9
5 Florida	$79.2	$15.5	$0.0	$45.0	$139.7
6 Georgia	$81.7	$7.4	$0.0	$49.1	$138.2
7 Oklahoma	$89.5	$12.9	$0.1	$26.6	$129.1
8 Pennsylvania	$45.9	$10.4	$0.0	$70.1	$126.4
9 Alabama	$100.2	$2.7	$0.0	$17.9	$120.8
10 Arizona	$67.0	$11.6	$0.3	$39.5	$118.4
11 Arkansas	$101.5	$1.0	$0.1	$12.4	$115.0
12 Ohio	$34.7	$26.3	$0.0	$53.3	$114.3
13 Puerto Rico	$97.7	$6.6	$0.0	$4.9	$109.2
14 Alaska	$81.2	$2.5	$11.8	$10.8	$106.3
15 South Carolina	$69.5	$2.4	$0.0	$34.2	$106.1
16 Washington	$79.2	$10.1	$0.1	$15.6	$105.0
17 Louisiana	$75.6	$1.9	$0.0	$24.3	$101.8
18 North Carolina	$60.1	$10.9	$0.1	$29.8	$100.9
19 Kansas	$90.9	$1.5	$0.2	$7.8	$100.4
20 Missouri	$70.7	$3.2	$0.1	$25.6	$99.6
21 Kentucky	$76.4	$5.5	$0.1	$16.9	$98.9
22 Wisconsin	$70.6	$6.8	$0.0	$20.7	$98.1
23 Illinois	$38.0	$8.7	$0.1	$50.0	$96.8
24 Virginia	$71.5	$2.1	$0.1	$20.2	$93.9
25 Michigan	$26.5	$12.0	$0.4	$53.0	$91.9
26 Tennessee	$48.9	$5.3	$0.0	$33.2	$87.4
27 West Virginia	$81.5	$0.5	$0.0	$5.0	$87.0
28 Colorado	$68.6	$3.3	$0.1	$12.7	$84.7
29 Oregon	$67.7	$4.1	$0.0	$9.8	$81.6
30 Indiana	$54.5	$4.1	$0.0	$15.0	$73.6
31 Minnesota	$49.9	$3.9	$0.4	$19.0	$73.2
32 New Mexico	$29.3	$5.3	$0.1	$38.3	$73.0
33 Montana	$64.7	$1.7	$0.5	$3.4	$70.3
34 Maine	$40.7	$9.8	$0.0	$4.8	$55.3
35 Massachusetts	$1.3	$17.6	$0.0	$30.1	$49.0
36 Idaho	$40.2	$3.1	$0.1	$3.1	$46.5
37 New Jersey	$9.2	$4.7	$0.0	$31.2	$45.1
38 Nebraska	$36.2	$1.7	$0.6	$6.0	$44.5
39 Wyoming	$42.1	$0.3	$0.1	$1.2	$43.7
40 South Dakota	$33.9	$3.9	$0.2	$5.5	$43.5
41 Connecticut	$19.3	$5.5	$0.0	$18.4	$43.2
42 Guam	$39.3	$0.3	$0.0	$2.3	$41.9
43 Nevada	$33.9	$3.5	$0.0	$3.1	$40.5
44 North Dakota	$34.9	$2.0	$0.2	$2.7	$39.8
45 Iowa	$32.0	$1.6	$0.1	$5.8	$39.5
46 Virgin Islands	$31.8	$0.0	$0.1	$5.3	$37.2
47 Maryland	$20.0	$0.4	$0.0	$10.0	$30.4
48 Vermont	$25.8	$3.2	$0.0	$1.3	$30.3
49 Utah	$18.6	$2.1	$0.0	$4.6	$25.3
50 N. Mariana Is.	$21.7	$0.0	$0.0	$2.0	$23.7
51 New Hampshire	$13.5	$0.6	$0.0	$1.0	$15.1
52 Hawaii	$6.7	$1.4	$0.2	$1.7	$10.0
53 D.C.	$0.0	$1.2	$0.0	$8.5	$9.7
54 Rhode Island	$0.1	$4.9	$0.0	$3.6	$8.6
55 Delaware	$1.5	$0.2	$0.0	$1.1	$2.8
56 American Samoa	$0.7	$0.1	$0.0	$1.6	$2.4
TOTAL	$2,978.0	$673.1	$16.4	$1,682.7	$5,350.2

Note: Numbers may not add due to rounding. Annual support amounts less than $50,000 show as $0 due to rounding. Support amounts shown are actual amounts disbursed. Amounts assessed and collected may be higher.

Source: USAC 2002 Annual Report

Attachment 2

2002 FEDERAL UNIVERSAL SERVICE DISBURSEMENTS
RANKED BY PER LINE SUPPORT IN EACH STATE

State	High Cost Support	Low Income Support	Rural Health Support	Schools & Libraries Support	Total Support	Total Lines	Monthly Support Per Line
	$ Millions						
1 N. Mariana Is.	$21.7	$0.0	$0.0	$2.0	$23.7	21,521	$91.77
2 Guam	$39.3	$0.3	$0.0	$2.3	$41.9	74,006	$47.16
3 Virgin Islands	$31.8	$0.0	$0.1	$5.3	$37.2	69,073	$44.88
4 American Samoa	$0.7	$0.1	$0.0	$1.6	$2.4	10,325	$19.37
5 Alaska	$81.2	$2.5	$11.8	$10.8	$106.3	461,194	$19.21
6 Mississippi	$199.7	$2.4	$0.0	$24.8	$226.9	1,443,215	$13.10
7 Wyoming	$42.1	$0.3	$0.1	$1.2	$43.7	312,778	$11.64
8 Montana	$64.7	$1.7	$0.5	$3.4	$70.3	553,795	$10.58
9 South Dakota	$33.9	$3.9	$0.2	$5.5	$43.5	410,229	$8.84
10 North Dakota	$34.9	$2.0	$0.2	$2.7	$39.8	392,284	$8.45
11 West Virginia	$81.5	$0.5	$0.0	$5.0	$87.0	1,035,885	$7.00
12 Puerto Rico	$97.7	$6.6	$0.0	$4.9	$109.2	1,333,656	$6.82
13 Arkansas	$101.5	$1.0	$0.1	$12.4	$115.0	1,509,333	$6.35
14 New Mexico	$29.3	$5.3	$0.1	$38.3	$73.0	1,003,993	$6.06
15 Vermont	$25.8	$3.2	$0.0	$1.3	$30.3	426,028	$5.93
16 Oklahoma	$89.5	$12.9	$0.1	$26.6	$129.1	2,035,796	$5.28
17 Maine	$40.7	$9.8	$0.0	$4.8	$55.3	883,970	$5.21
18 Idaho	$40.2	$3.1	$0.1	$3.1	$46.5	762,986	$5.08
19 Kansas	$90.9	$1.5	$0.2	$7.8	$100.4	1,666,630	$5.02
20 Alabama	$100.2	$2.7	$0.0	$17.9	$120.8	2,497,624	$4.03
21 Nebraska	$36.2	$1.7	$0.6	$6.0	$44.5	955,957	$3.88
22 South Carolina	$69.5	$2.4	$0.0	$34.2	$106.1	2,366,512	$3.74
23 Kentucky	$76.4	$5.5	$0.1	$16.9	$98.9	2,206,741	$3.73
24 Louisiana	$75.6	$1.9	$0.0	$24.3	$101.8	2,575,040	$3.29
25 Arizona	$67.0	$11.6	$0.3	$39.5	$118.4	3,095,149	$3.19
26 Oregon	$67.7	$4.1	$0.0	$9.8	$81.6	2,171,014	$3.13
27 New York	$49.0	$53.2	$0.0	$300.5	$402.7	13,076,558	$2.57
28 Texas	$187.8	$45.6	$0.1	$171.8	$405.3	13,192,061	$2.56
29 Nevada	$33.9	$3.5	$0.0	$3.1	$40.5	1,349,473	$2.50
30 Colorado	$68.6	$3.3	$0.1	$12.7	$84.7	2,948,466	$2.39
31 Washington	$79.2	$10.1	$0.1	$15.6	$105.0	3,743,055	$2.34
32 Wisconsin	$70.6	$6.8	$0.0	$20.7	$98.1	3,525,444	$2.32
33 California	$65.4	$313.6	$0.1	$266.6	$645.7	23,385,691	$2.30
34 Missouri	$70.7	$3.2	$0.1	$25.6	$99.6	3,630,138	$2.29
35 Georgia	$81.7	$7.4	$0.0	$49.1	$138.2	5,148,317	$2.24
36 Tennessee	$48.9	$5.3	$0.0	$33.2	$87.4	3,385,953	$2.15
37 Minnesota	$49.9	$3.9	$0.4	$19.0	$73.2	3,136,277	$1.94
38 Iowa	$32.0	$1.6	$0.1	$5.8	$39.5	1,704,785	$1.93
39 Utah	$18.6	$2.1	$0.0	$4.6	$25.3	1,172,443	$1.80
40 North Carolina	$60.1	$10.9	$0.1	$29.8	$100.9	5,106,719	$1.65
41 Virginia	$71.5	$2.1	$0.1	$20.2	$93.9	4,760,302	$1.64
42 Indiana	$54.5	$4.1	$0.0	$15.0	$73.6	3,803,634	$1.61
43 Connecticut	$19.3	$5.5	$0.0	$18.4	$43.2	2,406,704	$1.50
44 New Hampshire	$13.5	$0.6	$0.0	$1.0	$15.1	855,403	$1.47
45 Ohio	$34.7	$26.3	$0.0	$53.3	$114.3	7,053,650	$1.35
46 Pennsylvania	$45.9	$10.4	$0.0	$70.1	$126.4	8,301,408	$1.27
47 Michigan	$26.5	$12.0	$0.4	$53.0	$91.9	6,149,365	$1.25
48 Hawaii	$6.7	$1.4	$0.2	$1.7	$10.0	721,233	$1.16
49 Rhode Island	$0.1	$4.9	$0.0	$3.6	$8.6	641,977	$1.12
50 Florida	$79.2	$15.5	$0.0	$45.0	$139.7	11,317,933	$1.03
51 Illinois	$38.0	$8.7	$0.1	$50.0	$96.8	8,012,870	$1.01
52 Massachusetts	$1.3	$17.6	$0.0	$30.1	$49.0	4,410,394	$0.93
53 D.C.	$0.0	$1.2	$0.0	$8.5	$9.7	919,587	$0.88
54 Maryland	$20.0	$0.4	$0.0	$10.0	$30.4	3,940,615	$0.64
55 New Jersey	$9.2	$4.7	$0.0	$31.2	$45.1	6,923,410	$0.54
56 Delaware	$1.5	$0.2	$0.0	$1.1	$2.8	589,979	$0.40
TOTAL	$2,978.0	$673.1	$16.4	$1,682.7	$5,350.2	185,588,578	$2.40

Note: Numbers may not add due to rounding. Annual support amounts less than $50,000 show as $0 due to rounding.
Support amounts shown are actual amounts disbursed. Amounts assessed and collected may be higher.

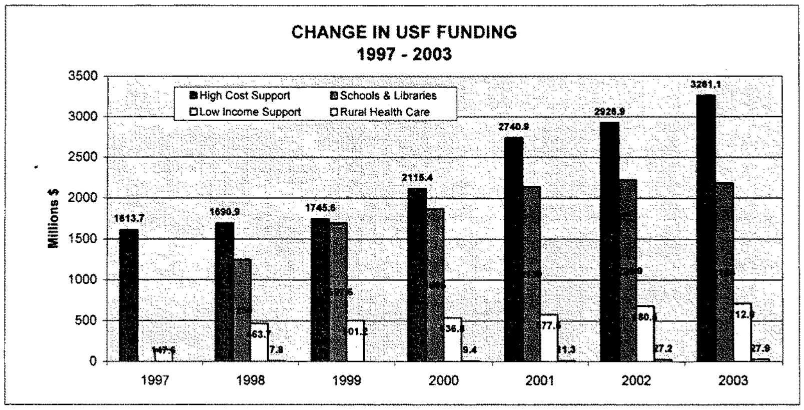
Source: USAC 2002 Annual Report
NECA 2002 USF Filing

Attachment 3

CHANGE IN USF FUNDING
1997-2003

USF Mechanism	1997	1998	1999	2000	2001	2002	2003	$ Change 1997-2003	% Change 1997-2003
High Cost Support	1,613.7	1,690.9	1,745.6	2,115.4	2,740.9	2,926.9	3,261.1	1,647.4	102.1%
Schools & Libraries	0.0	1,250.0	1,697.6	1,865.0	2,139.0	2,220.9	2,184.0	2,184.0	n/a
Low Income Support	147.6	463.7	501.2	536.6	577.5	680.5	712.9	565.3	383.0%
Rural Health Care	0.0	7.8	-1.7	9.4	11.3	27.2	27.9	27.9	n/a
Total USF Funding	1,761.3	3,412.4	3,942.7	4,526.6	5,468.7	5,855.5	6,185.9	4,424.6	251.2%
Interstate Revenue Base	65,350.0	69,274.0	75,305.5	80,359.5	80,708.0	74,158.1	68,912.1	3,562.1	5.5%
USF Assessment Rate*	2.70%	4.93%	5.24%	5.63%	6.78%	7.90%	8.98%	n/a	233.1%

*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
Interstate revenue base for 1997 estimated.



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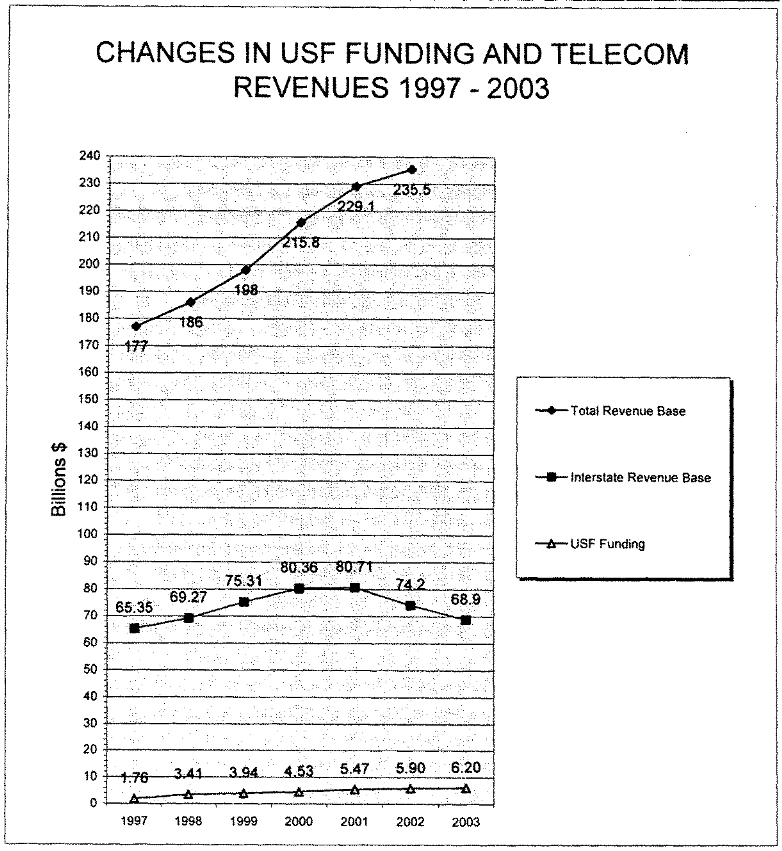
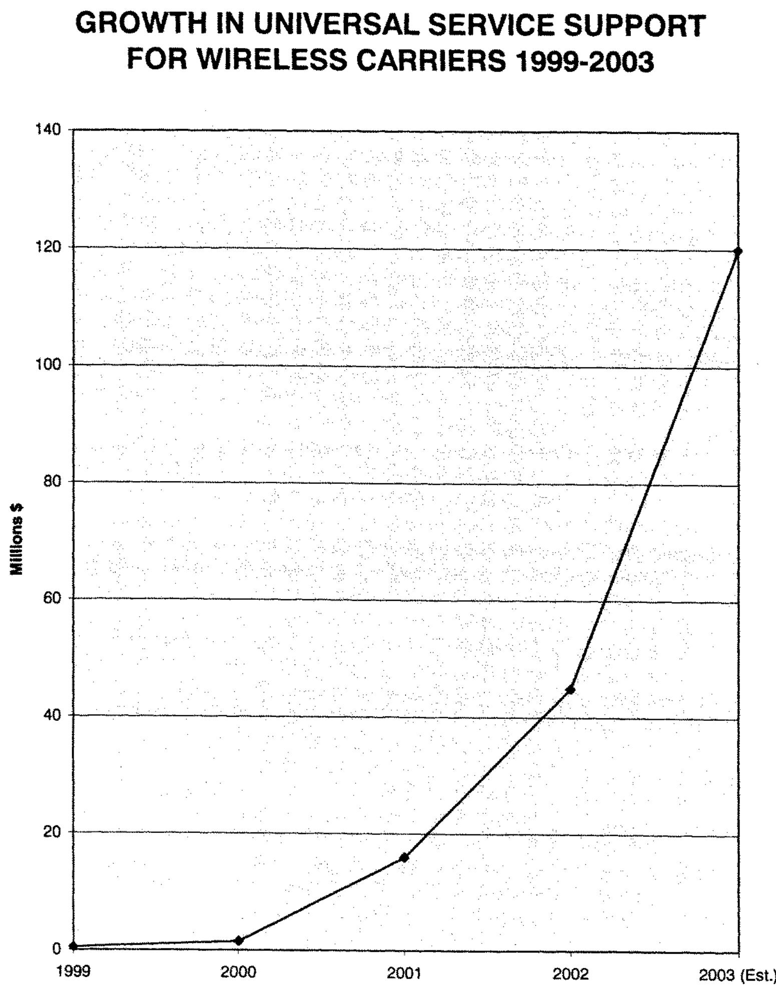
Attachment 4

CHANGES IN USF FUNDING AND TELECOM REVENUES
1997 - 2003
$ Billions

	1997	1998	1999	2000	2001	2002	2003
Total Revenue Base	177.0	186.0	198.0	215.8	229.1	235.5	na
Interstate Revenue Base	65.4	69.3	75.3	80.4	80.7	74.2	68.9
USF Funding	1.8	3.4	3.9	4.5	5.5	5.9	6.2



Attachment 5



Mr. UPTON. Thank you very much.

Those buzzers, you might have guessed, were not a fire drill. But we have got a couple of votes on the House floor. And we will temporarily adjourn at this point for about 20 minutes. We will resume with Mrs. Greene's testimony after these two votes.

[Brief recess.]

Mr. UPTON. I think we are okay for votes for a little while. Our next votes will be many more. So it will put a real crimp to where we are at. So we will try to get finished.

Ms. Greene, you are next. Welcome to the committee.

STATEMENT OF MARGARET H. GREENE

Mrs. GREENE. Thank you, Mr. Chairman. It is my honor to join this panel today in discussing universal service, one of the most important issues facing the future of the telecommunications industry, and its contributions to the country.

Connecting virtually all Americans is a key goal in a fundamentally altered communications world. Far beyond these halls, of course, we see broad evidence of this new world. Your son goes off to college and calls home via the computer. You walk down the street. And it seems the whole world has sprouted a cell phone from their ear. You sign up for cable television. And you get not just TV but internet and phone service as well.

It's an exciting time for consumers. It's a challenging time for our companies. And it is also a challenging time for this body. The old rules, written for the old world, have less and less application today. These rules have to be adapted as quickly as possible to a new marketplace that is being defined today by rapid technological change and mounting competition.

This is the challenge for U.S. telecom policy. The universal service is no exception. The fund is in significant jeopardy today. As communications migrate to broadband, the old world base of universal service funds, local and long distance wire line, is shrinking.

At the same time, demand for the fund's resources is exploding. The 1996 act dramatically expanded the size of the fund by declaring that universal service was no longer merely about ensuring folks in remote areas had service. Instead, it became about financing a choice of providers, a profoundly more expensive proposition in areas where the market alone struggles to support even one company at reasonable rates. This change opened the floodgates and could cost ratepayers an extra $2 billion annually in less than 4 years' time.

Some suggest we should cap the fund. Such an approach ignores a history of distorted economics around achieving universal service and allows the excesses that do exist to continue unabated. The more constructive approach, restore discipline in terms of who and how many companies have access and get all participants in the Twenty-First Century communications marketplace to contribute to a Twenty-First Century universal service fund.

In a marketplace being defined by the fact that cable satellite, wireless, wire line, and internet offerings all compete directly, it is imperative that outdated rules not be permitted to distort what should be consumer-driven competition. For universal service, that means ensuring neutrality on both sides of the equation, who pays in and who takes out?

For contributions, a reasonable fee assessed across today's far broader pool of market participants would help ensure the fund's viability without overburdening any set of companies or unfairly throwing a price advantage to newer platforms.

On the distribution side, United States Telecom Association, of which I served as chair this year, believes that the Federal fund should be asked to support only one ETC in each high-cost area. States that wish to subsidize companies by designating additional providers should be permitted to do so provided that they pay the additional cost so the fund is not destabilized for the entire Nation.

USTA also believes that there should be one high standard for eligibility across all platforms. Either you deliver true universal service or you don't. Of course, these public resources should serve their original purpose: helping offset the high cost of actual infrastructure. Given the candle-lit weekend so many East Coast residents have had in recent weeks, we as a Nation have a newfound appreciation of the need for policies that ensure essential infrastructure remains robust and reliable.

In terms of telecommunications, we can do that through a focused, adequately funded universal service fund, through policy that encourages companies to invest on their own, and by being less prescriptive in how networks are built.

Today universal service requirements go down to the service and the line. Why not demand one result? You've got to serve everyone. You've got to do it reliably. And you have to deliver service comparable in scope with what is available elsewhere in terms of public safety obligations like 911. And then let the companies figure out how best to get there.

Command and control regulations by nature are based on the past. Network architecture at such a pivotal moment in the information revolution must be free to look to the future. U.S. policy should encourage vigorous investment that keeps our infrastructure sophisticated and strong.

Grafting the old ways onto a new world doesn't get us there. That is primarily our concern with H.R. 1582. While we certainly appreciate Congressman Terry's leadership, we think this bill does not go nearly far enough to safeguard universal service. It does not address at all the contribution side of the equation. And it imposes no new discipline in either how many companies have access or what standard of service they provide. And the bill addresses only the non-rural side of universal service, leaving out the lion's share of the communities that the fund serves.

Mr. Chairman, we need to be bold in preserving the future of universal service in a new communications era. And time is of the essence. By asking everyone to pay in and everyone to meet the same high standard for eligibility, we can deliver a true, fair, and constructive universal service policy for the Twenty-First Century.

I thank you for holding this hearing today. It is an important issue. I thank you for your leadership and timely consideration.

[The prepared statement of Margaret H. Greene follows:]

PREPARED STATEMENT OF MARGARET H. GREENE, CHAIR, UNITED STATES TELECOM ASSOCIATION

Universal service is one of the most important issues facing the future of the telecommunications industry and its contributions to the country. Connecting virtually all Americans to the opportunity and security of the dial tone was one of the most important achievements of the last century. In today's Information Age, universal service continues to embody the nation's commitment to keeping the American dream alive in every community—urban and rural.

The United States Telecom Association represents the entire local telecommunications industry—from my company, BellSouth, to small rural companies to a host of innovative companies in between. We have worked extensively to forge an industry-wide position to ensure a strong future for this vital national priority in a fundamentally altered communications world. The old rules, written for the old world, have less and less practical, constructive application today. These rules have to be adapted—as quickly as possible—to a new marketplace that is being defined today by rapid technological change and mounting competition. In a marketplace being defined by the fact that cable, satellite, wireless, wireline and Internet offerings all compete directly, it is imperative that outdated rules and antiquated regulatory classifications not be permitted to continue to distort what should be consumer-driven competition.

This is the challenge for U.S. telecom policy. Universal service is no exception. The Fund is in significant jeopardy today, caught in a perilous limbo between our regulatory past and a future that's already here. The revenues that serve as the base for contribution to the universal service fund are shrinking, putting pressure on the revenue side of the Fund that is unsustainable. At the same time, demand for the Fund's resources is exploding in an undisciplined and arguably unproductive way. The issue of universal service must be dealt with in a comprehensive way. Both the assessment mechanism and the distribution formula must be addressed, and quickly, if we are to sustain this long held goal of affordable and robust communications for all Americans.

The funding side of universal service is in trouble. It focuses on historical distinctions in geography and technology that no longer serve as viable definitions in today's telecommunications world. Universal service funding is derived from an assessment on wireline companies, local and long distance, and wireless companies, based on a factor applied to interstate revenues. In a world of bundled minutes delivered over at least four different technologies, this becomes increasingly meaningless.

As communications migrate to broadband, the old world base of universal service funds—local and long distance wireline—is shrinking. And increasingly, alternate technologies, like cable modem and VOIP, offer directly competitive services while being exempt from the social responsibilities attendant to universal service. Like so many other aspects of our current regulatory scheme for telecommunications, this puts the historic providers of universal service, those living with the legacy of using wireline revenue flows to subsidize social goals, at a competitive disadvantage in a robustly competitive marketplace. This situation cannot exist without serious detriment to the regulated carriers and it must be fixed.

Fixing this competitive/social policy mismatch means, for the issue of universal service, ensuring neutrality on both sides of the equation. Parity of obligation must exist between those who offer functionally equivalent telecommunications services. If broadband connections are to be assessed, as DSL is today, then functional equivalents, like cable modem service, must pay.

Furthermore, users of intrastate as well as interstate services should contribute to universal service. The distinction between intrastate and interstate services is artificial and unsustainable in today's world. It creates perverse incentives to mischaracterize traffic and again places the burden of supporting universal service on less than the full universe of subscribers benefiting from universal service. It further puts a cost on the consumer of having to Fund the arcane regulatory exercise of allocating revenues to a particular geography or jurisdiction even though those revenues are derived from services, like bundled wireless or local and long distance minutes, designed to free the consumer from the constraints of geography.

Besides these serious issues that constrain the funding area, demand for the fund's resources is exploding. This is due to the 1996 Act, which dramatically expanded the size of the Fund by declaring that universal service was no longer merely about ensuring folks in remote areas had service. Instead, it became about financing a choice of providers—a profoundly more expensive proposition in areas where the market economics make it difficult to support even one company at reasonable rates. This change opened the floodgates. Left unabated, it is expected to cost ratepayers an extra $2 billion [annually] in less than four years' time.

On the distribution side, USTA believes this rise in demand on the Fund is unwise, unnecessary and unsustainable. Discipline must be brought to bear around distribution of the Fund. This can be accomplished by implementing some specific principles governing eligibility to draw from the Fund. Specifically, USTA asserts that the federal Fund should be asked to support only one ETC in each high-cost area. That ensures universal service. States that wish to subsidize competitors by designating additional providers should be permitted to do so, provided they pay the additional cost, so the Fund is not destabilized for the entire nation. Again, basic connectivity is the goal of universal service.

To ensure connectivity, rates in high cost study areas should be comparable to rates in other parts of the country and, thus, widely affordable. To that end, universal service support should be used to encourage continued investment in and rehabilitation of high cost study area infrastructure and help recover the actual or embedded cost of such networks (not lines or services) consistent with the recognition of appropriate distinctions based on the size of the study area. Telecommunications is a capital intensive business and steady investment is required for consumers to be well served. Choosing only certain lines or services to support ignores the essential nature of telecommunications as a network industry. Each part of the network can support multiple lines or services. It is administratively burdensome as well as nonsensical to attempt to allocate support to only certain lines or services provided by a network that operates as an integrated organism.

USTA also believes there should be one high standard for eligibility across all platforms. Either you deliver true universal service or you don't. Of course, it should go without saying that these public resources should serve their original purpose: helping offset the high costs of actual infrastructure. Given the candle-lit weekend so many East Coast residents have had in recent weeks, we as a nation have a newfound appreciation of the need for policies that ensure essential infrastructure remains robust and reliable. In terms of telecommunications, we can do that through a focused, adequately funded Universal Service Fund; through policy that encourages companies to invest on their own; and, by being less prescriptive in how networks are built.

Today, universal service requirements go down to the service and the line. Why not demand one result? You've got to be willing to serve everyone; you've got to do it reliably; and you have to deliver service comparable in scope with what is provided elsewhere, including meeting all public safety obligations. This is precisely the constructive role that government should play today. Yes, consumers should define the market—prices, services, technology. But government can ensure essential services—from 911 to ready, affordable access to a dial tone—reach all Americans. And, U.S. policy should encourage vigorous investment that keeps our infrastructure sophisticated and strong.

Grafting the old ways onto a new world doesn't get us there. That primarily is our concern with HR 1582. We certainly appreciate Congressman Terry's leadership, but we think this bill does not go nearly far enough to safeguard universal service.

There are three large categories of support in the federal Universal Service Fund; the e-rate for schools, libraries and rural health care, the low income program, and high cost support for high cost areas. The Terry bill focuses in on one of about twelve categories of funding in the high cost support program and essentially redistributes funds from high cost rural communities in Mississippi, Alabama and West Virginia. Its companion measure in the Senate (S. 1380) spares West Virginia from harm and slashes funding from the Commonwealth of Puerto Rico by redistributing two categories of funding.

In part to control the size of the Universal Service Fund and to ensure that support went to carriers providing a substantial amount of service to the highest cost, most rural areas, the FCC determined that levels of support for non-rural carriers should be averaged on a state-wide area. For large carriers, this is relatively consistent with the practice of averaging support on a "study area" basis, which for these carriers was generally an entire state.

Those non-rural carriers with large numbers of lines concentrated in urban areas relative to their rural lines did not generally receive support from this category of funding. Funding went to those carriers in states serving large numbers of rural lines relative to total lines.

The Terry bill seeks to change the granularity of calculation of the burden of high cost, largely rural lines from a state-wide average to a much smaller wire-center average and then impose an artificial "state-wide" cap of 5% in the House bill and 10% in the Senate bill on the distribution in the large company category of funding. The apparent purpose of those caps is to simply redistribute funding among large carriers without regard to the needs of affected consumers or actual investment. It in fact rewards carriers that have sold off rural exchanges and punishes those carriers that have consistently served rural communities.

The Terry Bill does not truly impose new discipline, either in how many companies have access to the fund or what standard of service they provide. It robs from Peter (Puerto Rico) to pay Paul (Qwest) and even then addresses only the non-rural side of universal service, leaving out the lion's share of communities the Fund serves.

Similarly, universal service cannot be looked at in isolation—the entire regulatory regime under which carriers operate today impacts their ability to provide universal service. Government managed competition is far inferior to the free market in its ability to efficiently allocate resources to provide quality ubiquitous services to consumers. Market based competition in telecommunications will lead to increased capital investment, new jobs, economic growth, and a positive impact on the ability of network operators to provide universal service with, in some cases, a lesser dependence on universal service funding.

We need to be bold in preserving the future of universal service in a new communications era. And, time is of the essence. Without significant change, four years from now, ratepayers will have a tab that's $2 billion higher—Federal policy will continue to discourage investment in vital national infrastructure—and outdated government rules will continue to pre-empt the consumers' judgment in defining the shape of American innovation.

By asking everyone to pay in and everyone to meet the same high standard for eligibility, we can deliver a true, fair and constructive universal service policy for the 21st century, one that keeps the nation's commitment to ensuring real opportunity in every American community.

Mr. UPTON. Thank you very much.

Mr. Lubin, welcome.

STATEMENT OF JOEL LUBIN

Mr. LUBIN. Thank you, Mr. Chairman and members of the subcommittee. Thank you for inviting me here today to testify on behalf of AT&T on the subject of universal service.

AT&T is the Nation's oldest and most far-reaching telecommunications carrier. And we are proud to serve customers in every corner of the country. More than any other carrier, we tie the Nation together. And we are proud to be the carrier that brought the term "universal service" to the telecommunications lexicon.

In 1996, Congress directed the FCC to ensure that universal service was reformed in a manner that would make subsidies specific, predictable, and explicit. Seven years later, this directive has not been met fully. The universal service system is struggling to keep up with the dynamic marketplace, technologically driven marketplace. And without change, the system will come under increasing pressure and ultimately become unsustainable.

Fortunately, there are changes that could be implemented by the FCC within the existing structure of the act that can both alleviate the pressures and provide a universal service system that will be compatible with technological change and competition. Today I wish to highlight two of these issues that we believe are essential.

First, the change necessary because of the demands on the system are ever-increasing while the base on the service, universal service, funds are collected is shrinking. The situation is both competitively biased and economically unsustainable. Left unchanged, it will put the USF in a death spiral while raising the assessment rates, will erode public support for the universal service concept. This would be a problem, not just for rural America but for all of America.

I estimate that the universal service assessment in the year 2004 will exceed 10 percent. AT&T's solution to the problem is to move away from a revenue base system to a contribution base system on telephone numbers for those services that have telephone numbers and on a connections to the public network for special access and private line services that do not utilize telephone numbers.

A numbers-based solution has several advantages over the current system. First, it would be competitively neutral. Second, it would be predictable and simple, two things that customers tell us they appreciate. Let's remember it is the customer who pays the bill. We all act as collection agents to collect the money and hand it off to USAC.

Third, a numbers-based solution will ensure that the system is not left to crumble as telephone traffic migrates to new technologies and protocols, such as voice over the internet. We believe that a numbers-based solution to the question of how carriers contribute to universal service could be achieved under the existing law. And we believe that a numbers-based solution would provide adequately for both current and future demands on the universal service system. What is needed is the will to reform the universal service assessment mechanism.

The second change that I would like to highlight today is the issue of eliminating the remaining disparities associated with interstate access rates. As I said at the start, AT&T is proud of its heritage as the carrier that truly ties America together, but today the challenge of tieing America together is being borne significantly by AT&T. AT&T is carrying the burden even as it must increasingly compete in the long distance market with regional Bell operating companies that provide service only in their largely urban lower-cost service areas.

As part of the 1996 act, Congress ensured that all Americans could be tied together affordably by mandating rate averaging and rate integration for long distance services. But interstate access charges, a significant component of the cost of long distance services, are not the same in all parts of the country. So that when AT&T averages toll rates Nationwide, it has to charge its customers in the RBOC territory more than it otherwise would in order to charge customers in small rural telco areas the same rate. This puts carriers that serve rural America at a competitive disadvantage vis-a-vis carriers that serve primarily urban and suburban customers. We do not believe this is something that good public policy should encourage.

Two years ago AT&T presented a proposal to reform rural access rates to the FCC. Since then, the economic challenges that led to our plan have gotten worse. We need relief. Without relief, the marketplace will drive AT&T and other National carriers to find other less optimal solutions to the problem. Options are not attractive, and rural America should not be forced to bear their costs.

I look forward to answering your questions. Thank you again for the opportunity to appear this afternoon.

[The prepared statement of Joel Lubin follows:]

PREPARED STATEMENT OF JOEL LUBIN, VICE PRESIDENT, AT&T CORP.

Mr. Chairman, and members of the Subcommittee, thank you for inviting me to testify on behalf of AT&T as you address the important topic of universal service reform.

It was AT&T that brought the term "universal service" to the telecommunications lexicon. We are proud of our more than 125-year history as the nation's oldest and most far-reaching long-distance carrier; more than any other carrier, we tie together all parts of America. On the basis of this experience, we understand the importance of maintaining a vibrant and sustainable universal service system.

In 1996, the Congress directed the Federal Communications Commission, with the assistance of a Federal-State Joint Board, to charter a new universal service mechanism—one that would work with, not against, competition in all markets. This new universal service mechanism was to be specific, predictable, and sustainable as competition grew, and it was to be competitively neutral, both in the way that contributions were collected and support distributed.

Unfortunately, seven years and many Commission proceedings later, these goals have yet to be achieved. Some progress has been made, most notably through adoption of the CALLS plan in May 2000 and later with adoption of the MAG plan in October 2001, but we cannot yet say that we have a universal service system that meets all of the goals set forth by Congress in 1996. Instead, we have an ever-increasing fund that is being raised from an ever-shrinking funding base—interstate and international end-user telecommunications revenues—and a collection mechanism that is discriminatory and self-defeating. Something has to give.

It is beyond question that the fund is increasing. The fund today stands at more than $6 billion per year. Both the Office of Management and Budget and FCC staff project additional increases in the size of the universal service fund, even if the Commission makes no further policy changes that add to the obligations supported through the USF. OMB projects total growth at just under 2% per year for FY2004-2007. Only two parts of the fund won't grow—the schools and libraries fund and the $650 million interstate access support for areas served by price-cap carriers. All other parts of the USF can and are likely to increase.

At the same time the system faces increasing demands for support, the universal service funding base—interstate and international end user telecommunications revenues—continues to shrink. In 2001 and 2002, the universal service funding base shrank by an average of 8% per year. If that rate of decline continues in combination with the projected growth in the demand for universal service support, in three years, the USF contribution factor—the rate carriers are assessed and that they pass on to consumers at the bottom of the bill—would rise from 9.5% today to 12.8% in 2006. I believe that such a result is likely to be both economically and politically unsustainable.

The competitive inequities built into the current system for raising universal service funding will only speed the shrinkage of the universal service funding base. These competitive inequities take several forms. For example:

- if a consumer is a high-volume user of interstate long-distance service—the customer who traditionally has contributed the most to the support of universal service—that consumer can pay substantially less into the fund by migrating his or her long-distance calling to a wireless phone.
- if a consumer purchases interstate long-distance service bundled with local service or information services, he or she can contribute less to the universal service fund if the carrier providing the bundle allocates more revenue to the parts of the bundle that do not contribute to the support of universal service than to the interstate long-distance portion of the bill, which does contribute to universal service.
- if a consumer uses service provided by international carriers that carry little or no interstate traffic, he or she can avoid universal service charges altogether on that international calling.
- if a consumer uses some Voice over Internet Protocol services, e-mail, or instant messaging, it is likely that he or she would not contribute anything to support universal service.

Each of these outcomes encourages carriers to seek ways to avoid contributing to the universal service fund and, increasingly, price sensitive consumers are moving to services that allow them to avoid charges related to the support of universal service. When this happens, the universal service fund's contribution base shrinks, which causes the assessment rate to rise, which drives more consumers to find ways to minimize their contribution. Perpetuation of this scenario will drive the fund into a "death spiral," something that is completely at odds with what the Congress directed when it added Section 254 to the Communications Act.

Because AT&T is deeply concerned about this problem, we have proposed a solution to the FCC—a universal service contribution system based on telephone numbers for those services that use telephone numbers, and on connections associated with special access and private line services that do not use telephone numbers. If numbers and number-equivalent connections grow 2% per year, a 2% annual increase in the fund would not change the projected $0.98 per number universal service assessment.

Moreover, a numbers-based solution offers the advantage of being "future-proof." Voice-over-Internet-Protocol (VoIP) providers give their customers a telephone number so that those customers can receive calls from the public switched network. This assignment of numbers will trigger an obligation to support universal service, with the effect of keeping VoIP in the universal service contribution base. Preventing "leakage" from the universal service system is key to maintaining the stability of the fund, and by focusing on numbers rather than technologies, we can avoid the need to impose "one-size fits all" regulation on emerging services such as VoIP.

A numbers-based solution could be implemented today by the Commission, under its existing statutory authority. This is not true with respect to the call to "expand the base" by assessing intra-state revenues. Statutory change clearly would be necessary to achieve that goal, and even with such a change, it is not clear that just adding intra-state revenues to the mix would be sufficient to sustain the fund over the long haul. Revenues are unpredictable and it is not clear that revenues will continue to climb; if revenues plateau or drop, the assessment factor will have to rise—exactly as it has today as interstate revenues have stagnated.

The connections-based solution proposed by BellSouth and SBC suffers from the fact that it would not necessarily eliminate the problem of having customers face multiple USF charges. In my view, this is a major failing both because it contributes to consumer confusion and because it imposes additional cost on the industry.

Whether or not the Congress contemplates amendments to Section 254, what is needed is the will for reform.

If, however, Congress decides that additional statutory authority is a necessary precursor to reform of the universal service system, such legislation should be narrowly tailored and exclusively focused on enabling the Commission to consider a wider array of inputs for funding universal service programs. An "enabling approach" to universal service legislation should permit the Commission to consider a funding mechanism based on inter- and intra-state revenues, assigned, working telephone numbers, connections to the public switched network, or any combination of these elements, so long as such funding mechanism is competitively neutral among all providers and technologies. Reform along these lines could help to ensure the near- and long-term sustainability of the fund, maximize the support of universal service among the broadest array of providers of telecommunications services, reduce the need for regular revisions in the assessment mechanism (which would minimize carrier costs and consumer confusion associated with such changes), and reduce the likelihood that any reforms adopted by the Commission would be subject to challenge in the courts.

As I said at the outset, AT&T is proud of its heritage as the carrier that truly ties America together. But today, the burden of tying America together—of providing long distance service in all corners of the country—is being borne substantially by AT&T. AT&T is carrying this burden, even as it must increasingly compete in long distance with RBOCs that provide long distance service only in their largely urban, lower-cost service areas.

As part of the 1996 Act's universal service provisions, Congress ensured that all Americans could be tied together affordably by mandating rate averaging and rate integration for long distance services.

But interstate access charges—a significant component of the cost of long distance service—are not the same in all parts of the country. The geographic toll rate averaging provisions of Section 254(g) make it imperative that the remaining traffic sensitive cost disparities be removed from interstate access rates and this support be provided instead through the universal service fund.

In most areas served by the RBOCs, this reform was implemented through the CALLS plan, and interstate access charges are now approximately .6 cents per access minute. In the areas served by small, rural carriers not covered by the CALLS plan, the average interstate access charges AT&T faces are much higher. For example, the average NECA minute of access averages 2.6 cents per minute. When AT&T averages its toll rates nationwide, it has to charge its customers in the RBOC territory more than it otherwise would, in order to charge the customer in the small, rural carrier's service area the average rate.

This burden was barely bearable before Bell entry into the long distance market, when AT&T had to compete with MCI, Sprint, and other carriers that could choose not to serve certain geographies or service areas. Now, with the Bells having secured approval to enter the long distance market in most of the country, this burden has become intolerable. Verizon, which is already the nation's third largest long distance carrier, gets an unfair competitive advantage from the Act's toll averaging requirements because it doesn't serve all of America. In addition to incenting certain carriers not to serve rural America, these high access changes—and the desire to avoid paying them—provided the economic incentive for the "Canadian Gateway" access fraud committed against AT&T.

Fortunately, the 1996 Act allows for a solution that preserves toll averaging while restoring a level playing field to long distance competition. The local network costs—primarily high switching and transport costs—that lead to these high rural company access charges—which can be as high as 10 cents per minute of use—could be supported through explicit universal service funding.

More than two years ago, AT&T and several other carriers presented just such a proposal to the FCC. Unfortunately, the Commission has not implemented our proposal, and since that time, the economic challenges that led us to file our plan have gotten worse. The need for relief is now acute.

In order to alleviate these competitive problems and eliminate any incentive for parties to "game the system," the Commission should move expeditiously to reform the inter-carrier compensation regime. Unless the Commission acts aggressively, the marketplace will force AT&T and other national carriers to find other, less optimal solutions. Those options are not attractive to us, nor should they be attractive to policymakers, and rural America should not be forced to bear their cost.

Thank you again for the opportunity to testify here today. At AT&T, we believe firmly that a vibrant, sustainable universal service system is important to the well-being of both the telecommunications industry and the American economy. But decisions must be made, and some bold actions taken to secure universal service for the future. On behalf of my company, I hope you agree, and look forward to working with you and the members of this Subcommittee as you continue your important work in this area.

Mr. UPTON. Thank you.

Mr. Post?

STATEMENT OF GLEN POST

Mr. POST. Thank you, Mr. Chairman. My name is Glen Post. I am Chief Executive Officer and Chairman of the Board for CenturyTel. I appreciate the opportunity to speak before you today. I am representing CenturyTel and the Independent Telephone and Telecommunications Alliance, ITTA. ITTA is an association of 13 mid-sized telecommunications companies who together serve more than 10 million lines in 40 States.

CenturyTel is a leading provider of telecommunications services to 2.4 million customers, mostly in rural areas, the smaller cities across the country, in 22 States that include many of the States represented by the members of this subcommittee.

Many regulatory and technology changes have taken place since the act was passed in 1996. We want you to know that ITTA companies share common goals with the larger Bell operating companies and the smaller telephone companies to maintain the incentive to invest in our markets and to see meaningful deregulation of our businesses. However, this hearing should not be about companies. It should be about consumers and the continuity of the network that keeps us all connected.

The Nation's telecommunications future is at a crossroads. Evolving technology, competition, and converging network platforms are rapidly outpacing our ability to keep rates comparable and affordable for all consumers, regardless of where they live. In our view, affordable modern telecommunications infrastructure and advanced services can make the difference between success or failure in economic development, creation of jobs in rural markets.

Universal service support as envisioned by the act is still the telecommunications linchpin for millions of Americans and thousands of communities. It would be fair to say that perhaps no other industry has the potential to more directly impact and improve the lives and livelihoods of your constituents than the telecommunications industry. However, for that potential to be fully realized, some bold changes must take place to provide much-needed stability for this industry.

Today there is an undeniable need to address the full array of issues associated with telecommunications reform. We support those initiatives. However, the first and highest priority of the Congress should be to stabilize and strengthen the Telecommunication Act's universal service mandates, which include predictability, sustainability, and sufficiency.

If meaningful universal service reform is not accomplished first, other needed reforms, such as deregulation, inter-carrier compensation, and the future of broadband deployment, are likely to be grounded on an unsure foundation and are likely to fail to deliver their full-intended benefits for the American consumer.

Addressing the rapidly eroding USF contribution base is the first critical step in the process of shoring up the universal service system. Contributions to universal service funding should be based on revenues. A revenue-based assessment methodology is both competitively and technologically neutral. Assessing revenues, instead of connections or numbers, avoids imposing a regressive flat fee on low-volume consumers. A revenues-based system eliminates potential gaming that may be associated with connections or numbers-based approaches and also anticipates future changes in technology that may make connections-based approaches meaningless.

Also, the FCC should be permitted to assess the broadest base of revenues possible, including intrastate revenues. However, this is only part of the solution.

If Congress is going to effectively deal with the crisis looming over universal service, it must consider expanding the contribution base to all providers that currently rely on the telecommunications network. Congress and the FCC must make sure that any new contribution mechanism is capable of keeping pace with technology by assessing the broadest base of providers possible.

Also, current caps on universal service funds have a direct and negative correlation to advancing the universal service and advanced services deployment goals of the act. The growth and size of the fund are controlled today by arbitrarily capping the funds without regard to the impact on consumers. This is not the answer. In rural areas, significant investment is still needed.

Also, the rapid increase in the number of competitive eligible telecommunications carriers raises critical issues for the consumers in rural America. Present rules for ETC designation are being interpreted in widely different fashions by stakeholder service commissions and are often not consistent with the intent of the act.

We're concerned that present rules allow carriers to offer varying levels of service commitments to customers based on investments and cost of the ILEC. This raises obvious questions regarding the reasonableness of this method of distribution of universal service funds.

The following are recommendations of actions related to universal service that need to occur to protect consumers. First of all, telecommunications providers, regardless of their network platforms, should be required to pay in the universal service fund. This includes cable broadband providers, internet service providers, all wireless services, long distance, and local exchange companies.

Second, States that approve additional ETCs should be required to help with additional funding needs.

Third, CETC portability rules need to be changed to reflect reality and reasonableness. Regulatory oversight should ensure that funds are truly being used to serve consumers in high-cost areas and that the amount of support reflects the service commitment.

Finally, consumers must not be overlooked in the process of achieving telecommunications reform. Congress should make sure that rural consumers do not bear a disproportionate rate burden that would place advanced services out of the financial reach of most Americans.

This committee and the Congress have a great opportunity before them to initiate legislative changes and provide meaningful direction to the FCC that will offer much-needed positive signals to the telecom sector of our economy. Our Nation's telecommunications system did not happen by accident. There has been and should always be a strong commitment to building and maintaining evolving networks that connect all of our citizens in rural and urban areas to each other and the rest of the world.

Thank you for the opportunity of speaking with you today.

[The prepared statement of Glen Post follows:]

PREPARED STATEMENT OF GLEN POST, CEO AND CHAIRMAN OF THE BOARD FOR CENTURYTEL ON BEHALF OF THE INDEPENDENT TELEPHONE AND TELECOMMUNICATIONS ALLIANCE (ITTA)

Good afternoon. My name is Glen Post, and I am Chief Executive Officer and Chairman of the Board for CenturyTel. I appreciate the opportunity to appear before you today representing CenturyTel and the Independent Telephone and Telecommunications Alliance (ITTA). ITTA is an association of 13 mid-sized telecommunications companies who together serve more than 10 million lines in 40 states.

CenturyTel is a national telecommunications company with headquarters in Monroe, Louisiana. We are a leading provider of telecommunications services in 22 states that include many of the states represented by members of this Subcommittee including Michigan, Louisiana, Texas, Ohio, Wyoming, New Mexico, Mississippi, Oregon, Missouri, and Tennessee. We specialize in providing high quality telephone, long distance, Internet, broadband and advanced services in rural and small urban markets. Today, CenturyTel is the eighth largest telephone company in the United States with 2.4 million access lines. Much of CenturyTel's recent growth has come from the acquisition of telephone lines from the larger Bell Operating Companies in multiple states. The majority of our 3 million customers and 7,000 employees live and work in the very areas that have the most critical stake in the issue we will discuss today.

Many regulatory and technology changes have taken place since the Telecommuni-cations Act was passed in 1996. We want you to know that ITTA companies share common goals with the larger Bell Operating Companies as well as the smaller telephone companies to both maintain the incentive to continue investing in our markets and to see meaningful deregulation of our businesses. However, this hearing should not be about companies. It should be about consumers and the continuity of the network that keeps us all connected. It should be about the future and not the present. We empathize with the other providers that serve high cost markets and appreciate the challenges and concerns those markets pose from a service and investment standpoint.

The nation's telecommunications future is at a crossroads. Evolving technology, competition, and converging network platforms are rapidly outpacing the existing regulatory mechanisms' ability to keep rates comparable and affordable for all consumers regardless of where they live. There are a number of proposed changes in telecommunications that could put the stability of rural telecommunications at risk. We commend Chairman Tauzin and Chairman Upton and the members of this Subcommittee for addressing these issues that are crucial to consumers in so many regions of our nation.

I have been asked to provide you with a mid-size company perspective about our view of telecommunications and universal service as it relates to our customers and the markets we serve. Mid size companies understand that our business success depends on the long-term economic viability of our communities. In our view, affordable, modern telecommunications infrastructure and advanced services can make the difference between the site for a proposed industrial park remaining a field of weeds, or actually being considered as a promising location by a global manufacturing company. Businesses today look for areas where the telecommunications infrastructure has kept pace with technology and which provide the ability to communicate anywhere in the world. Universal service support plays a big role in this picture.

As members of this Subcommittee know, agriculture has long been the leading economic driver for much of rural America. However, I would ask that you also consider telecommunications as a force that will create jobs, spur investment and allow all citizens to effectively connect with the rest of the Nation and the world. It would be fair to say that perhaps no other industry has the potential to more directly impact and improve the lives and livelihoods of your constituents than the telecommunications industry. However, for that potential to be fully realized, some bold changes must take place to provide much-needed stability.

The one thing that has not changed since the passage of the Telecommunications Act is that rural and small urban markets remain unique in their demographics, service needs and cost-of-service characteristics. Universal service support, as envisioned by the Act, is still the telecommunications lynchpin for millions of consumers. These consumers have become increasingly sophisticated in the types and quality of services they need and expect. Thanks to the Universal Service system, our companies like CenturyTel have been able to ensure that rural America has not been left behind by the digital revolution. We believe that in a global economy, rural and small urban consumers not only deserve, but also truly need, reliable and affordable advanced telecommunications services to talk with loved ones, conduct business, be entertained and connect with the rest of the world.

One of the challenges these customers and their phone providers face is the ability to keep basic and advanced services affordable and to overcome the challenges of distance associated with high cost markets. However, this premise and the system that supports it are under attack from a variety of fronts. The reason we are here today is to attempt to find reasonable solutions that will help to keep America's telecommunications system the model for the rest of the world.

A vast and complex task awaits, but there is a need for sequencing and prioritization of the issues we face. To attempt to resolve all pending issues simultaneously prior to stabilizing universal service is to run the risk of failing from the outset. There is an undeniable need to address the full array of issues associated with telecommunications reform, and we support those initiatives and the need to move ahead as an industry. Our industry is in serious need of economic stabilization that can be brought about through deregulation and free market competition. However, the first and highest priority of the Congress must be to stabilize and strengthen the Telecommunication Act's universal service mandates which include: predictability, sustainability and sufficiency.

Few issues more directly affect consumers, the economy, job creation or investment in the country's national security infrastructure than universal service. Whether we are talking about affordable services for everyone, national security, bridging the Digital Divide or successfully placing an emergency 911 call, universal service is the key component that affects our industry and customers. Stabilization of universal service must be viewed as the "base" upon which all other reforms are built. If meaningful universal service reform is not accomplished first, other needed reforms such as deregulation, intercarrier compensation and the future of broadband deployment are likely to be grounded on an unsure foundation and are likely to fail to deliver their full-intended benefits to the American consumer.

CONTRIBUTION MECHANISMS

Addressing the rapidly eroding USF contribution base is the critical first step in the process of shoring up the universal service system. Without ensuring a predictable, sustainable, and sufficient funding base, other reforms could end up being academic. Contributions to universal service funding should be based on revenues. A revenues-based assessment methodology is both competitively and technologically neutral. Assessing revenues instead of connections or numbers avoids imposing a regressive flat fee on low-volume consumers. A revenues-based system eliminates potential "gaming" that may be associated with connections or numbers-based approaches and also anticipates future changes in technology that may make connections-based approaches meaningless. All providers have revenues that may be fairly assessed on a non-discriminatory basis, which makes such an assessment competitively neutral among consumers. The FCC should be permitted to assess the broadest base of revenues possible, including intrastate revenues.

However, this is only part of the solution.

To provide true long-term sustainability, the base of contributors must be expanded beyond what may be considered the traditional or legacy providers of today. Consumers are rapidly adapting to a world in which they receive their telecommunications services, including voice service, from their Internet Service Provider such as AOL or their cable modem provider, neither of which are currently subject to assessment. If Congress is going to effectively deal with the crisis looming over universal service and not simply postpone the day of reckoning, it must consider expanding the contribution base to all providers that currently rely on the telecommunications network. Anything less perpetuates rather than resolves the underlying problem. Ultimately, the expansion of universal service contribution mechanisms must be a progressive process with the goal of achieving long-term sustainability that is immune to technological change.

The FCC is considering basing its assessment on other metrics beside revenues. Some carriers who would advocate the use of telephone numbers as an assessment mechanism are, ironically, companies that do not have a telephone number link with customers, and would consequently be mostly immune from such an approach. Additionally, telephone numbers are not able to capture new technologies that provide voice service such as Voice Over Internet Protocol (VOIP) or even Instant Messaging services that are so prevalent today. Furthermore, the VOIP industry currently works with traditional telephone numbers and without them. A telephone number-based approach would skew the VOIP industry toward a non-numbers based approach. Congress and the FCC must make sure that any new contribution mechanism is capable of keeping pace with technology by assessing the broadest base of providers possible.

DISBURSEMENT OF UNIVERSAL SERVICE FUNDING

The rapid escalation in the number of Competitive Eligible Telecommunications Carriers (CETC's) raises critical issues for the customers of ITTA members. Present rules for ETC designation are being interpreted in widely different fashions by state public service commissions and are often not consistent with the intent of the Act. We are concerned that present rules allow carriers to offer different levels of service commitment to customers even though they are receiving the same level of support. This anomaly in universal service portability requirements places an ever-increasing pressure on universal service funding that directly or indirectly affects all American phone users.

Appropriate standards for the ETC designation process must be instituted and enforced. Unchecked distribution of universal service support threatens consumers and carriers alike. Currently, designations are often based on inconsistent or non-existent criteria. Minimum uniform, technologically neutral national criteria for state review of applications would do much to rationalize a chaotic, unpredictable process that ultimately does not serve the consumer's interest. Any such standards would also require some provision for enforcement, both at the federal and state levels, if they are not to be rendered meaningless from the outset.

CAPS ON UNIVERSAL SERVICE FUNDING

Reform of the contribution mechanism and disbursement procedures, while necessary first steps, are nonetheless insufficient by themselves to cure the ailing universal service system. Current caps on universal service funds have a direct and negative correlation to advancing the universal service and advanced services deployment goals of the Act. Existing caps are fundamentally in conflict with the broad universal service mandates laid down in the 1996 Act. They are also a disservice to rural consumers and an impediment to the delivery of advanced services to all consumers. Carriers, competitors and consumers alike will benefit from removing existing fund caps.

The growth of the fund is controlled today by arbitrarily capping the funds without regard to the impact on consumers. This is not the answer. In rural areas, significant investment is still needed.

INTERCARRIER COMPENSATION REFORM COULD THREATEN UNIVERSAL SERVICE

Carriers that use our networks should continue to pay fair compensation to use those networks. Access charges that long distance companies pay to compensate local phone companies have been reduced and the balance of that money has been shifted into universal service funding. Further access charge reductions will only put more pressure on the funds. Increasing downward pressure on access rates becomes a problem, particularly for the customers of companies operating in high cost rural areas. Zeroing out carrier access charges will mean that the customer ultimately pays an increased price to subsidize the stockholders of long distance companies.

RECOMMENDATIONS TO ADDRESS UNIVERSAL SERVICE ISSUES

There are no easy answers to solving all of the issues associated with universal service or telecommunications reform. However, there are a combination of actions that need to occur to protect consumers. First, all telecommunications service providers, regardless of their network platform, should be required to pay into the universal service fund. This includes cable, all broadband providers of any kind, Internet Service Providers (ISPs), all wireless devices, long distance and local exchange companies. Second, states that approve additional ETC's should be required to help with the funding. Third, CETC portability rules need to be changed to reflect reality. Today, CETC's are drawing the same support as the incumbent phone provider based on the ILEC's cost. This is putting increased pressure on the fund. They should have more stringent certification standards than they have today. The FCC should establish minimum criteria that individual state commissions can use in assessing eligibility. CETC's should be required to serve an entire rural study area—something they are not being held accountable for today. Regulatory oversight should ensure that funds are being used to serve consumers in high cost areas for all recipients of support.

Finally, CenturyTel believes portability requirements should be modified to recognize that many of today's USF dollars are actually access charges formerly paid by long distance companies—these dollars should not be portable to competitors.

CONCLUSION

Ultimately, consumers must not be overlooked in the process of achieving telecommunications reform. Consumers have seen a steady increase in their local phone bills due to a variety of end-user charges that have been systematically applied since the passage of the Act. Consumers also face shouldering the burden of pending proposals that would eliminate carrier-to-carrier revenues, such as access charges, and replace them with higher customer charges such as local rates and subscriber line charges. Congress should make sure that rural consumers do not bear a disproportionate rate burden that would place advanced services out of the financial reach of most Americans or add additional pressure to universal service funds.

This Committee and the Congress have a great opportunity before them to initiate legislative changes and provide meaningful direction to the FCC that will offer much-needed positive signals to the telecom sector of our economy. Telecommunications has the potential to create jobs, spur investment and provide economic stability to literally every state and to every section of the country. We must remember that our nation's telecommunications system did not happen by accident. There has been, and should always be, a strong commitment to building and maintaining evolving networks that connect all of our citizens in rural and urban areas to each other and the rest of the world.

Mr. UPTON. Thank you very much.

Mrs. Shank?

STATEMENT OF SIDNEY SHANK

Ms. SHANK. Good afternoon. I am the manager of Bloomingdale Telephone Company, which is an independently owned telecommunications corporation headquartered in Bloomingdale, Michigan. We've been engaged in the provision of local exchange service for nearly 100 years. Today we serve approximately 2,000 customers in our Bloomingdale exchange itself. However, we serve about 8,500 customers in Allegen, Kalamazoo, and Van Buren Counties with other telecommunications needs.

We are involved in the provision of telecommunications business systems, networking, internet, broadband services, long distance, cellular, competitive local exchange services, and DBS services.

We are proud of the record of service, which is representative of the Nation's small rural incumbent local exchange carriers. That's why I'm so pleased to be appearing on behalf of the hundreds that are represented by NTCA and OPASTCO.

The success of Bloomingdale and its small rural ILEC colleagues is tied directly to a dedication to community and the Nation's commitment to universal service. Yet, in the uncertain competitive deregulatory environment that we operate in today, these constants may be in jeopardy. Left hanging in the balance could be quality, affordable service for rural areas and telecommunications.

It's no secret that the ability to fully recover costs is the very lifeblood of our small rural ILECs. Thus, of particular concern to all of us today are the many regulatory and judicial proceedings that will either sustain or destroy this ability and subsequently the continued investment in rural telecommunications infrastructure will be in jeopardy.

Any adjustment to one of the three components of our cost recovery, the local end-user rates; inter-carrier compensation, such as access charges; and universal service, requires the inverse adjustment of the others. Not surprisingly, the local end-user rate component is the least able to tolerate increased pressure. Conversely, the inter-carrier component is the one most susceptible to regulatory and competitive-oriented pressures. This leaves universal service as the most likely to contend with cost recovery fluctuations.

In past access charge reduction proceedings, the universal service fund has been charged with such residual cost recovery responsibilities. And the current debate over additional inter-carrier compensation adjustments has suggested this could happen again. Yet, with other regulatory dilemmas currently facing the USF, we fear it is ill-prepared to take on another such obligation.

Perhaps the most notable of these is how easily many States and the FCC are granting USF ETC status to competitors. Adding insult to injury is the fact that under the FCC's current rules, competitor support is based on the incumbent's costs, this despite the fact that the law requires carriers to certify support is for actual universal service-allowed costs. This has led to a ballooning USF, which could eventually erode public support for the underlying National policy. Also problematic is change in economic and regulatory environment that is eroding the USF funding.

We believe that all policymakers must take the responsibility of granting ETC designations much more seriously. NTCA and OPASTCO have both put forth sets of standards on which such decisions could be based. These focus on encouraging policymakers to impose the same service, billing, quality, capability, and recording standards on competitors that incumbents already face.

We also strongly believe that Congress should direct the FCC to follow the law when asked for the contributions to the universal service fund. The FCC is entertaining the idea of adopting certain contribution proposals we contend would not adhere to the law. Some of these proposals, connections and numbers-based, would allow today's larger contributors, the long distance mammoths, to escape their statutory universal service responsibilities.

Considering the current dilemma that faces the USF, we should expand the base of contributors and revenues that are accessed, rather than relieving entities of a statutory responsibility. We have registered our views, both in the State and Federal regulatory arenas. In many cases, we have done so with the judicial as well. Yet, we now believe it is time for Congress to weigh in on these matters.

We are hopeful that with your direction, policymakers and judicial, the public, and competitors alike, will be guided by the principle that USF is a scarce National resource. Congress has the ultimate authority and responsibility to ensure that the USF is carefully managed in order to best serve the public interest. Universal service is not a tool to be used to incite artificial competition. It is a tool to help ensure the existence of a Nationwide ubiquitous telecommunications network, a network that has been proven again and again to be so critical to our National and economic security.

Congress must continue to ensure that the underlying principles of this long-lasting National policy are safely adhered to now and in the future. And I thank you so much for your time and for allowing me to be here today. Thank you.

[The prepared statement of Sidney Shank follows:]

PREPARED STATEMENT OF SIDNEY SHANK, MANAGER, BLOOMINGDALE TELEPHONE COMPANY ON BEHALF OF THE NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATIONAND THE ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

Chairman Upton, members of the subcommittee, my name is Sidney Shank, and I am the manager of Bloomingdale Telephone Company, which is an independently owned telecommunications corporation headquartered in Bloomingdale, Michigan. We've been engaged in the provision of local exchange service for nearly 100 years. Today we serve approximately 2000 customers with an investment of over 250 miles of cable. But that's not all we provide to our community and the surrounding area. In addition, we are involved in the provision of Internet, broadband services, long distance, cellular, competitive local exchange services, and Direct Broadcast Satellite (DBS) services.

We are proud of this record of service, which is representative of the nation's small rural ILECs. That's why I'm also pleased to be appearing on behalf of the hundreds that are represented by the National Telecommunications Cooperative Association (NTCA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO).

THE IMPORTANCE OF UNIVERSAL SERVICE

Today, the Subcommittee will hear from a variety of witnesses that are deeply interested in the future of universal service—each for very different reasons. Let me state at the outset that our concern is centered exclusively on ensuring that the strong mandates of the nation's long-standing policy of universal telecommunications service are carried out in a manner that best serves consumers. That is how we have always conducted our businesses.

The success of Bloomingdale, and its small rural ILEC colleagues, is tied directly to a dedication to community, and the nation's commitment to universal service.

Yet, in the uncertain competitive deregulatory environment that we operate in today, these constants may be in jeopardy. Left hanging in the balance could be quality, affordable, universally available rural telecommunications service.

It's no secret that the ability to fully recover costs is the very lifeblood of small rural ILECs. Thus, of particular concern to us today are the many regulatory and judicial proceedings that will either sustain or destroy this ability—and subsequently the continued investment in rural telecommunications infrastructure.

Any adjustment to one of the three components of our cost recovery—the local end-user rates, intercarrier compensation such as access charges, and universal service—requires the inverse adjustment of the others. Not surprisingly, the local end-user rate component is the least able to tolerate increased pressure. Conversely, the intercarrier component is the one most susceptible to regulatory and competitive oriented pressures. This leaves universal service as the most likely to contend with cost recovery fluctuations.

In past proceedings on access charge reductions, the USF has been charged with such residual cost recovery responsibilities. And the current debate over additional intercarrier compensation adjustments has suggested this could happen again. Yet with other regulatory dilemmas currently facing the USF, we fear it is ill prepared to take on another such obligation.

GREATER OVERSIGHT AND REFORM OF THE ETC DESIGNATION PROCESS IS NEEDED

Perhaps most notable of these regulatory dilemmas is how easily many states and the FCC are granting USF ETC status to competitors today. These carriers are receiving this valuable designation without having to comply with the same stringent service, billing, quality, capability, coverage, and reporting requirements that ILECs must, and have been happy to, adhere to each and every day. Is it too much to ask carriers to meet such obligations as a condition of receiving scarce USF support? We think not. Adding insult to injury is the fact that under the FCC's current rules, competitor support is based on incumbent costs. This despite the fact that the law requires carriers to certify support is for actual universal service allowed costs.

This problem is particularly pronounced with regard to wireless competitive ETCs. For example, since 1999, universal service support allocated to wireless CETCs has increased dramatically from $500,000 in 1999 to a projection of approximately $240 million in 2003. This astonishing growth in support to wireless CETCs is particularly troubling since these carriers are not held to the same regulatory obligations and service standards faced by other carriers.

We ask that Congress reaffirm its strong admonition about financially supporting competition when it crafted section 214(e) of the Act. In enacting this section of the law governing the designation of multiple ETCs, Congress clearly recognized that supported competition would not always be in the "public interest" of areas served by rural telephone companies. Sadly, some state commissions and the FCC have ignored the intent of Congress and have designated additional ETCs without thoughtfully considering the factors that determine the public interest. Regulators have placed far too much emphasis upon the Act's general goal of competition at the expense of rural markets and consumers. The result of state government-sponsored artificial competition in rural service areas has been a swollen USF that has put the entire universal service program at great risk.

POSSIBLE SOLUTIONS TO THE CETC DESIGNATION PROCESS

Mr. Chairman, many witnesses come before your committee without solutions. However, I am very pleased that both NTCA and OPASTCO have each developed their own principles to strengthen the public interest standard governing the CETC designation process.

This past July, during a forum of the Federal-State Joint Board on Universal Service, NTCA put forth, and urged the adoption of a seven-point public interest test for evaluation of ETC designations in rural telco service areas. The points are as follows:

1. Is the additional ETC designation of the requesting carrier required to ensure that consumers living in the rural ILEC service territory have access to the nine support services listed in the definition of universal service at rates that are comparable to similar services and rates received by consumers living in urban areas?
2. Would the requesting ETC designation be able to provide service to the entire rural ILEC service territory, as required by FCC rules?
3. Do the potential benefits to the rural service area of granting the ETC designation outweigh the ultimate burdens on consumers that will occur through the added growth in state/federal universal service funds?

4. Is the carrier requesting designation willing to demonstrate its cost to provide universal service to consumers living in the rural ILEC service territory?
5. Would the ETC designation result in excessive support to the requesting carrier based on the amount of support distributed under the identical support rule?
6. If the carrier seeking ETC designation is offering rural consumers universal service at a rate that is at, below or slightly above the comparable rate for supported services, why is the requesting carrier seeking universal service support?
7. Is the carrier requesting ETC designation willing to adhere to quality-of-service guidelines or other state-specific requirements?

Earlier, OPASTCO had developed an industry white paper, titled, "Universal Service: A Congressional Mandate At Risk." This paper elaborates upon how misinterpretations of the public interest standard by state and federal regulators when designating multiple ETCs has placed the universal service fund in serious jeopardy. The recommendations of the OPASTCO paper have also been presented to the Joint Board for its consideration. It lays out the following principles, guidelines and requirements that State commissions and the FCC should utilize in their consideration of ETC applications for rural telephone company service areas:

1. Rural consumers should receive access to affordable, high-quality telecommunications and information services, including advanced services that are reasonably comparable to those services provided in urban areas and at reasonably comparable rates.
2. The high-cost support mechanisms should not be used as an incentive to attract uneconomic competition in the areas served by rural telephone companies.
3. The USF is a scarce national resource that must be carefully managed to serve the public interest.
4. Rural universal service support reflects the difference between the cost of serving high-cost rural areas and the rate levels mandated by policymakers.
5. The public interest is served only when the benefits from supporting multiple carriers exceed the costs of supporting multiple networks.
6. In areas where the costs of supporting multiple networks exceed the public benefits from supporting multiple carriers, the public interest dictates providing support to a single carrier that provides critical telecommunications infrastructure.
7. The cost of market failure in high-cost rural America could be severe.

Along with the adoption of public interest principles, the OPASTCO white paper further recommends that in order to be considered for ETC status in a rural telephone company service area, a carrier should be required to demonstrate to the state commission or FCC that it meets, and will abide by, all of the following qualifications and requirements:

1. A carrier must demonstrate its ability and willingness to provide all of the services supported by the federal High-Cost program throughout the service area.
2. In fulfilling the requirement to advertise its services and rates, an ETC must emphasize its universal service obligation to offer service to all consumers in the service area.
3. A carrier must have formal arrangements in place to serve customers where facilities have yet to be built out.
4. A carrier must have a plan for building out its network once it receives ETC designation and must make demonstrative progress toward achieving its build-out plan in order to retain ETC designation.
5. A carrier must demonstrate that it is financially stable.

Lastly, OPASTCO suggests State commissions and the FCC should also adopt the following policies regarding ETC designations in rural telephone company service areas:

1. ETC designations in rural telephone company service areas should be made at the study area level (an ILEC's entire service territory within one state).
2. State commissions and the FCC should ensure that competitive ETCs will be capable of providing high-quality service to all of the customers in the service area should the rural ILEC find it necessary to relinquish its own ETC designation.
3. Any service quality standards, reporting requirements and customer billing requirements established by the state commission should be applied equally to all ETCs in the state.
4. State commissions have the authority to decertify any ETC that is not meeting any of the qualifications or requirements enumerated above.

We strongly believe that the long-term sustainability of the federal USF has been greatly threatened by federal and state regulator decisions about whether to designate multiple ETCs in an area served by a rural telephone company. The number of competing carriers seeking designation as eligible to receive universal service support is growing at an everincreasing pace. If the size of the USF reaches a point where further growth is prohibited, yet the number of carriers receiving support continues to grow, then no carrier will have the funding necessary to provide affordable, high-quality telecommunications services and rural consumers will be denied the benefits promised by the Act. This is an area that Congress simply can no longer ignore.

CONTRIBUTION METHODOLOGIES MUST ADHERE TO STATUTORY MANDATES

Unfortunately, there are other major regulatory proceedings that are still underway that have the potential to undermine the USF and its underlying national policy. It is very possible that the FCC could still adopt a "connections-based" or "numbers-based" proposal for revising the universal service contribution methodology, which without a legislative change, may not comply with the Telecommunications Act of 1996's requirement that every interstate telecommunications provider contribute to the Fund on an "equitable and nondiscriminatory basis." We urge the Congress to direct the FCC to follow the law and ensure that interstate carriers continue to contribute their fair share to the Fund. We also believe the FCC should be strongly encouraged to take action that would broaden the base of contributors to universal service. NTCA and OPASTCO have both advocated a narrow legislative approach as one part of this solution, which would effectively overcome a judicial decision that limits USF assessments to interstate and international revenues.

The FCC has recently given consideration to three different "connections-based" proposals for revising the universal service contribution methodology. The first proposal would impose a flat monthly fee for each end-user connection and assess a "minimum" contribution from each interstate telecommunications provider regardless of whether the carrier provides connections. The second proposal would split "connections-based" based contributions between switched access and interstate transport providers. The final proposal would assess contributions on the basis of telephone numbers assigned to end-users. We are very concerned that through these proposals the Commission is considering possibly adopting a new contribution methodology that would violate the requirement set forth in the 1996 Act that calls for "equitable and nondiscriminatory" contributions from every interstate telecommunications carrier.

In addition, we also all strongly believe that any reform of the universal service contribution methodology should expand the base of contributions to the Fund. As you know, the universal service system has been funded by a broad-based national system of industry contributions. The traditional contribution base—the long distance market—has steadily declined, eroding the funding base for universal service. Alternatives to long distance—wireless, e-mail, Internet Protocol (IP) telephony, and most broadband platforms—have not been asked to contribute their fair share to alleviate the shortfall. We are very concerned that the proposals currently pending before the FCC would fail to broaden the contribution base sufficiently, and fail to ensure the stability and sufficiency of the USF for the long-term.

The manner in which contributions are assessed for the USF is a very complex and controversial issue. Furthermore, I can assure you in the strongest possible terms that we are unified in our view that any further modifications by the FCC to the contribution methodology must be consistent with the statute's clear requirement that all interstate telecommunications services contribute to the USF on an equitable and nondiscriminatory basis. Regardless of how the FCC ultimately approaches this issue, interstate interexchange carriers have to remain principal contributors as mandated by the law.

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 aware of growth in the USF and concerned about shifts in the types of interstate services consumers are utilizing. These developments have created a serious issue about how to prevent erosion and evasion of support mechanisms. Thus, we firmly believe 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.

We need to emphasize that the gradual but ever-growing use of broadband platforms and Internet Protocol (IP) networks plays a growing role in the instability of the contribution base. Consumers use IP networks in a variety of ways (access to the World Wide Web, e-mail, instant messaging, Internet telephony) and via various platforms (cable, wireless, satellite) to substitute for interstate calls on the public switched network. As this "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. All other Internet access providers using other platforms remain exempt from the obligation.

Federal law allows the FCC to assess all providers of interstate "telecommunications" if the public interest so requires, even if they are not common carriers. We believe 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 other 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 even the "modified safe harbor" adopted by the Commission last year.

More specifically, in reassessing who must contribute 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 USF. Broadband service providers, whether considered information service providers or telecommunications service providers, also should be included as supporters of universal service. Finding an equitable way of assessing contributions to universal service support on carriers, and—as I just discussed—broadening the base of contributors to universal service are significant issues the FCC needs to resolve to make universal service support funding sustainable.

UNIVERSAL SERVICE IS GOOD PUBLIC POLICY FOR AMERICA

The high-cost component of the universal service program handles approximately $3.3 billion in annual carrier-to-carrier support transactions, which represents slightly more than half the amount that is channeled through the overall fund each year. The high-cost component is a "safetynet" of sorts for rural carriers 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 linkup programs, and millions of rural Americans, have nothing. Modern telecommunications infrastructure in rural America enables diversity of education, 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. 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 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.

Mr. UPTON. Thank you very much.

Mr. Stanton?

STATEMENT OF JOHN STANTON

Mr. STANTON. Thank you, Mr. Chairman. The burden and luxury of being the final speaker of a large panel is that I have the opportunity to make some of my comments responsive and the burden and responsibility to attempt to be brief.

The wireless industry celebrates its 20th birthday, the anniversary of the first customer becoming a wireless customer in Chicago, Illinois in October. So in October 1983, our industry was born. In that time, the industry has grown to the point that roughly 55 percent of Americans now have a wireless phone. The industry's revenues in total now exceed as of 2003 the total revenues of the local exchange business in the United States. So the wireless business on that basis has become the largest part of the telecom industry.

Wireless is fundamentally the best way to provide services in rural areas from an economic point of view. In areas with population densities below ten people per square mile, in most exchanges, wireless can provide service more efficiently and more economically over the long term.

Western Wireless, the company that I founded in 1994, provides services to approximately 800,000 square miles of territories. We built the 1,500 sites that we offer in the 9 years that the company has been in existence in addition to some sites that were built by predecessor companies that we operated.

We have managed during that time to also build systems that are relied upon by our 1.25 million customers as their primarily telecommunications device. Our company has been a leader in terms of building systems that we believe can be responsive to consumer needs.

About 5 years ago, in the Antelope Valley of Nevada, no telephone service, wired or wireless, was available. We in an agreement with PacBell and with the Nevada Public Service Commission agreed to build a wireless system that literally represented the first form of any telecommunications services that was available in that community.

Two years later, in Regent, North Dakota, we introduced the first competitive wireless service, providing services directly competitive with the local exchange carrier. Two weeks later, the local exchange carrier that we connected with cutoff our access to the public switch network by cutting off our switch, which was restored only a few weeks later. The challenge for us has been we operate in an intensely competitive environment, but we have also done I think the right thing.

In the Pine Ridge Indian Reservation in South Dakota, we have introduced services about 3 years ago on Election Day 2000. And in doing so, we now have majority market share in that market because we have been willing to commit substantial investment and we have been able to grow that business.

Earlier this month, we introduced a wireless data service. And while not directly a result of universal service monies, our ability to build a voice-grade system enabled us, then, to layer on top of that data services. The two little girls in this picture had their first opportunity to interact with the internet via a wireless connection and their only opportunity to interact with the internet via that wireless connection.

New services are possible because of universal service. Our company began attempting to get certified as an eligible telecommunications carrier roughly 5 years ago. And I can guarantee you that commissioners such as Chairman Rowe and Commissioner Gregg as well as the other commissioners across the country have been rigorous in examining the applications of wireless carriers. It has taken us a total of 5 years to get certified in 13 of the 14 States in which we have applied.

We have as a result of that and in reliance on the understanding that we were going to be able to access the universal service monies invested approximately $500 million, extending our coverage and expanding our services into rural areas. That commitment, doubling the total property, plant, and equipment that the company operated, was a direct result and in reliance on our understanding of the new rules promulgated by the 1996 act.

The 1996 act effectively allowed new players to enter the market. It also allowed new players or players that were in the market to contribute effectively to the fund. Commissioner Gregg cited the increase in the fund from $1.8 billion to $6.1 billion. Nearly 40 percent of those monies come from the wireless industry.

In fact, between 2002 and 2003, the amounts of monies that the wireless carriers will pay into the fund increased from $900 million to $1.8 billion. And, in total, wireless carriers now contribute approximately 30 percent of the money going into the funds. And, yet, even with an increase recently in amounts coming out, our payments coming out of the fund represent less than 2 percent of the fund's total. So we pay in 30 percent, and we take out 2 percent, despite the fact that companies like my own make substantial commitments to rural areas.

The core issue is, do you support competition in rural areas? Competition benefits rural customers. It disciplines all of the operators within the market. And it guarantees the ability of customers to get better services in rural areas than they would otherwise.

Thank you, Mr. Chairman.

[The prepared statement of John Stanton follows:]

PREPARED STATEMENT OF JOHN STANTON, CHAIRMAN, DIRECTOR & CHIEF EXECUTIVE OFFICER, WESTERN WIRELESS CORPORATION

Mr. Chairman and members of the Committee, I commend you and your colleagues for conducting this hearing to examine the critically important issue of the future of universal service. I especially appreciate this opportunity given to Western Wireless to address a subject—universal service—that is not only of great interest to this committee, but also is a subject that runs to the core of the company I founded in 1994.

Western Wireless provides wireless telecommunications services in 19 western states with a focus on serving the telecommunications needs of rural consumers. Over the years, wireless service has become essential to a growing number of Americans who are increasingly using wireless service for their basic and advanced telecommunications needs. In urban areas, wireless and wireline carriers compete with one another based upon their costs of providing service, which has resulted in intermodal competition to the benefit of consumers. In rural areas, however, wireline carriers have historically received an exclusive subsidy, called universal service, that has provided the incumbent local exchange carriers a decisive advantage over their only potential competitors—wireless carriers.

In 1996, Congress adopted sweeping changes to the telecommunications landscape by introducing competition into the local market, including the universal service market. Now, for the first time, many rural consumers are realizing the benefits of competition brought about by the Telecommunications Act of 1996 and the pro-competitive policies of the Federal Communications Commission. Coincidently, with competitive carriers' entry into the universal service market, incumbent local exchange carriers have cried foul, attempting to reverse the 1996 Act's pro-competitive promises for rural consumers and restore their monopoly power over the local market.

Congress' vision for universal service, which I share, is that it is an evolving set of services based upon consumer preferences. In rural and urban areas alike, consumers increasingly prefer wireless service over wireline service for their communications needs. The FCC and state commissions have recognized this trend and have concluded that the public interest is served by designating wireless carriers as eligible for universal service support. So, instead of talking about competition brought about by the competitive local exchange carriers ("CLECs"), we find ourselves here today talking about one of the bigger successes of the 1996 Act and that is universal service and the fact that rural consumers are, for the first time, beginning to experience the benefits of a competitive local telecommunications market.

In this testimony, I explain that: (i) wireless communications serves the needs of rural consumers; (ii) a competitive universal service system allows rural consumers to realize the benefits of a competitive market; and (iii) Congress should continue its oversight of the emerging competitive universal service market to ensure that rural consumers remain the primary beneficiary of efforts to reform the system.

WIRELESS SERVES THE NEEDS OF RURAL CONSUMERS

Western Wireless provides cellular telephone service in 19 western states, including on more than 85 Indian reservations and American Indian communities. The Company is the second largest wireless carrier in the country based upon geography served, covering approximately 25 percent of the continental U.S. with an average population density of approximately eleven people per square mile. Western Wireless serves many areas that do not have access to basic telephone service, much less advanced telecommunications services.

Western Wireless has a long history of providing service to unserved and underserved consumers. In 1994, through a unique arrangement with the Nevada Public Utilities Commission and the incumbent local exchange carrier, Western Wireless began providing wireless local loop service to small businesses and residential consumers in a remote area of Nevada that did not have access to wireline local telephone service. In 1999, Western Wireless began offering wireless local loop service in Senator Dorgan's hometown of Regent, a community of less than 300 people, which was one of the first competitive local telephone service offerings in rural America, resulting in the availability of new and innovative services to consumers for the first time. In August 2000, Western Wireless took another step towards serving the telecommunications needs of consumers living in some of the more rural areas of the U.S. by entering into a historic agreement called *Tate Woglaka* (Talking Wind) with the Oglala Lakota Tribe on the Pine Ridge reservation, resulting in many tribal members having access to basic telephone service, including emergency 9-1-1 service, for the first time. And more recently, Western Wireless embarked upon an effort to more broadly bring the benefits of competition to the local telephone market in rural America. The centerpiece of this effort was the Company's petitions seeking designation as an Eligible Telecommunications Carrier (ETC) for purposes of universal service support. Today, Western Wireless is an ETC for purposes of universal service support in 14 states, plus the Pine Ridge Indian reservation in South Dakota, and has emerged as the preeminent competitive universal service provider in the United States.

A COMPETITIVE UNIVERSAL SERVICE SYSTEM

It has been a national policy since 1934 to make available to all Americans, regardless of the location of their residence, affordable telecommunications services. In too many cases, rural areas have been effectively excluded from the benefits of a competitive telecommunications market because incumbent local telephone companies have historically monopolized access to universal service support necessary to provide affordable telecommunications services in these rural, high-cost areas. The 1996 Act changed all of that and now, through a competitive universal service system, rural consumers are beginning to realize the benefits of competition.

Many consumers are using mobile wireless service in lieu of wireline as their primary mode of communications. Wireless service has emerged as a fully robust competitor to traditional wireline telephone service. Survey results and other data reveal a strong willingness by a substantial number of consumers to substitute wireless service for wireline telephony. For example, a recent study by Ernst & Young and PriMetrica Research Survey confirms the growing displacement of primary lines by wireless service. The study surveyed 700 households and found that:

- Close to one-half of households would drop their wireline service for a family share wireless plan with 600 shared base minutes offered at $50 per month.
- Roughly one-third of US households would drop their wireline service for a family share wireless plan with 2000 shared base minutes offered at $130 per month.
- Not surprisingly, households that currently have wireless service expressed a greater willingness to drop their wireline service than households that do not have any wireless service.

Survey data focusing on consumers in rural areas shows similar results. Western Wats, an independent consultant, completed a survey in February 2003 that provides what may be the best, most current insight into the needs and preferences of rural consumers. The survey asked 1,000 rural residents within Western Wireless' territory about their use of wireless phones. The survey found that of the rural consumers who had wireless service:

- 50% stated that their wireless phone has become more important to them, while their landline phone has become less important;
- 51% said that wireless service has replaced some or a large percentage of their home landline service;
- 48% reported that wireless service has replaced 90% or more of their landline long distance;
- Nearly 25% reported that they consider their wireless phone to be their primary phone; and
- Approximately 65% reported that they have friends or family members whom they contact primarily on their wireless phone.

These surveys confirm that wireless service is essential to a growing number of Americans, many of whom are substituting wireless for wireline service. This fundamental change, which is occurring in rural areas, as well as in urban areas, reflects the "will" of consumers, which must be recognized by government policies that are competitively and technologically neutral. The universal service system as implemented by the FCC is a good example of a competitively and technologically neutral policy that has enabled rural consumers to realize the benefits of competition envisioned by the 1996 Act.

Consumers will likely increasingly "cut the cord" implement services, like local number portability and enhanced 9-1-1 services, that further blur the lines between wireline and wireless service. To this end, Western Wireless is in the process of sending bona fide requests for number portability to many of the wireline and wireless carriers within its markets.

Competition is the means by which rural consumers can obtain service reasonably comparable to those services provided in urban areas. Over the last few years, as competition has developed in the universal service market, it has become clear that competition preserves and advances universal service by:

(1) Making service available in areas previously unserved by incumbent carriers. As many state commissions know, there are numerous areas within rural states where consumers do not have access to affordable landline service. On the Pine Ridge Indian reservation, Western Wireless' competitive universal service offering has made telephone service available to many tribal members for the first time, resulting in dramatic increases in telephone penetration rates. In Reese River Valley, Nevada, Western Wireless has provided telephone service for the last 10 years to residents not served by the landline carrier. In Montana, Western Wireless serves many rural consumers that do not have access to landline telephone service. All of these examples demonstrate how universal service is advanced by competition.

(2) Providing new and innovative services that are reasonably comparable to those services provided in urban areas. Western Wireless' entry into the local telephone market has not only resulted in new and innovative services being available to rural consumers, but has also forced the incumbent carrier to offer better service. For example, in Regent, North Dakota, after Western Wireless entered the market and began offering new services previously unavailable, the incumbent carrier responded by offering an expanded local calling area, lower rates, and data services.

(3) Facilitating access to advanced services. Many rural areas do not have access to advanced services and are unlikely to be served in the future by landline carriers due to wireline limitations. Competition provides the only hope to bridge this "digital divide." Recently, Western Wireless demonstrated the capabilities of wireless service to bridge the digital divide in the small rural town of Terry, Montana, where the Company deployed advanced high-speed digital technology with the capability to offer data speeds of up to 140 Kbps.

a. The establishment of a competitive universal service market, and specifically Western Wireless' provision of universal service on the Pine Ridge Indian reservation, is also bridging the "digital divide" in rural America. In September 2003, Western Wireless introduced high-speed data services on the Pine Ridge Indian reservation through the implementation of next generation digital technology and the donation of 22 laptop computers capable of internet access at speeds up to 140 Kbps. Western Wireless' ability to provide advanced telecommunications services on the Pine Ridge Indian reservation and other rural areas are dependent upon high-quality network facilities in rural areas, which, in turn, is largely dependent upon the availability of universal service support.

State Commissions and the FCC agree that a competitive universal service system benefits rural consumers. There is near unanimous agreement among policymakers that the public interest is served by a competitive universal service system. Specifically:

- The Minnesota commission acknowledged that Congress and the Minnesota Legislature were "deeply committed to opening local markets to competition," but that it was responsible under Section 214(e)(2) to determine on a case-by-case basis whether some rural telephone company areas could not sustain or benefit from competition. The state commission first looked to whether Western Wireless' designation would benefit consumers in rural Minnesota, and determined that Western Wireless would bring reliability, high service quality, affordability, customer choice and new and innovative services.
- The Kansas Commission stated that the clear and unmistakable public policy imperative from both the federal and state legislatures is that competition is a goal, even in rural areas. Arguments were made that competition is not in the public interest in any rural telephone company service area because it may jeopardize universal service. However, the commission concluded that no articulable facts had been presented to reach the broad conclusion that competition and universal service are never able to exist together in rural areas. The Commission did not accept the assertion that designating additional ETCs in rural areas will necessarily threaten universal service. The commission found that the benefits of competition and customer choice should be available to Kansans living in non-rural areas and that general concerns and speculation are not sufficient justification for adopting a policy that would result in benefits and services that are available to other Kansans not also being available to rural telephone customers. The Commission concluded that the rural telephone companies did not demonstrate any adverse impacts and that competition should not be withheld from customers in rural areas.
- The Nebraska Commission concluded "the public interest requirement for designation of an ETC in rural areas is not meant as a protective barrier for rural telephone companies but rather as a method for ensuring that rural areas receive the same benefits from competition as their urban neighbors."
- The South Dakota Commission found that Western Wireless' provision of "universal service throughout the study areas will be beneficial to the public."
- The North Dakota Commission summed things up this way: "The Commission finds that designating Western as an additional ETC in the study area of each rural telephone company will advance universal service by bringing new telecommunications services to North Dakota consumers, by bringing competitive choice for universal services to residential customers, by offering a highly reliable and top quality universal service offering, and by providing cost effective means for customers in remote areas to acquire universal services."
- The Texas Public Utilities Commission said in 2000, when designating Western Wireless as an ETC: "[T]he Commission is unwavering in its support of a simple proposition: Rural Texans are not second class citizens and should not be deprived of competitive alternatives or access to new technologies."

CONGRESS SHOULD CONTINUE ITS OVERSIGHT OF THE EMERGING COMPETITIVE UNIVERSAL SERVICE MARKET.

Congress and this Subcommittee in particular should continue its oversight over the development of a competitive universal service market to ensure that rural consumers continue to be the primary beneficiary of universal service policies. To this end, I suggest the following:

1. Create A Stable, Sustainable Universal Service Funding Mechanism By Ensuring Adequate Funds Are Available To Preserve And Advance Universal Service. Until universal service evolves to a market-based solution for providing telephone service to rural America, any support provided to rural areas must be distributed on an equitable, non-discriminatory basis to both incumbents and competitive carriers. Federal legislation may be necessary to provide the FCC with the authority to base universal service contributions upon a broad range of revenue sources to ensure a stable, sustainable universal service funding mechanism. At the same time, universal service support to carriers must be based upon the most efficient technology for providing service.

2. As Consumers' Telecommunications Needs Evolve, The Universal Service Policy of the U.S. Needs To Reflect Consumers' Increasing Reliance On Wireless Services. The focus of any universal service policy should be the consumer. Wireless service has emerged as a fully robust competitor to wireline telephony, resulting in many rural customers "cutting the cord" and other consumers using wireless as a substitute for wireline usage or additional lines. Competitive Eligible Telecommunications Carriers ("CETCs"), including wireless CETCs, use high cost support to serve unserved and underserved areas, thereby "advancing" universal service.

3. Universal service policies must be competitively-neutral. It has been a national policy since 1934 to make available to all Americans, regardless of the location of their residence, affordable telecommunications services. All too often, however, rural areas have been effectively excluded from the benefits of a competitive telecommunications market because incumbent local telephone companies have historically monopolized access to universal service support necessary to provide affordable telecommunications services in these rural, high-cost areas. Clearly, a competitive carrier that does not have access to universal service funds would not choose to enter the local market and compete with incumbent carriers who do have access to universal service support. I89CONCLUSION

The competitive universal service system is working: rural consumers are gaining access to services previously reserved to their urban counterparts. Rural consumers today have begun to realize the vision of the 1996 Act's pro-competitive mandates, including those that apply to the universal service market. Wireless service provides the only real option for rural consumers to bridge the "geographic divide" and fully participate in our global economy. A competitive universal service market is a success because of the progressive thinking of Congress and pro-competitive policies of the FCC and state commissions. Congress should continue to oversee the development of universal service in the United States and take action, as necessary, to further develop the emerging competitive universal service market.

Mr. UPTON. Thank you all very much.

Again, I apologize that the votes interrupted it in the middle. At this point, we are going to alternate between the Republican and Democrat side asking questions of 5 minutes each. And we'll move in the order that members appeared and their seniority, knowing full well that a couple of members have an extra 3 minutes for those that deferred their opening statements.

I would like to focus my time on the eligible telecommunications carrier, ETC, issue. Ms. Shank, in your testimony, you suggested that there was a "Lax state in Federal Communications Commission consideration of what constitutes the public interest when granting ETC status to competitors." I would like to have a little better picture of what that means and the implication of such lax considerations. What are they for rural ILECs and universal service funding in general?

Ms. SHANK. In public interest, I feel that small telephone companies are regulated. We have demands to meet. We have quality of service. And I think the public interest people want those things. It doesn't matter where somebody builds a new house or what. We're there to provide service to them.

What is happening is our wireless is coming into our area and not that that is all bad, but the problem is you get two and three of them coming in a small area like Bloomingdale Telephone Company if they're all pulling on it. It does affect it very much.

Our public interest people, I think that they so need the network that we set up years ago. And they have an interest in being able to always know they can rely on telephone service. And if you look back when we have bad things happen, like in New York and everything, where those systems of wireless and everything didn't work, you saw lines of people at pay stations. So I think public interest still has a desire to continue with a good strong network in the United States.

Mr. UPTON. Commissioner Abernathy, how would you respond to the suggestion that there is a lax state in FCC consideration of what constitutes the public interest?

Ms. ABERNATHY. I guess I would respond by saying one of the reasons that the FCC referred the ETC issue over to the joint board was a recognition that we need to make this process better. And there are some improvements that can be made.

Most of the parties who responded in response to the whole joint board process on either side of this issue have said that it would be very beneficial to have more concrete guidance from the FCC about what it takes to be designated and guidelines for being designated as an ETC because at the end of the day, there has to be a public interest analysis associated with it.

Some of the concerns have been that because funds continue to run to both the wire line provider as well as the new ETC, that there may be no incentive to really do a public interest analysis because no harm, no foul. You're not going to lose any support.

So I think at the end of the day, this is one of the major areas that we're looking at as the joint board. And we can do better.

Mr. UPTON. What do you think with regard to Mr. Stanton's comment that the wireless industry contributes 30 percent and, yet, receives only about 2 percent of the fund?

Ms. ABERNATHY. I think that that really goes to the question of when you're contributing to the fund, is there any obligation to then receive support from the fund? And the answer pretty much is no because the way it works is all telecom carriers contribute and not all qualify for funding.

Now, again, at the end of the day, as we all know, it's passed through to consumers. And so what we're really looking at is our consumers contributing fairly and equitably. And are we distributing it in a way that there is no arbitrage between the various industries?

I do agree with Mr. Stanton that wireless has been of tremendous benefit to rural America, no question in my mind. So what we are deliberating about is at what point does a company that is lightly regulated and has done a fabulous job in rural America, when they then come to the government and say, "And now I would like to be able to receive some subsidy support," what are the bells and whistles? What are the obligations that go along with receiving that subsidy?

As long as they're out there providing service competitively with their own capital investment, we pretty much do leave them alone, but I think there are some obligations that necessarily go along with being qualified to receive government subsidies.

Mr. UPTON. Ms. Shank, what are some of your obligations as the carrier of last resort? How do those requirements compare to the obligations of carriers serving the same areas? And how should the fact that a rural ILEC is the carrier of a last resort factor into whether a competitive carrier should be designated as an ETC in the same area?

Ms. SHANK. No. 1, we're regulated. We have to provide service to whoever comes in there. We are regulated by billing standards. We are regulated by the rates we charge and all of those things.

And, as a last resort provider, there is never a question. When somebody applies in our service, they are provided with service.

You have some of the other competitors coming in. In all areas, it doesn't always work either in our exchange. So people cannot depend on that. As a last resort, they depend on us to provide that service. And we're there under regulations to provide it and will provide service to each and every customer living in our exchange.

Mr. UPTON. I see my time has expired. Mr. Gordon?

Mr. GORDON. Thank you.

Mrs. Greene, in Tennessee, you're not only regulated by the FCC but also by what we call the Tennessee Public Service Commission. And so with that, there are implicit and explicit additional charges for universal service. What are some of the issues we are concerned with as we look at this about the relationship between the FCC and various State universal service regulations?

Mrs. GREENE. You are correct that we are regulated by the Tennessee regulatory authority. And what we have right now is really a situation where we have conflicting theoretical schemes that have been layered on top of each other that have the potential to do a lot of damage to the incumbent local exchange industry.

We have a social pricing program that is imposed by States, all the States, like the Tennessee commission. And in that social pricing program, we have a history of pricing regulations that have business subsidizing residential and urban subsidizing rural.

When you take that and you overlay it with a pro-competitive plan that is enforced by the FCC that not only creates our wholesale business but makes us price that wholesale business at a deeply discounted rate you then have a series of interlocking implicit subsidies that really don't work anymore. If those implicit subsidies were made explicit, the size of the universal service fund would just really explode.

Mr. GORDON. So what do we need to do about that?

Mrs. GREENE. Well, first of all, I think we need to breathe life into a couple of things that were required by the 1996 act that have not yet been implemented.

The 1996 act had three basic goals. One was to create competition. And it has been very successful at that. In our service territory alone, in our nine States, we have on any given day between 350 and 385 competitors just in the wire line space. So it's been very successful in creating competition.

The other two premises of the act were, first of all, to make implicit subsidies explicit. The State public service commissions have not stepped up to the plate either by creating State universal service funds or by allowing rates to rise to their natural level with some sort of protections about comparably affordable services between urban and rural areas.

But, in addition to that, a final goal of the Telecommunications Act was to encourage deregulation and to allow marketplace competition to supplant command and control regulation. That has not happened at all. And, in fact, today what you have is both at the State and Federal level more regulation than we have had at any time in our history.

Mr. GORDON. Ms. Abernathy, as we look at this, what are your concerns in terms of the State issues versus the FCC and that interrelation?

Ms. ABERNATHY. Actually, it's something that we addressed as a joint board when we were dealing with this whole non-rural support mechanism. And one of the major issues that came up there was given that we generally look at Statewide average costs per line for non-rural carriers and then we compare that to a Nationwide benchmark, how do you, nevertheless, ensure that support is sufficient and that the rates are reasonably comparable?

What we have done historically is that we presume that if they're within 135 percent of the Nationwide average, that the States are in a position to make sure that urban and rural rates are reasonably comparable because you spread the rates across your low-cost customers and your high-cost customers. That's been the interaction with the States.

What we did as a joint board is we then said, "Okay. In addition, as another safety mechanism, to the extent that you still may not have reasonably comparable rates for various reasons within a State, then"—this is the recommendation again from the joint board—"you can come back either to the FCC, to the Nationwide USF, or to a State USF and ask for additional funding dollars providing the documentation about why you're unable to keep your rates at comparable levels for between urban and rural customers."

The reason this approach has been historically taken was the belief that while rural carriers aren't able to absorb any of these high costs themselves and so, therefore, they qualify based on their own costs, that with the larger carriers, such as the incumbent BOCs, that they are able to engage in this shifting of burdens between high and low-cost customers.

Mr. GORDON. And then where that does leave us with a so-called level playing field?

Ms. ABERNATHY. Well, where that leaves us is at the end of the day, customers are fine under the current approach. The real question is, is it unfair to the carriers, the larger carriers, who now face competition for their lower-cost customers that traditionally have been absorbing some of the costs of the higher-cost customers?

So now you're really engaged in a debate about, is this the best way to manage the USF? Is it fair to the carriers who are now facing competition? Can they continue to be able to balance off these costs between high and low-cost customers?

Necessarily, if we change this method, you will drive up the size of the fund explicitly because you won't have large companies any more that are doing this for you within their own customer base.

Mr. GORDON. Thank you, Mr. Chairman.

Mr. WHITFIELD. Mr. Terry is recognized for 5 minutes.

Mr. TERRY. Thank you. I appreciate that. I had a statement, but I appreciate the effort.

With that, let me just start off by saying that this has been a fairly decent hearing and I have appreciated listening. I think we could have had more diverse opinions up here, but I will get into that later. Certainly I think one of the issues that anyone listening to the testimony here would take is just how complicated universal service is and will become when we factor in new technologies.

And just down on the far end at my left, it was an interesting discussion between Western Wireless and Bloomingdale Telephone Company. And one that is raging within my own State back home is the role of wireless in universal service fund in rural areas. And it really begs the question, and I think it forces us to have to go back and say, "Hey, what is universal fund? What is the purpose of it? How are we going to define it because times have changed? Do we need to modernize it or is it simply going to be that every residence for safety purposes should have one line into their house?" It's going to take a Herculean effort to modernize universal service fund. And I'm certainly willing to participate in that. In fact, I have mentioned to Chairman Upton on a couple of times that I think we should put together a very diverse but controlled, not controlled in the sense that we control the outcomes but certainly if you have a 40-member panel versus a 10-member panel, you could probably get more accomplished with the smaller, but I think we should put together a panel of diverse views and have discussions amongst those and really figure out new and unique ways to do it.

It's just been my year now that I dove into the universal service fund. I see that there are a variety of different ways to fix this. And I just think we need a total fix. I am just not very confident that will ever come about.

I mean, even if we could put together an effort, I am just not sure that with all the interests that have just been displayed here today, that we are ever going to get there. So let me lay down the second premise here.

We are all in it for our own. Okay? I am representing a State that I feel is getting screwed right now, to put it bluntly. And that is why I have been so emphatic regarding the high-cost non-rural fund and its distribution.

It just baffles me when we have six counties in the State of Nebraska that rank as the poorest in the Nation, when we have counties like Cherry County that are larger than two States and have 800 people in it, in that county, that we can't qualify for that fund. And I see States that are listed here that are just as rural, the Dakotas, for example, that don't share in this high-cost fund. And so there seems to be something inherently wrong.

And since the FCC adopted this, Ms. Abernathy, you are going to get some of my questions here. Now, just as a member of the commissioners, are you aware of this discrepancy in distribution in the high-cost non-rural fund?

For example, my State that pays into this, that's a rural State but doesn't receive anything out of it. Is this something that the FCC is aware of or you are aware of personally?

Ms. ABERNATHY. I'm personally well-aware of it, thanks to having spent some time with you and your staff. And I do appreciate the discussions we have had because this is very complex.

What I had always focused on before this point was the USF funds that flow to Nebraska and South Dakota and North Dakota, Wyoming, Utah. And they're net receiver States. So I had always looked at, as a rural State, are you receiving the U.S. dollars? Are you paying in but getting more than you pay in? And the answer is yes, to the tune of around $8 million, sometimes $20 million.

What I had never stepped back and said, "But what about the non-rural carrier within that State? Are they able to continue to balance rates between rural and urban without any USF support?" Again, historically what has been done is to say, "Larger carriers, you do that balancing within the State. And then at the back end, if you need more support, we give it to you."

But it has been an obligation placed on the larger carriers. So all the rural carriers within your State, you know, they're receiving the payments. The non-rural, the large carrier, which would bequest, yes, they are expected to absorb some of this. And is that methodology sustainable given competition?

Mr. TERRY. Let me ask the follow-up in there. Do you feel that that methodology, the current methodology, is——

Mr. WHITFIELD. Mr. Terry, your time has expired, but——

Mr. TERRY. Will you yield me your time?

Mr. WHITFIELD. I'm sure when the chairman gets back, he may do another round.

Mr. TERRY. I will do the second.

Mr. WHITFIELD. Mr. Markey is recognized for 5 minutes.

Mr. MARKEY. Thank you, Mr. Chairman.

Looking ahead, it is now clear to almost everyone that the current universal service policy's days are numbered. The clamor for additional funds keeps growing. Meanwhile, the traditional interstate revenue base for providing such funds continues to hemorrhage. That's because so-called long distance service is increasingly becoming conjoined with flat rate local and long distance packages for both wireless and wire line service. In addition, there will be an inevitable and in my view rapidly accelerating migration from circuit switch telecommunications services to nontraditional internet protocol-based telecommunications services.

So, Ms. Greene, you are from BellSouth. Are you any relation to Judge Harold Greene, who broke up the Bell system?

Mrs. GREENE. Actually, I got hired right after the breakup of the Bell system, and I had a lot of people at BellSouth ask me that. They really weren't very nice to me until I answered it. But no, sir, I am not.

Mr. MARKEY. You claim no relationship? I didn't think so.

Do you believe, Ms. Greene, given the sweeping nature of the change in the marketplace that the FCC and the States should nickel and dime some minor adjustments to current formulas for collecting universal service and continue to monitor IP telephony and other issues or do we need a more comprehensive revamping of how such fees are collected and distributed?

Mrs. GREENE. Yes, sir. I think we need a comprehensive overview of the fund. We need a comprehensive view of who contributes. And we also need to look at the distribution of the fund. So no, I don't believe nickel and diming is correct. We do need a comprehensive overview.

Mr. MARKEY. Mr. Lubin, could you give me your quick view on that?

Mr. LUBIN. Yes. I have a tremendous sense of urgency. I think the universal service mechanism is broken. I think the assessment rate today of 9.5 next year will exceed 10 percent. I think it's only going to get worse. And I urge——

Mr. MARKEY. Comprehensive?

Mr. LUBIN. Comprehensive.

Mr. MARKEY. A re-looking of the whole system?

Mr. LUBIN. Correct.

Mr. MARKEY. Okay. Thank you. Thank you both for your questions.

Let me yield the balance of my time to the gentleman from Michigan, Mr. Stupak, which he can use in addition to his own time.

Mr. STUPAK. I appreciate the gentleman yielding.

Commissioner Abernathy, I understand that the commission is completing its review of the support mechanism for non-rural carriers. As you know, representative Terry and I have H.R. 1582. Will the commission in its review of this fund be providing comment on our legislation as well?

Ms. ABERNATHY. At this point, I haven't seen a draft item from the bureau. As far as I know, there was nothing in the record comparing the legislation. So to the best of my knowledge, we will not, but I will certainly give you better information as we get more information from the bureau.

Mr. STUPAK. Okay. In your testimony, you were talking a little bit about intrastate. What is the reason that intrastate revenues were not included in the contribution methodology? And it would seem to me that there is not a strong objection among the stakeholders regarding including intrastate revenues. Won't that at least provide some measure of relief?

Ms. ABERNATHY. Is the question, would it help us if we are able to effect both interstate and intrastate?

Mr. STUPAK. Yes.

Ms. ABERNATHY. Absolutely. It makes a huge difference for a couple of reasons.

Mr. STUPAK. Why wasn't it included initially, then?

Ms. ABERNATHY. By Congress?

Mr. STUPAK. By Congress.

Ms. ABERNATHY. Well, I don't know, but I think there was some belief——

Mr. STUPAK. There was——

Ms. ABERNATHY. [continuing] originally that we could.

Mr. STUPAK. Yes.

Ms. ABERNATHY. And then the case went up on appeal and the court said we couldn't. So it may very well be that Congress thought that we were able to assess.

Mr. STUPAK. Okay. Mr. Lubin, yesterday several organizations put out an ad in the Washington Post—I think they were AARP, Rainbow Push, National Grange—urging the FCC to maintain a revenue based universal service funding system. They also sharply criticized a connections-based system, such as the one that you have proposed, claiming that it will unfairly burden low-income customers. Could you respond to that comment or criticism?

Mr. LUBIN. Yes. From our point of view, first of all, we supported the telephone number approach, which is similar to a connection-based approach. Our belief is that absolutely does not harm low-income individuals. In fact, what we suggest the commission might consider is to exempt people who are on lifeline programs. So people who are on life line programs would not pay the dollar.

But I would like to go even one step further. Every time we have looked at the data, people who are considered low-volume, which was the other point that they raised in that article, that low-volume, there really is no correlation usage and people with ethnicity or age or income. In fact, what you find are people who have low usage follow the whole demographic spectrum. Conversely, people who are low-income at various points in time could be high-usage toll users.

So we think, actually, a connections-based or a numbers-based, which we put forward, creates simplicity, stability. The customer knows exactly what they are going to be paying every month.

Mr. STUPAK. I guess my time is up, Mr. Chairman. I will look for my opportunity to ask questions later.

Mr. UPTON. Thank you.

Mr. Walden? And you get the extra bonus of 3 minutes.

Mr. WALDEN. The bonus points. Thank you, Mr. Chairman.

Let me go to Commissioner Abernathy. I am trying to get a better understanding of this high-cost rural area fund. The "high-cost non-rural fund" I guess is the term.

I have seen this printout that shows contributions to USF by State—I am sure you have seen it, too—and then payments from the USF. I am just trying to figure out why this occurs the way it does in this particular fund and then how this fund is related to other funds that make other payments that you have alluded to.

For example, with all due respect to my friend from Mississippi, Mississippi gets $104 million and Alabama gets $43 million and West Virginia gets $26 million. And then it's a couple of million and a bunch of zeros from there on.

Can you explain how we arrive at that and then, anybody on the panel, too, if that is a fair distribution of funds because it seems kind of odd——

Ms. ABERNATHY. Right.

Mr. WALDEN. [continuing] unless you're from Mississippi or Alabama?

Ms. ABERNATHY. Which I am not. I will explain, and then I may yield to my colleagues to help with this.

The way it is supposed to work is you look per State at the number of rural high-cost customers that are entitled to USF. You then look at the amount of money you're collecting from all of the customers within the State to support all USF programs. You then back out all of the revenues that they receive and see what the total amount is.

So, in theory, the way it should work is that the States that are receiving the most funds are those that have the largest number of high-cost rural carriers as——

Mr. WALDEN. And how is that defined? What is a high-cost rural carrier?

Ms. ABERNATHY. High-cost rural carrier. It's based on an average. You look at Nationwide averages. You calculate whose costs are above and whose costs are below that benchmark. And that's how you define who are the high-cost companies. And then——

Mr. WALDEN. Is that on a company-wide basis?

Ms. ABERNATHY. For the rural carriers, it is based on their cost models that are used to identify their costs. For the non-rural carriers, the non-rural carriers then end up receiving support depending upon the volume of high-cost customers they have versus the volume of low-cost customers they have. And even if they have numbers of high-cost customers, if the low-cost customers ultimately drive their overall costs down to within a Nationwide average, then they won't get that much support.

But I think I may allow Billy Jack to step in or Bob Rowe.

Mr. GREGG. There are about 185 million land lines in the United States. And we have rural carriers, which tend to be the smaller, more rural carriers; and non-rural carriers, which are the larger carriers, like the regional Bell holding companies.

Mr. WALDEN. But they may cover a rural area.

Mr. GREGG. Right, but the——

Mr. WALDEN. As well as an urban area?

Mr. GREGG. Right. And there are only 80 non-rural carriers in the entire United States, but they serve 90 percent of all the access lines. There are 1,358 rural study areas that serve only 10 percent of the access lines.

The non-rural high-cost fund that you have been speaking of amounts to $240 million a year. That's only 7.2 percent of the entire high-cost fund. The lion's share of the high-cost fund goes to these 1,358 rural carriers, $2.5 billion each year. Eight hundred million total goes to these 80 non-rural carriers. Two hundred forty is the high-cost model. And that is the——

Mr. WALDEN. That's the chart we're looking at?

Mr. GREGG. Right. And it's the distribution of that support. That $240 million is as she stated. First, you calculate a National average cost of all of the non-rural carriers. And that's about $22 per line per month. Then you apply a benchmark. The benchmark that has been used, heretofore, is 135 percent. That results in about a $30 per line per month benchmark.

Any States, any non-rural States, that have costs over that benchmark, the Federal fund will support 76 percent of that difference. So you have 8 States that have per line costs per month above $30. The others are below. There are two that are very close, Nebraska and South Dakota, to the benchmark.

Depending on what the FCC does with the Tenth Circuit remand decision, which is due out next month, there may be more States getting high-cost distribution or less. It just depends on what they finally come up with.

Mr. ROWE. Mr. Chairman, representative, if I could weigh in, too? Both your State and my State do receive significant support in the fund targeted at the small programs. And your concern, again, is to the large company program.

The FCC's initial decision was appealed to the Tenth Circuit, was remanded to the FCC. The court said, among other things, that the commission failed to adequately define terms "reasonably comparable" and "sufficient" and failed to explain how the particular mechanism was consistent with the statutory requirement that urban, underline "urban," and rural rates and services be reasonably comparable.

That decision was then referred by the FCC to the joint board. Everyone worked on that in good faith and very diligently. I was one of the dissenting commissioners and wrote at length that, in my view, comparing rural and insular costs to National average costs was not compliant with the statute.

Quoting the former economist for this committee, who went on to serve on the FCC, we have to, as a first matter, follow the law. That's, of course, an unusual sentiment coming from an economist. But in my view, despite good effort and some progress coming out of the joint board recommendation, we have not yet followed the law in that very basic way.

Depending on how you determine the urban average cost—and there are a number of ways that were included in the record before the joint board—it might be necessary for one of the large carriers to have average costs of 164 percent of an urban average up to, using a rural utility service study from several years ago, 233 percent of the urban average before they would be eligible for support under the large company program.

As Mr. Gregg pointed out, the large company program represents a very small portion of the overall universal service fund, also represents a very small portion even of the high-cost fund. So this is a critical problem.

If I could, I would add that this has been perceived as a quest issue. I don't consider it a quest issue, Rather, I would say, first of all, it's a question about providing sufficient support for networks that serve all customers.

Second, I think it's of potential concern to competitive providers, who follow the advice of another good economist, Willie Sutton, and go where the money is.

Mr. WALDEN. I have got 4 seconds left. Let me just try and find out an answer. Do you think, then, that this is a fair distribution of this $200 million or is it inequitable that the basis of the $200 million goes to just a handful of States, including Montana?

Mr. ROWE. Mr. Chairman, representative, in my view, no for the reasons that I stated in my dissent.

Mr. WALDEN. All right. Ms. Abernathy?

Ms. ABERNATHY. In my view, again, so long as rates are affordable and reasonably comparable across States, then I think it is fair. And we have managed to make sure that happens through the support mechanism safeguards we have in place.

Mr. WALDEN. All right. Thank you very much.

Mr. UPTON. Thank you.

Next we will go to the chairman of the full committee, the chairman from Louisiana, Mr. Tauzin.

Chairman TAUZIN. Thank you, Mr. Chairman. And thanks for conducting this hearing.

To start with, I wasn't here for the opening statements. And I missed a lot of the questions. I apologize, but we were working on a Medicare conference. So excuse me.

I would like to take us back a bit. I mean, universal service fund was based upon a rather simple notion, was it not? Was it not based upon the notion that we wanted everybody in the country to be connected so that by homogenizing rates somewhat in the country, we could make it affordable for sparsely populated parts of

America that should also be part of the telephone networks? So my phone became more valuable because more Americans were connected to it. So we all benefited in a sense.

I mean, that was a simple notion, was it not? It wasn't an attempt by government to, if you will, socialize telephones as an economic entity. It was a design to make sure everybody had a phone. Therefore, all of our phones were valuable to us and the whole economic network by which our country communicated would be more valuable as a result. Wasn't that basically it, anyone? I see no disagreement.

Mr. GREGG. Absolutely. The problem now is, how do we transition that system that was borne in a monopoly environment into a newly competitive——

Chairman TAUZIN. It's more complex than that. I mean, it has really become a Rube Goldberg kind of structure where all of you have been discussing for some time now—I have read a lot of statements on the background of this. All of you have been discussing who is paying and who is paying into the system and who gets money out of it, who should be paying it, and who should be receiving money, and how they get in one State region or another, and where the long lines ought to pay more than the ILECs.

I mean, it has really gotten to be something that the average American would find extraordinarily difficult to follow. From the simple notion that we started out with that we were homogenizing rates in America so that everybody could afford a phone, we have gone way, way beyond that simple notion now. And it has gotten to such a complex, difficult bureaucratic mess that we are literally I think at some point going to have to re-simplify the system.

Is that basically correct or do you want to make it more complex? If we are re-simplifying the system and we are facing the fact that American communication, world communication is changing, people are going to be making telephone calls on different systems other than the telephone. They're going to be making telephone calls on the internet, making telephone calls on wireless systems and satellite systems that were never designed as telephone systems. They were data systems or they were video systems. They've suddenly become all amalgamated in broadband distributions, what have you. But they are outside of this system of support, aren't they, today?

So you have got cable companies and other companies that are going to be distributing video signals. They could be your utility company, could be your wonderful utility company that you depend upon for electricity and sometimes leaves you in the dark. They will be supplying you now with telephone service and even video signals with it so you can see who you're talking to. And that's going to be both wonderful and frightening simultaneously.

So all of that is going to change, but they are outside the support system today, are they not? And so we face a situation where the simple notion of homogenizing rates so everybody can have a phone has now become a system where more and more of the folks who put into that system are going to be delivering telephone service without being part of it; and, second, where the amount of money available to make sure everybody has a phone is diminishing while demand grows for money under the system.

So it's sort of like Social Security. I mean, when we started out with Social Security, there were 15 people working for every person collecting Social Security. We're down to—what is it, folks? Aren't we down to about two, two and a half people, I think, less than three now? We're working to support every person retired. And it's becoming a stressed system. And this system is becoming stressed for that reason. Is that about right? Everybody is shaking their heads.

So the question is, is it time for us to reform this system so it's simple again, No. 1? And does that mean that we have to make it a simple proposition, anybody who is providing voice service by any means has to be part of that system, so that everybody can benefit from that system mutually the same way the universal service fund was originally designed, or do we just scrap the system? Is it outdated? Is it outmoded? Has it served its usefulness? What is correct here? Which way do we go?

Mr. GREGG. I believe, Mr. Chairman, since all benefit, all should contribute. It's a very simple proposition.

Chairman TAUZIN. Anyone else?

Mr. ROWE. I believe, Mr. Chairman, on the contribution side, in particular, both of the leading proposals, either a number-equivalent assessment or broadening and depending the revenue base, are very much in the spirit of your suggestion that we simplify the collection mechanism and, in simplifying it, reconcile how we collect support much better with how the market is working, how services are being packaged, and how the network is evolving.

Chairman TAUZIN. Let me give you a warning. I appreciate anyone who wants to jump in at any time. Come on in. We had something called a property tax relief system in Louisiana. We had property tax exemptions for people up to a certain limit. And then the State paid the counties or the parishes for the amount of money they lost to support that system.

And parishes started working out gimmicks to cheat on it. The court finally threw it all out. It got too complex. It got unfair. People were benefiting unequally under it. And our Constitution generally says, particularly when it comes to taxes and government, that we sort of have got to treat people equally and fairly. And when some people start benefiting and other people skip out, free from their obligation, sooner or later, a court is going to step in and throw it all out.

Are we in danger of that with the universal service fund at some point?

Ms. ABERNATHY. I think we have a real opportunity to simplify the collection mechanism here and figure out a better way to collect the revenues. The biggest challenge, the one you recognized, is, how do we distribute it and to whom do we distributed it and who is entitled to it?

Chairman TAUZIN. Well, there is one other thing you have got to think about that we have to think about because it has been raised by this committee. Mr. Chairman, I know my time has expired, and I will just lay it on the table for everybody to think about.

The old notion was everybody should have a telephone. Is the new notion that everybody should have more than just a telephone? Is the new notion that we want to make sure that everybody in rural America has the same advantage in the new communication structures we're building in this country as anyone who lives in an urban area? Are we going to have "haves" and "have nots" in the new broadband world, in effect? Do we use the universal service fund to make sure that doesn't happen?

I will yield back, but, Mr. Chairman, maybe somebody wants to comment.

Mr. GREGG. The act mandates that all customers in all parts of the Nation, including high-cost areas, have comparable services, including advance services, at comparable prices. But our whole task is to make sure that we promote access and not excess, that we don't go out and support four or five lines per home when, really, what we are trying to do is have one line to each home and an affordable line here.

The rest of it should be up to the individual or individual State if they want to go beyond that. But the Federal universal service fund should establish a baseline for everybody.

Mr. POST. Two observations. First, I agree with a lot of the thought process that you articulated in terms of learning from the last 6 years. And I would hope that we would learn such that we would define a mechanism that does not distort the marketplace, that minimizes leakage in the future so that we don't come back in two or 3 years and find we picked a method that, in fact, allows leakage.

I would also hope we would find a solution that is predictable for customers, customer-friendly. And once we identify what that solution is, we then ask your second question. And your second question is, what should be funded? For example, do I want to have wireless infrastructure in rural America comparable to what I have in urban America? That is a question which, unfortunately, gets confused today by granting ETC status, which is supposed to be head-to-head competition. But it's really not head-to-head competition.

If it is, you look at that question versus if what they're going to do is upgrade the infrastructure and give two and three and four connections to a customer's household, I'm not making a decision whether that is good or bad. What I am saying, pick a rational mechanism and then ask the question, what do I want it to fund?

And then the next question you should be asking is, how much is it going to cost? And is that what I want to see this new line item to be on everyone's bill? And, all of a sudden, you would have a very rational, coherent way of looking at the problem.

Mr. STANTON. Mr. Chairman, I would like to just add. I think that you are absolutely right. The system needs to be simplified. What I would, respectfully, disagree with is that the system is universal service.

Our industry, the wireless industry, is about 20 years old, almost 20 years old. And we generate as an industry now more revenues than the local exchange business does. Our industry now contributes about 30 percent of the monies to the fund and only takes about 2 percent out. But the bigger issue is not universal service. It is the continuation of rate of return regulation of carriers, including the local exchange carriers when they have competition.

Between Judge Green and the Telecom Act, if we fundamentally change the system so that competition can replace regulation where competition exists, universal service is a small subset of the total. Monies are paid in access charges that are a part of the total. Rate of return regulation is a part of the total. Using the most economic technology with which to provide service to people who can't otherwise get telephone service, which I believe wireless is, is a part of the solution.

But you can't just take universal service in isolation. I think we have suggested to the joint board and the FCC and would suggest to the Congress that there is a bigger picture that needs to get simplified. And in the end, competition replaces the need for regulation.

Mr. UPTON. Thank you. The gentleman's time has expired. I would recognize the gentleman from Michigan, Mr. Stupak, for 5 minutes.

Mr. STUPAK. Thank you, Mr. Chairman.

Let me follow up on what the chairman was asking, but let me ask it this way. Ms. Greene, you don't seem to be a fan of Representative Terry's and my bill in looking at your testimony and some of your statements here today. Let me ask you this question, though. Since places like—what was it?—Mississippi and West Virginia and some of these others are getting so much money out of that universal service fund, what service are they being provided, the simple telephone or with the money that is coming out of the universal service fund for Mississippi, $103 million last year, do they have all kinds of other services being added to the rural customers in Mississippi?

Mrs. GREENE. Well, the non-rural fund—this kind of goes back to the conversation that we were having earlier. The non-rural fund is a very small part of the universal service overall compensation flow.

Mr. STUPAK. Granted, but they did still get $103 million out of it last year.

Mrs. GREENE. Right.

Mr. STUPAK. So are they getting just a simple telephone, as the chairman asked, or are they getting voice, data, and all the other services with it that are being funded by the rest of the Nation?

Mrs. GREENE. What they are getting is a stipend that offsets the high cost of providing service in Mississippi.

Mr. STUPAK. Understood.

Mrs. GREENE. And that is not a function of specific service that is provided. We do provide advance services to good parts of Mississippi.

Mr. STUPAK. But the services, you're getting this $103 million out of the fund. And with that, you are able to provide more than just a simple telephone but other services, too, where Nebraska doesn't get it because they won't get any money out of the fund or northern Michigan won't receive those added services because they don't have any money out of the fund?

Mrs. GREENE. Well, Nebraska does get about $33 million out of high-cost universal service funds. They don't get money out of the non-rural fund.

Mr. STUPAK. They don't get any money out of the high-cost non-rural fund.

Mrs. GREENE. Right. And in large part of why Mississippi and Alabama get the amounts of money that they do——

Mr. STUPAK. I understand all of that. I understand all of that. What I am trying to ask you——

Mrs. GREENE. I thought your question indicated that maybe you didn't understand, that it was a function that we serve 90 percent of the States,——

Mr. STUPAK. I understand it.

Mrs. GREENE. [continuing] like Qwest, which serves only a small portion of this.

Mr. STUPAK. This fund has only been around since we did the Telecommunications Act of 1996. Therefore, I would think if you are going to spend $103 million last year and I'm sure other years close to that more money just in Mississippi, not only would you be putting in telephone lines, but it would think you would also be putting in the services that a lot of us don't have in rural areas, like the broadband, like the data, like the voice, "Yes" or "No"?

Mrs. GREENE. Yes, we are, but you're really kind of confusing the way that the fund works and what eligibility for the fund is attributable to.

Mr. STUPAK. Here's the part I'm not confused on. The part I'm not confused on, if I am getting $103 million out of a fund that all the Nation kicks into but only about 7 or 8 States are allowed underneath the formula to take advantage of, not only are they being provided the service that we all want them to have underneath telecommunications, but they also have that distinct advantage of receiving other services the rest of us, who are just as rural, but because we may have a big city like Detroit, therefore, we are offset, we do not receive money underneath the high-cost non-rural fund only.

Now, I agree there are other areas that they can apply for, but the kicker for us and for some of us who feel that this is just simply wrong is not only do you take 2 States getting about 70 percent of the money, but they are also, and rightly so, getting added services and benefits the rest of us do not have an opportunity to have or the carriers working our areas don't have access to the money to put in the extra services. So we see two advantages: lack of money and lack of upgrade of services that would benefit our areas because of the money that is coming out for just a few States.

I am sure Mr. Gregg wants to say something.

Mr. GREGG. Yes. Just in terms of how that money is used, I can give you the personal example of what we do in West Virginia. We receive about $31 million from the non-rural high-cost fund. We conduct an annual rigorous review of that money before it is received.

We use approximately $26 million of it to reduce rates for customers. We have some of the highest rates in the Nation. It's an average credit on each person's bill in the State that's served by Verizon of $3 per month.

The FCC's latest rate survey that just came out show that we still have the second highest rates in the Nation, even after the credit.

Mr. STUPAK. I don't disagree with that, but the part that I have a problem with is not only the money part, but, look, there are non-rural carriers who serve rural customers in over 40 other States. So those rural customers that are being served by a non-rural carrier, why shouldn't they get a discount on their bill also from money out of this fund?

I just think it's a simple fairness issue and not only is it a fairness issue on reduction of rates, but now I understand it is also fairness on the services that are being provided.

Chairman TAUZIN. Would my friend yield?

Mr. STUPAK. Sure. Go ahead.

Chairman TAUZIN. What is so crazy about this system is you have got grandmas and grandpas on Social Security subsidizing their children who are earning good money on their phone bills today. Isn't that correct?

I mean, it's true. It depends where you live. You could be living on a Social Security income, aged, and barely struggling to pay your food and your drug bills. And, yet, the system requires you to be subsidizing your children who are making a good living but living a different place in America. It's a little nutty. There are inequities all over it like that as you begin to study it.

And that's why, again, my friend is right. It's full of those kind of inequities. The more you look at it, the more you see them. And the more you come to the conclusion we need to simplify this thing.

Thank you, sir.

Mr. UPTON. The gentleman's time has expired.

The gentleman from Kentucky, Mr. Whitfield.

Mr. WHITFIELD. Thank you, Mr. Chairman. I want to thank the panel for joining us today and for their patience. I know it has been a long afternoon.

I want to congratulate Mrs. Greene for her—I guess you are coming to the end of your years as chairman of the USTA. And I'm sure it's been an exciting year for you.

I think the testimonies showed quite clearly today that there are a lot of inequities in this system and that at least the appearance is that most people think there need to be comprehensive reform.

I noticed, Ms. Greene, in your testimony, you indicated that USTA believes that Federal funds should be used to support only one eligible telecommunication carrier in each high-cost area. Is that correct?

Mrs. GREENE. That's right.

Mr. WHITFIELD. And other members of the panel, do you all have any response to that or any views on that recommendation?

Mr. GREGG. I have made a variation on that proposal, which is that on the truly high-cost areas, those above $20 per line per month in terms of support, there would be a limitation between $20 and $30 per line per month. Only one additional eligible carrier would be allowed and above $30 only one carrier at all.

This would encompass half of the study areas in the United States served by rural carriers but only 1.7 percent of all the access lines. It's the truly small high-cost areas. That's where we need to restrict the amount of subsidy going. It doesn't make any sense to have multiple subsidized carriers there. Below $20 per line, I would part ways with USTA.

The section 214E of the act mandates that we have multiple ETCs in areas served by non-rural carriers. Non-rural carriers receive high-cost support, too. The highest is Puerto Rico Telephone Company that receives about $8 per line per month. So obviously there is unlimited subsidy there.

And I believe that allowing areas that receive less than $20 per line per month, whether they be rural or non-rural, to have multiple ETCs would be reasonable and would not excessively increase the fund like allowing multiple ETCs in these really high-cost areas.

Mr. STANTON. I would respectfully disagree with the notion of having a single carrier be designated. There is an underlying presumption that if you only designate one ETC, that you designate the wire telephone company in that geography. In many cases, that is, particularly as I said in my oral testimony, in areas below ten people per square mile, which is the vast majority of the territory that my company serves. You are excluding the more efficient provider of service, that wireless can provide service at a lower cost in those areas. And, therefore, not only are you excluding them in, for example, Commissioner Gregg's proposal, but you are actually punishing all of the system by requiring that you subsidize the less efficient provider.

And I would argue that if you create arbitrary milestones that say you only allow one if the cost per company is above a certain level, that you create incentives for the telephone company to actually increase their costs to be above that level to preclude having competition.

You, in effect, reward inefficiency associated with high cost. And I'm an admitted capitalist. In my view, there is only one mechanism by which you can truly create the most efficient system. And that is the introduction of competition. And having multiple carriers able to provide service on a level playing field in a market is the way to create competition.

Mr. WHITFIELD. Mr. Lubin, were you going to make a comment?

Mr. LUBIN. Yes. The thing I want to highlight is I think we have two issues that get mixed up. And I appreciate the question because I am going to try to use it to highlight the point.

One issue is, do I want to create head-to-head competition? And that is a public policy question. You have to come to grips with an answer. In those areas of the country where you want head-to-head competition and you want wireless to compete with the incumbent wired, make a decision if you want that. If you do, so be it.

The second question is, in those areas where you don't want competition, Billy Jack comes up with a mechanism to do that. That's fine. Make a public policy decision that says, "In some geographic areas, I don't want to see competition." But there is one more issue. And that issue is, with wireless, let's say you want head-to-head competition. So you mark that box, "I want head-to-head competition." But now the wireless company comes in and says, "I am going to offer you four connections in a household"; whereas, maybe the wired house only has one.

If you had head-to-head competition, do you want to fund four connections? Let's hypothetically say the subsidy per line is $10. Now you're putting pressure on the fund. All I am highlighting to you is that is an explicit issue for public policy considerations because without considering it, you are going to expand the fund.

Mrs. GREENE. But let's go back 1 second to the original purpose of universal service. The original purpose of the universal service was to provide a mechanism to encourage companies to invest in a marketplace where market economics alone would not make it worthwhile to invest.

And we had a concept called carrier of last resort that was born out of that. And it goes along with the whole concept of universal service. To have multiple carriers of last resort in a marketplace where the economics of that marketplace don't even support a single carrier is sort of a questionable activity. And that's what the USTA position is designed to reflect.

Mr. WHITFIELD. Mr. Chairman, if I may interrupt, I waived my opening statement. And I thought——

Mr. UPTON. Oh, I'm sorry. You get an extra 3 minutes. So you've still got——

Mr. GREGG. I just wanted to amend one thing that Mr. Lubin said. The question is not whether we will have areas where there is no competition. That is a policy decision that has already been made by Congress. The whole issue is, are there areas where we don't want to have subsidized competition?

And as far as the issue raised by Mr. Stanton of there could be an inefficient carrier in an area where you have limited ETCs, that is up to each State. And States have the power to decertify ETCs and to place some other carrier in there that they believe can do a better job of providing universal service. It's the State's call.

Mr. WHITFIELD. Now, in the 1996 act, of course, as you all have said, we expanded from ensuring rural services to also financing choice of providers. And wireless is one of those providers now and is doing a good job.

The question I would have is, do each of these providers have the same public service obligation or is there a difference in that? And if there is, should that have any input into who receives the benefit?

Mr. ROWE. Mr. Chairman, there are substantial differences. Those differences are complex. This and the primary line discussion are areas where I am actually fairly confident that the joint board is going to make some progress.

As to the service obligations, the question that we are currently looking at is, should the competitive carriers be subjected to effectively the same obligations, either by the FCC or by the State commission, as are the incumbent carriers? Should the FCC set a floor, allowing State commissions to exceed that floor? Is it possible to develop an appropriate set of service quality expectations for wireless carriers specifically? I think all of those things are on the table.

Generally State commissions do not regulate wireless carriers but are allowed to regulate essentially service quality issues. Also, as part of certifying competitive carriers, States may impose appropriate restrictions.

There is a lot more thought going into this than there was even three or 4 years ago, when the first round of applications came in. And we are all paying more attention to it.

Mr. WHITFIELD. Ms. Greene?

Mrs. GREENE. One of the fundamental differences, of course, being that wireless doesn't serve the same serving territory that a wire line does. It's not as comprehensive a serving territory.

Mr. WHITFIELD. Ms. Abernathy?

Ms. ABERNATHY. I think the only thing I would add is that part of what we are trying to do with this ETC proceeding in front of the joint board is come to grips with the fact that the new competitors build out differently and provide service differently than the incumbents.

But to the extent we want to encourage competition in rural areas, somehow we have to reconcile how much subsidy support do we give to a new provider without jeopardizing or risking basic support for the incumbent for the customers?

Mr. POST. Just a couple of comments. The sole purpose of the USF has been not to provide competition or defaults to competition but to provide affordable local service rates to customers in rural America or in high-cost areas. I think we have, I know the States have, lost sight of that in the areas we operate. That seems to be the only criterion for a carrier entering a market that it provides additional competition. The real issue or the real focus or purpose of the universal service fund is really forgotten in many cases.

Second, there has to be some kind of control here or obviously universal service funding is going to collapse under its own weight. There has to be some type of criteria developed that says this is what is required for a company to qualify for universal service funding because in some of our markets in rural America, we have four and five wireless carriers in these markets.

If every one of them has funded it $20 or $30 a line, those markets, or more in some cases, you can see what happens. Where is the funding coming from? How is the money going to be used? Obviously it is not in the public interest when that happens.

Mr. STANTON. If I may add from the one wireless perspective on the panel, the taking on the responsibility of being a carrier of last resort is a decision that a wired company made at some point in time in its history, probably before any wireless companies existed in many cases.

The presumption that they should continue to be that carrier of last resort I take issue with. Our company, for example, is the carrier of last resort in the Antelope Valley in Nevada, which I spoke of before. The alternative was that the local residents could pay $100,000 to bring wires in. And that was how the telephone company, the wire telephone company, was going to make service available to them.

The residents couldn't afford that. We were willing to build service out into that community and take on, in effect, the carrier of last resort responsibilities. And we are willing to take that on in a number of cases.

I don't represent all wireless companies. I can't tell you all of them would be willing to do that or how they would be willing to do it. But we are willing as a company to participate in the process fully, and we have taken on some responsibilities and are more than happy to continue to do that. But I think what we ask is to be treated fairly, not like the new kid coming to the party gets all of the burdens and none of the benefits.

Mr. WHITFIELD. Thank you, Mr. Chairman.

Mr. UPTON. The gentleman from Florida, Mr. Deutsch.

Mr. DEUTSCH. Thank you, Mr. Chairman.

Ms. Greene, could you take a moment to explain the concept of negative dollar flow from the universal service fund and why BellSouth cannot access the universal funds in Florida?

Mrs. GREENE. This goes back to the discussion that we had about the non-rural carrier fund. We access only as a non-rural or large company carrier.

One of the fundamental structures that governs non-rural is that need is calculated as Statewide level. And so in Florida, we have enough urban areas to offset the rural areas. And as a result of that, we don't qualify for taking funds in that area.

Mr. DEUTSCH. So even though there obviously are areas that are both by definitional status rural and by logical status rural throughout the State, I mean, you know Florida very well, as I do——

Mrs. GREENE. Yes, sir.

Mr. DEUTSCH. [continuing] that none of those areas qualify for any of the funding?

Mrs. GREENE. And that is a good point. BellSouth serves more rural access lines than all of the independent companies in our service territory put together. We take money from this very small segment of the universal fund, the non-rural fund, only in two States, even though we do serve rural access lines in our other seven States.

Mr. DEUTSCH. Again, it just seems a little bit illogical. I mean, is there any proposal that you could see the FCC changing to provide relief in this situation?

Mrs. GREENE. Well, I think that any time that we have a discussion—I am sitting here next to Mr. Gregg's charts. Any time that we have a discussion about rural universal service fund, I think we need to have a comprehensive discussion about all the different subsidy flows that go to offset the cost of rural universal service.

I do think that we need to have a comprehensive look at how to redo this system.

Mr. DEUTSCH. In any specifics that you would suggest or we just really need to go through the process of really looking at it in terms of this anomaly that you are describing?

Mrs. GREENE. Yes. I think we need to go through the process of looking at it. I think we need to simplify the multiple funds. I think we need to, most importantly, broaden the base of payers.

Mr. DEUTSCH. Yes. Go ahead, Mr. Rowe.

Mr. ROWE. Mr. Chairman, as I have suggested earlier, the discussion about the large company fund is not necessarily a debate between BellSouth, on one hand, and other carriers, on the other. In my view, if you were to go back to what the law says, reasonable comparability of rural and urban rates and services, and if you were to deal seriously, very seriously, with the problems in the hybrid cost proxy model, upon which support is based, certainly carriers that currently receive money would receive a different amount of money.

But it would not necessarily be disadvantageous to BellSouth overall. It would simply be better met with what we do than what the law now requires.

Mr. DEUTSCH. Thank you.

Mr. Gregg?

Mr. GREGG. Yes. Just to follow up on what Ms. Greene said, the rural carriers in Florida receive about $79 million from the high-cost fund. BellSouth, even though it serves rural areas, does not because, as she said, their overall average cost is low because they also serve urban areas.

Mr. DEUTSCH. Right.

Mr. GREGG. One of the things that we have to keep in mind when we look at reforming any of this, the distribution or the size of the fund, is to be mindful of what the chairman said. Everybody in the United States has to pay for this. And if we end up doing things that end up growing the fund exorbitantly, that is going to have to be paid for. And we are already under pretty unrelenting pressure.

I think that the joint board when they recommended what they did in the Tenth Circuit remand was mindful of trying to keep the fund under control but to provide relief in those areas where it was truly needed. That was the supplemental rate request that Commissioner Abernathy spoke of.

If, even with all Federal support and all State support, you still didn't have comparable rates,—that is the real litmus test—they can come back for additional support under that recommendation. And we will see what the FCC does in October on that.

Mr. DEUTSCH. Right. I mean, I understand what you're saying. It just seems a little bit from the policy side if you're treating customers—and most of my constituents or, in fact, maybe all of my constituents are BellSouth customers or a very extraordinary high percentage are BellSouth customers. They have this distinct in terms of their own rates disadvantage.

I mean, I can articulate a policy reason why the other carriers kept that advantage and BellSouth obviously has other advantages over them, but it clearly makes my constituents pay more on average.

Do you want to give me the extra time or not the extra time? Last question. And hopefully just Commissioner Abernathy can give a short answer. The future of universal service is something that we all need to focus on.

I am glad to be here today for that important discussion, but ultimately I feel that we need a decision out of the FCC soon, as we all know that the current path is unsustainable, technology is changing every day.

Could you speak to the FCC's efforts to address the internal conflict between the telecommunications service and the information services in terms of contribution methodology?

Ms. ABERNATHY. Yes. Thank you. We put out for comment the question about, how do we handle this by statute? We can legally decide that, even if a service is an information service, not a telecommunications service, that that entity could be obliged to contribute to the universal service fund. So the real question, then, is, what do we do once we define what broadband services are? And all of those entities, if they are treated alike, will they be contributing to USF or will they not be contributing?

It's an open question in front of the FCC. I can't tell you how all of us are going to vote. I have said publicly that it seems to me that a fund of this size and this obligation, that you spread it across as broad a base as possible so you have as small a hit as possible on multiple providers.

But this additional issue goes to a proceeding that is ongoing about what category of service will broadband fit into. And then you ask, following that answer, what are the USF or other kinds of obligations that may go along with it?

Mr. UPTON. Thank you.

Mr. Bass gets the advantage of the deferral, 8 minutes.

Mr. BASS. Thank you very much, Mr. Chairman. It's an interesting hearing, very complex.

Telecommunication in a State like New Hampshire is really a form of transportation. There are many different reasons why New Hampshire is way down. In fact, it didn't even make the top 50 States. We are 51 in terms of support of this universal fund. And there are lots of reasons for that, some of which have been dealt with in this discussion.

The New Hampshire Public Utilities Commission from the very beginning has had a philosophy that telephone service must be very low-cost. And today you can still get a telephone for less than $10 a month. Now, the telephone providers have to juggle things around a little bit, but ultimately they are required to do that.

Unfortunately, that may be part of the reason why New Hampshire is so low on that list because it may look in this formula like it's very urban because the utility PUC requires that the rates be very low.

The other problem is that New Hampshire is not really a State—and there are a lot of other States like this—where income and wealth are fairly even across the States. We are a relatively wealthy State, but there is significant disparity.

So in some parts of the State, you may have all kinds of services. In other parts of the State, you have nothing but no subsidy on top of all of that.

I guess my question is, should there be a different mechanism for determining the allocation of high-cost support that is not based on States' boundaries but, rather, on even a single line or a single service or a town or a community or a county because there are counties in New Hampshire that are very poor and there are counties in New Hampshire that are amongst the richest in the Nation? Does anybody in this panel have any thoughts about that concept?

Mr. GREGG. Yes. Section 152B of the act preserves the traditional State roles and on top of the Federal roles. In fact, that was the limiting factor that caused the Fifth Circuit to limit the ability of the FCC to assess on all revenues, was that traditional province of State rate-making and control over their intrastate revenues.

And that's why I believe we should continue to look at equalizing costs and trying to keep rates comparable among States from the Federal viewpoint and then leaving it to the States to try to keep rates comparable within their borders. It's a partnership, a Federal approach to comparable and affordable rates.

Now, in terms of New Hampshire's $10 rate, the support formula is based not on rates, but on cost. And it looks at the cost in New Hampshire compared to a Nationwide average cost. Now, that is one of the issues.

If New Hampshire is not requiring their end users to contribute close to what the cost of that service is, is it fair to ask other consumers in, say, inner-city Baltimore or in Denver or in Arizona to contribute to their rates or their upkeep of their network through having support there when their rates are so low?

That's why we put in the supplementary rate review, so if there are truly areas where in spite of Federal support, in spite of State support, you still have exorbitantly high State rates, they can ask for supplemental support. But if your rates are still down around $10, it seems like there needs to be some additional contribution from end users as well as, say, the State universal service fund before you ask other people in other States to contribute to helping.

Mr. BASS. Any other comments from anybody else?

Mr. ROWE. I think Mr. Gregg made the correct point in describing the difficulty doing a rate-to-rate comparison. When we have looked at how retail rates are set, there are many important variables. The one I focus on, in particular, is the size of the local calling area.

My guess is the local calling area in your State is relatively small. Even if it may be large geographically, you probably can't reach that many customers for your local rate, depreciation rates, assignment of costs to the long distance services or local service, a lot of variables in the rate component. So generally I think a cost-to-cost comparison makes more sense.

The two alternatives that have been focused on primarily are: one, going right down to the smallest possible unit of making a comparison, a central office typically, less of a concern for the rural, the small, carriers because they typically don't have as many offices, less territory to average over. That can be an important factor for the Bell companies, in particular.

The other alternative, though, if you are going to stay with what we are calling a State-to-State comparison—it's really a telephone company study area to study area comparison—is to be very serious, very rigorous about the statutory requirement of reasonable comparability of rural and urban rates and services. And, again, I think for the large companies, if we do a better job with that, the results will also be better for everyone.

Mr. BASS. Mr. Terry's bill provides for a 5 percent cap on high-cost lines, high-cost funds. What about the concept of having a 5 percent cap for the entire universal service fund per State?

Mr. GREGG. There currently are caps on several of the mechanisms in the universal service fund. The biggest caps is the schools and libraries. It's capped at $2.25 billion each year and always has been. That's a hard cap. The high-cost loop portion of the high-cost fund that goes to rural carriers has a cap on it. It grows each year by a certain factor, but it is capped.

The concept of caps can work. However, I think that it is better to if you are going to have a cap at least let it grow so that it can move around as conditions change.

As you heard in here today, there are conflicting demands on the fund. On the one hand, people want the fund to be affordable. They want the assessment rate to be low. That means it shouldn't grow. On the other hand, people want the fund to go out and support all of the new whiz bang services that everybody wants. And that is going to require more money.

Mr. BASS. The caps you talked about were not per State. They were per fund.

Mr. GREGG. They were per fund, right.

Mr. BASS. I am talking about a 5 percent cap for State for the universal.

Mr. GREGG. I think it might be arbitrary because what you would do is States that have a very large need; for example, Wyoming or Mississippi, that has very large per-line needs, might not get enough support to have comparable services.

Mr. BASS. Fair enough. Fair enough.

Yes, commissioner?

Ms. ABERNATHY. I think it would be very difficult to just in a sense say, "You're not entitled to any more money, regardless of how high-cost your loop costs are, to build out to these rural areas."

But I think one other factor we have to continually bring ourselves back to is it's not simply that urban and rural rates have to be reasonably comparable. Rates have to be affordable, too.

What is affordable gets mixed into this debate at the same time because what we ultimately decided at the joint board is while it might be nice to have a $10, a $15, or even a $20 rate, that it is okay for rates to go as high as around $30, I think we said. And we viewed that as affordable because otherwise what you are really doing is saying there is no limit on how much you would support. It would be decided by the State about how low they wanted to drive their rates.

Mr. BASS. Interesting point.

Thank you, Mr. Chairman.

Mr. UPTON. The gentleman from Maryland, Mr. Wynn, is recognized for 5 minutes.

Mr. WYNN. Thank you, Mr. Chairman. I apologize for not being here earlier. I just have a couple of questions.

First, for Ms. Greene of BellSouth, I understand that you do represent rural and lower-income areas. And the question I have is whether the FCC's list of universal service providers should be expanded to include broadband services. I don't know if this has been covered earlier. And should we move away from a service-based approach and support networks?

Mrs. GREENE. Yes, I do agree that we should move away from a service-based approach and support networks. Basically, the way that this system is administered today, it's on a service or a line basis. And that has the effect basically of constraining the investment and making government decide, instead of consumers, what investments in forward-looking technology should be. So I think that it should go to a network basis.

Mr. WYNN. Now, what about the expansion regarding universal service? Should it include broadband?

Mrs. GREENE. Again, I think that it should be a function of doing the calculations on what is the cost of universal service. And then that money should be provided to the carrier. And the carrier should make the decisions on network infrastructure, instead of listing each specific service that should be required in universal service.

Mr. WYNN. Thank you.

Mr. ROWE. Mr. Chairman, representative, could I follow up?

Mr. WYNN. Sure.

Mr. ROWE. When the joint board looked at this issue, we were required to evaluate services under the act. I think your point is right on target. I said earlier that all services basically ride over the same network. And the best thing we can do is to support the development of a robust network that is forwardly upgradable.

The cost, the incremental cost, of providing, for example, DSL service over the wire line network is now negligible provided that wire line network is built in a sufficiently robust fashion. It's been referred to as the no-barriers approach. It's equally applicable to wireless networks. So, again, I think a network focus, rather than a service focus, is in many ways very helpful.

Mr. WYNN. Okay. Thank you.

Mr. Lubin, how would broadband services, such as those in large companies with private networks, be assessed under your model for universal service?

Mr. LUBIN. AT&T took no position in terms of the assessment of DSL or cable modem services. And so the reason, quite candidly, we went to a numbers-based mechanism is we thought it was an effective way to broaden the base, actually under the existing statutory authority that the FCC has to go to numbers, which would be a way to not focus on a revenue basis but, rather, start assessing connections for special access pipes, private line pipes. The fatter the pipe, the more you pay. And where you have a telephone number, you assess the number. And you don't worry about what services are being carried over the connection or the number.

Mr. WYNN. But what would you anticipate would be the possible costs on a per-line basis?

Mr. LUBIN. The number that we put in the record was 98 cents per telephone number and per connection. The fatter the pipe, you would pay more. We also in the record at the FCC suggested that you might want to exempt people who are lifeline consumers, who have a lifeline assistance program, such that they would not pay the 98-cent fee. If you did that, then the fee would be approximately 99 cents or $1.

Mr. WYNN. Okay. Thank you.

Ms. Abernathy, one question. I get a sense—and maybe this was covered earlier and, again, my apologies—that we are looking at redefining the definition of universal service, as opposed to how the traditional telephone access for everyone to call police and fire and people like that, to covering a broader range of service, internet access and things like that. Is that where you're headed? Is that what we're talking about? Are we still back at the kind of traditional notion that we need to at least make sure everyone has access to basic telephony?

Ms. ABERNATHY. That is not where the FCC's proceedings are currently headed. And, in fact, previously the joint board looked at this issue of, should we broaden the definition of support in services?

The joint board made a recommendation to the commission that no, we should support the existing services that have traditionally been supported. The FCC looked at that order and implemented that recommendation in July of 2003.

So we're not at this point exploring whether or not we should expand the list of supported services. Rather, we are looking at, at least in the broadband context in one of the FCC's proceedings, should broadband providers be obligated to contribute to the USF fund, like other providers, such as wire line and wireless and long distance?

Mr. WYNN. Did you take a position on that?

Ms. ABERNATHY. On the joint board?

Mr. WYNN. No. On the question of whether broadband providers ought to be included?

Ms. ABERNATHY. Not yet. It's still pending in front of the FCC.

Mr. WYNN. You don't want to give us a hint, do you?

Ms. ABERNATHY. I already gave a hint a little earlier, unfortunately, although——

Mr. WYNN. I'll talk to you about it. I relinquish the balance of my time. Thank you.

Mr. UPTON. Thank you.

The gentleman from Mississippi, Mr. Pickering, is recognized for 8 minutes as he deferred earlier.

Mr. PICKERING. I thank you, Mr. Chairman. I want to commend you for having this hearing.

I don't think there is anything in telecommunications more important or significant than the debate that we are beginning now in the hearings. The universal service fund and the possibility of reform is probably the most important policy question that we have in telecommunications, either as we try to move in this Congress or hopefully in the very near future. It is something that started in the 1996 act and that you all have all captured very well with the current state of both emerging technologies, emerging competition, and the changes that those have brought to the universal service fund.

Mr. Gregg, you did a great job in saying where we have been and where we are at present. The question for us is, where will we be 5 years from today? Where will we be 10 years from today? And basically where will we be for the next generation? The decisions that we make in a universal service fund reform could shape. And the 1996 act has shaped dramatically, as you described, the services we have in rural areas, the deployment that we have, the advanced services, education, health care.

What I would like to ask, has anybody done any of the projections on where we are going to be in 5 years? In 1996, the universal service fund was $1.6, $1.8 billion. And today it's approximately $6 billion. What is that fund going to be in 5 years? Mr. Gregg?

Mr. GREGG. Most of the projections have gone out to about 2007. They were usually in conjunction with the FCC's contribution base proposals. They were looking at, what would the contribution base be under different alternatives? What would the assessment rate then be based on the expected fund size for that period?

Mr. PICKERING. What if we did nothing?

Mr. GREGG. The problem is that the projections that we had in that case I think were before we started having a big up swing in the number of eligible carriers for the high-cost fund. They projected a total fund of in excess of $7 billion, around $7.3 to $7.5 billion. However, if we continue to have a doubling of new ETCs drawing on the high-cost fund each year, those may be low.

For example, new wireless ETCs received only $500,000 in the fund in 1999. And I'm glad, actually, Mr. Stanton, that wireless carriers in all technologies are accepting the obligations of being eligible telecommunications carriers. However, we have to be mindful of their overall impact on the fund.

It's gone from $500,000 to $20 million to $40 million, this year to $120 million. Next year we expect it to more than double because of all the ETC applications that are in the pipeline. So we may be looking at a total fund probably closer to $8 or $9 billion if there is no limitation such that I have described earlier, the limitation on single-line support, the limitation on the number of ETCs in high-cost areas.

Mr. PICKERING. And would $7, $8, $9 billion be sufficient to sustain what we are currently doing with the universal service fund?

I guess the question is, if we have a consensus that the current system is either inequitable, that's one area of debate. I think that's very fair to Mississippi and Alabama and to our region. And we want to protect that. But it's a broader question. Not only is it fair, but is it outdated? Is it inequitable? Does it actually hinder deployment? Does it hinder and burden the companies that are trying to provide these services? Does it hinder competition? And those are larger public policy questions. And so is the current system sustainable?

My sense is that everybody in the panel would say no. Just trying to get the points of consensus. Would everybody agree with the one line limitation? Would there be a disagreement on the one line? The principle of all who play pay, everybody pays in? Should there be a principle of competitive neutrality, that we try to find ways to be competitively neutral and technology-neutral as we try to reform the system?

This is an area that I think we're coming to a place, one of those rare political moments, where everyone agrees that the current system is not sustainable, that it serves no one as well as it should, which gives us an opportunity possibly to get local, long, although distances, now we have really reached a point where there is not a distinction in distance in the service.

And we're also having the bundling of services. So you don't have this distinction of you have no longer the segregated markets, but now you have the commingled, bundled offerings of service. So you no longer can really calculate based on the particular offering and so as we try to find some new system of collection based on what service. All of those things as we try to follow a principle of simplification, just like the tax reform, if you could simplify and broaden and increase participation, you can actually lower the cost to each so it benefits everyone would actually increase and sustain the fund over a period of time. I think that is what we want to achieve.

And I think that we are at that time where we could get rural, non-rural, long, local, CLECs, wireless to a table to possibly see if we could come up with a comprehensive approach to modernize universal service so that it achieves the objectives.

And, Mr. Chairman, I look forward to working with the committee and the staff and with all the industry participants to start that. And I think the sooner that we do that, the better. And I do think we have some emerging principles that we could all at least establish a framework of discussions and reform on.

I know the joint board is soon to make some decisions. That would give us some clarification in major decisions. But Congress really needs to act in this area to get the full benefit of what we need to do.

I know that I am talking more than I am asking, but I have listened for a long time. I do appreciate all of your participation. Mr. Chairman, again, this is a very important issue. And for my own State of Mississippi and rural States like Mississippi, this is critical to the new deployment and making sure that we maintain the services.

BellSouth has done a tremendous job in a State like mine and across the Southeast. We have wireless companies that are doing a great job of going in to rural areas. And competition is beginning to development. So how do we get all of those at the table so we can make something work? And that's what we want to see happen?

To my friend from Nebraska, if Southern Mississippi meets Nebraska—you have to give me at least a 10-point spread—we will set aside universal service fund debates in the next Congress and find a fair and equitable solution for the Cornhuskers.

Mr. TERRY. I kind of like the catfish and steaks one that we discussed earlier.

Mr. UPTON. Have you talked to Coach Osborne?

Mr. PICKERING. He is going to give me 14 points. Mr. Terry I am having a hard time getting ten points.

I would say, in all seriousness, I don't know if regional approaches are going to work. So I would like to sit down with Nebraska and Michigan, not in a way to look at which regions get more. We would argue that Michigan and Nebraska give more than Mississippi in energy assistance. I think it would be counterproductive and wouldn't be what will eventually pass, but if we look in a broad, comprehensive way, I do think that we can modernize it, simplify it, and increase participation and sustain the fund for the long term.

With that, I yield back. Thank you, Mr. Chairman.

Mr. UPTON. I would just remind the gentleman from Mississippi that I think Southern Mississippi played the Wolverines in a ball game a couple of years ago. And I could give you 40 points and still win.

Mr. PICKERING. I think it was 35 points.

Mr. UPTON. The gentleman from Nebraska.

Mr. TERRY. Yes. Times have changed over the last few years, especially for us Huskers.

In listening to Chip's discussion here, frankly, we were on the same page until he said that Mississippi should be able to keep all of that money. That's the only part that I disagreed with.

Mr. Chairman, maybe I should be so bold to suggest that Chip and I even start a task force on your behalf with your guidance as chairman to start looking into this.

I appreciate all the senators that have gone on the Stupak-Terry or Terry-Stupak bill, but I would really like to see the House drive the discussions on universal service reform.

Again, I want to come back to the point that I still have——

Mr. UPTON. If the gentleman would yield just for 1 second?

Mr. TERRY. Yes.

Mr. UPTON. I would note that today, despite a lot of things going on, a health conference on prescription drugs and a host of other things, we have had 22 members of this subcommittee come at some point——

Mr. TERRY. It shows the importance.

Mr. UPTON. [continuing] to discuss. And they have been very engaged and involved and concerned about where we are going. Clearly, it is, as I said in my opening statement, the engine is broken, sort of like the Fram oil filter commercial, the bottom line being if not now, when are you going to pay, something like that, right, pay me now, pay me later, pay me now or pay me later.

So we are going to continue this good dialog listening. I look forward to your input. We have had a good amount of your interest for sure. And it's one of the reasons why we're having the hearing today.

Mr. TERRY. And I greatly appreciate that you are having this hearing today.

In that respect, I would like to take it from listening to action at some point in time. But I worry, as we have seen here just in the series of questions that Chip asked the panel, out of the nine people up there to each panel, we saw people nodding their heads "Yes" and "No" to the same questions.

And I think that shows the difficulty that it's going to be to simplify the system in the long run. That certainly would be my goal as long as rural areas are treated uniformly and fairly, which brings me back to the question that I couldn't get to, Chairman Abernathy. And that's you recognize that there are these types of discrepancies up here, just the States that I think are inherently rural, although may have some metropolitan area, that receive nothing from the fund, Arizona, Arkansas. No one of us would think of Arkansas as just highly cosmopolitan and metropolitan. They've got a significant rural population but receive nothing. Georgia, Iowa, Kansas, Kentucky, Minnesota. I've been to northern Minnesota, not northern Michigan, but there is nothing but rural population up there.

So my question is just, in a personal sense, do you think that's fair that eight States under this fund share the entire pool where States that do have significant rural populations that are serviced by the Bell receive nothing?

Ms. ABERNATHY. I guess, again, I would go back to say, are these States receiving universal service support? They are. Now, the non-rural companies are not. You're absolutely right. The non-rural companies are not. So I just want to distinguish between——

Mr. TERRY. Sure.

Ms. ABERNATHY. [continuing] do the States go, do they not?

Again, I can only tell you historically why this has existed and is it fair. I guess when I look at the USF system, there is very little about it that I think any one person would say, "Oh, well, this seems eminently fair."

Most of it seems unusual or somewhat convoluted. I know why we are where we are with the non-rural. Again, the idea was, let's funnel most of the money to the rural carriers. And these big companies that were the spinoffs from AT&T, they can move the money around as long as they have enough low-cost customers.

This premise was based on a pre-competitive environment. And so now the question is, can that model survive in a world where everyone is facing competition? And is this fair to the customer base that they serve? I think it is a question we are going to have to answer.

I look, for example, at the District of Columbia. You know, this is not a needs-based system. So there is no money flowing into the District of Columbia. Are there people who live in the District who are supporting universal service who don't make a lot of money? Yes, there are. So, you know, we have a lot of challenges in front of them.

And I don't dispute that the inherent equities of the system are questionable in some respects. What we are trying to do through the joint board efforts and through meeting with all of you is to slowly peel back at these issues and try and rationalize them in as best a way we can given the technology of the day and the competitive market of today.

Mr. TERRY. Thank you.

My time is up unless you want to yield me some more.

Mr. UPTON. You can ask another question if you'd like.

Mr. TERRY. No. Go ahead.

Mr. UPTON. Well, this concludes the hearing for today. I appreciate your time. I know Mr. Rowe had to leave early to catch a plane. Actually, he had to leave on time to catch a plane. But we appreciate your testimony and the members' participation. We look forward to seeing you in the days ahead. Thank you.

[Whereupon, at 5 p.m., the hearing was adjourned.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF F.J. POLLAK, PRESIDENT AND CEO, TRACFONE WIRELESS, INC.

I am F.J. Pollak. I am President and CEO of TracFone Wireless, Inc. TracFone is a wireless telecommunications company headquartered at Miami, Florida. It differs from other wireless providers in that it offers primarily prepaid services. Consumers purchase wireless phones (which we subsidize) from retail outlets (including, for example, WalMart, K-Mart and others) and usage cards which provide quantities of wireless service usage that vary depending on the price of the card selected. Unlike traditional wireless providers, TracFone customers purchase service on a "pay-as-you-go" basis. There are no credit checks; no minimum volume or term commitments; no early termination fees. Many of TracFone's customers are lower volume, often lower income, users for whom wireless service would otherwise be either unavailable or at least impractical. TracFone service also is popular with families who want wireless phones for their own or their children's safety but who do not need and possibly cannot afford a traditional service plan. Currently, TracFone has more than 2.6 million customers and its business continues to grow. TracFone service is available throughout the United States, including offshore locations.

TracFone is profoundly concerned about certain proposals before the Federal Communications Commission (FCC) to change the manner in which telecommunications service providers contribute to the Universal Service Fund. TracFone believes that the fairest, most competitively neutral and most appropriate way to assess universal service contributions is based on each service provider's revenues. TracFone believes that cries by certain providers that interstate revenues are decreasing are unsupported and are factually inaccurate. While it may be true that certain carriers' revenues are decreasing, total interstate revenues are increasing as consumers migrate their services to those of wireless providers, Voice over the Internet Protocol (VoIP) providers and others.

In December 2002, the FCC took several significant steps to address shortcomings in the universal service contribution methodology. First, it raised the wireless safe harbor from 15% to 28.5%. This was a step in the right direction, but the FCC should not stop there. We believe that several of the major wireless providers' interstate usage levels are well above 28.5% and there is no reason why wireless carriers—like other telecommunications carriers—should not be assessed on their actual interstate usage revenues. Their interstate usage is measurable. Second, the FCC wisely has prohibited service providers from "marking up" their pass through of universal service contribution charges. By eliminating the opportunity for certain providers to turn their universal service contribution obligations into "profit centers," the FCC has reduced the impact of those consumers who pay to support universal service without reducing the amount of support for the Universal Service Fund.

Neither the connection-based nor the telephone number-based plans which have been proposed by the FCC and supported by a few carriers should be adopted. Those plans would violate the statutory requirement that "every" telecommunications carrier that provides interstate service must contribute on an equitable and nondiscriminatory basis to support universal service. Moreover, those plans would result in lower volume users (who are often lower income consumers) paying a disproportionate share of the universal service burden. Simply put, it is neither equitable nor nondiscriminatory for a consumer who makes $1.00 of interstate calls per month to now be charged $2.00 per month while a large volume user who makes $1,000 of interstate calls per month would be charged $1,001.

TracFone recommends that a revenue-based contribution methodology be maintained, but that the methodology should include all revenues derived from telecommunications. Specifically:

- The wireless safe harbor should be eliminated as no longer being necessary and each wireless provider should contribute based on its actual interstate revenues;
- The FCC should use its existing statutory authority to assess all providers of telecommunications. This would include cable modem services, other broadband services, and Voice Over the Internet Protocol (VoIP) telephone services.
- Congress should grant the FCC the authority to assess intrastate revenues, but only to the extent needed to generate sufficient funding to meet requirements of the Universal Service Fund.

Thank you for affording TracFone the opportunity to present its views on universal service to the Subcommittee.

AARP
April 28, 2003

The Honorable MICHAEL K. POWELL
Chairman
Federal Communications Commission
445 12th Street, S.W.
Suite 8B201
Washington, DC 20554

Re: Reply Comments to Federal-State Joint Board on Universal Service, CC Docket 96-45; and CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

DEAR CHAIRMAN POWELL: As the FCC prepares to issue a final ruling on proposed changes to the way in which the Universal Service Fund (USF) is collected, AARP would like to reiterate and reemphasize views submitted to the Commission in August of last year. AARP has been a strong supporter of the universal service fund, recognizing its importance in providing essential telecommunications services to traditionally underserved communities. We are firmly on record supporting the elimination of surcharges and line items as a means to collect universal service funds.

Absent elimination of such charges, however, the existing system of collecting contributions is preferable to the contemplated move to a per-line charge.

AARP has lent its support to the implementation of the Universal Service Fund, particularly the assistance it provides to low-income consumers, since its inception. We have actively promoted the Lifeline/Link-Up programs within the community. In fact, the Commission participated in an event AARP sponsored with the Florida Public Service Commission in Tallahassee last year to educate consumers about the two telephone savings programs. Therefore, we have a clear understanding of the need to adequately fund the program. We believe that a mechanism that levies contributions from every consumer equitably, based on a percentage of the charges assessed for long distance calls, would provide the monies needed to implement the USF without having to make any changes to the existing formula. By "equitably", we mean that special exemptions or preferential rates should not be afforded certain classes of consumers, as is currently the case. The carriers who employ this practice continue to unfairly discriminate against residential consumers, and AARP believes that now is the time to discontinue the practice.

We are concerned that the move to a per-line charge would further institutionalize the universal service line-item charge. Such a change in regulation now would diminish chances of eliminating the per-line charge from consumer's monthly bills, as we have contended it should be in previous filings with the Commission. However, the existing funding mechanism at least does not penalize consumers who make few or no long distance telephone calls. Under the proposed funding mechanism, these low-volume long distance service callers would be required to pay the bulk of the funding for Universal Service. Based on comments filed with the Commission during its review of low-volume long-distance users in 1999, some 44% of consumers fall into this category. While the goal of the Universal Service Fund is to maintain affordable rates for all consumers, this proposal appears to ask those who most need help to provide a disproportionate amount of the funding.

Ideally, all consumers should see their monthly USF charges decline to $.00 through a system that would allow carriers to recover their cost in rates as a legitimate cost of business. AARP believes that the elimination of line-item charges would advance universal service and ultimately benefit more residential consumers. Absent that fundamental shift, however, we support maintaining the existing system of funding the Universal Service Fund based on a percentage of the cost of long distance phone calls a consumer makes. We commend the Commission for increasing the "safe harbor" percentage for wireless carriers in your interim ruling as a means to better capture the true percentage of long-distance calls. We hope that you maintain this system so that carriers can assign the percentage recovery equitably preventing residential consumers from being further disadvantaged.

In summary, adequate funding of the universal service program is of critical importance. AARP commends the Commission for seeking the appropriate means with which to implement the program. However, we believe that the move to a per-line charge would be harmful to the very population the fund seeks to help. Therefore, we reiterate our request that the Commission not adopt a per-line cost recovery mechanism and offer our assistance in continuing to seek more suitable alternatives.

If you have any further questions, feel free to call me, or have your staff contact Jeff Kramer of our Federal Affairs staff at 434-3800.

Sincerely,

DAVID CERTNER
Director, Federal Affairs

AMERICAN COUNCIL OF THE BLIND
June 27, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington. DC 20554

Re: Federal-State Joint Board on Universal Service, CC Docket 96-45; and CC Dockets 98-171, 90-571,92-237,99-200, 95-1 16,98-170

DEAR MS. DORTCH: As the FCC prepares to issue a final ruling on proposed changes to fund the Universal Service Fund (USF), the American Council of the Blind (ACB) would like to share with you our thoughts. As the nation's leading membership organization of blind and visually impaired people, ACB is concerned about how proposed changes in the USF funding mechanism could disproportionately harm low and fixed income consumers, many of whom are blind and visually impaired.

Universal service is very important to people with disabilities. It helps ensure the delivery of affordable and accessible telecommunications services to all Americans, including those who live in high-cost areas and/or on limited incomes, as well as to schools, libraries and rural health providers. As many Americans with disabilities live on fixed or limited incomes and are more likely to be unemployed than Americans without disabilities, ensuring the maintenance of the USF is very important to our organization.

We are very concerned that the current proposal to switch from a revenue-based universal service funding mechanism to a connection-based one would be harmful to the very population the fund seeks to help. Under a connection-based methodology, customers would be charged the same amount for universal service whether they make one interstate phone call or 100, e.g., a low volume residential customer would contribute the same amount as a high-volume business customer. So rather than helping provide affordable service to those that need it most, this proposal appears to ask them to contribute a disproportionate amount of the funding.

We are also concerned about the impact of this connection-based funding mechanism on users of pre-paid wireless services. For the blind and visually impaired, wireless phones provide significant benefits including safety, security and convenience. Pre-paid wireless services, in particular, are an important product to many people with disabilities. Pre-paid wireless gives people who cannot afford or cannot qualify for regular cell phone service the opportunity to enjoy its benefits. We are troubled that changing the USF mechanism to connection-based would significantly increase the cost of pre-paid wireless companies' USF contributions which would force companies to increase the usage charges for such services. We urge you to ensure that any changes to the USF mechanism do not inadvertently raise the cost of pre-paid wireless service to the detriment of consumers who need it most.

We appreciate the opportunity to share with you our concerns and urge you to ensure that any changes to the universal service funding mechanism do not unintentionally hurt the very people universal service was created to help.

Sincerely.

CHARLES CRAWFORD
Executive Director, American Council of the Blind

REPLY COMMENTS OF COMMUNITY ACTION PARTNERSHIP, AMERICAN ASSOCIATION OF PEOPLE WITH DISABILITIES, CONSUMER ACTION AND RAINBOW-PUSH COALITION

APRIL 18, 2003

Re: Reply Comments to Federal-State Joint Board on Universal Service, CC Docket 96-45; and CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

The following organizations jointly provide these reply comments addressing a proposal under consideration by the Federal Communications Commission (Commission) that focuses on how universal services are funded:

I. STATEMENT OF INTERESTS

Community Action Partnership (CAP) is the national association representing the interests of the 1,000 Community Action Agencies (CAAs) organized to change people's lives, embody the spirit of hope, improve communities, and make America a better place to live. CAP serves as a national forum for policy on poverty and to strengthen, promote, represent and serve its network of member agencies to assure that the issues of the poor are effectively heard and addressed. CAP works to advance the economic condition, educational attainment, political influence, health and civil rights of low-income Americans. CAP works hard to ensure that low-income Americans are not left behind.

American Association of People with Disabilities (AAPD) is the largest national nonprofit cross-disability member organization in the United States, dedicated to ensuring economic self-sufficiency and political empowerment for the more than 56 million Americans with disabilities. AAPD works in coalition with other disability organizations for the full implementation and enforcement of disability nondiscrimination laws, particularly the Americans with Disabilities Act (ADA) of 1990 and the Rehabilitation Act of 1973.

Consumer Action is a San Francisco-based education and advocacy organization that has worked on telephone, banking and privacy issues for more than 30 years.

Consumer Action works through a national network of more than 6,500 community-based organizations that serve low and moderate-income consumers, recent immigrants and people of color.

Rainbow/PUSH Coalition is a progressive organization that advocates for social change. With a membership of nearly 300,000, Rainbow/PUSH is a national coalition of under-served employees, consumers, and entrepreneurs committed to securing equal protection, opportunity, and access under the law. Consistent with this mission, Rainbow/PUSH seeks to ensure equal access to services, employment and ownership opportunities in the telecommunications industry. The connection-based methodology proposal (CBM) being reviewed at the Commission will pose a disproportionate financial burden on low-income and low-volume consumers. Rainbow/PUSH has a substantial interest in this proceeding, because of the adverse impact that the CBM will have on many of our constituents.

II. COMMENTS

Under the current system, telecommunications firms are required to use a percentage of their interstate revenue to support the Universal Service Fund (USF). Under the proposed system, contributions would be based on a flat monthly connection-based fee. Considering that many of the Commenters' members/affiliates are eligible for the universal service programs, we are strong supporters for the Universal Service Fund, and the need to provide a reliable source of funding for universal service programs. We also endorse the Commission's recent changes to the universal service contribution methodology. However, we are wary about radical changes to this revised contribution methodology that may negatively affect the populations we ultimately serve.

We believe that a connection-based mechanism unfairly and adversely impacts lower income and lower volume users of interstate services, and on carriers who provide services to such consumers. The Commenters point out that a connection-based mechanism is neither equitable nor nondiscriminatory to carriers who provide services to our members/affiliates, which violates Section 254(d) of the Communications Act which states that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to be specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service."[1] The implementation of a connection-based mechanism would present a significant, unnecessary change in the way in which USF contributions are collected.

We recommend that the Commission consider alternative modifications to the contribution methodology. The Commenters bring to the Commission's attention some example modifications noted by TracFone Wireless, Inc.'s recent comments in which they

> ". . . urges the Commission to consider additional changes to the revenue-based contribution methodology, such as eliminating the wireless safe harbor and ensuring that broadband Internet access services, particularly Internet based telephony services, contribute to the Universal Service Fund."[2]

We concur that such changes could provide significant additional resources for universal service programs. Additionally, these suggested changes would most likely not have a negative effect on lower income and lower volume users of interstate services.

CONCLUSION

In summary, the Commenters believe that radical changes to the revised contribution methodology may have unintended negative consequences on consumers. We believe that the best available alternative to ensure the continued viability of the universal service programs is to consider alternative modifications to the contribution methodology, such as eliminating the wireless safe harbor and ensuring that Internet based telephony services contribute to the Universal Service Fund. Hence, we respectfully request that the Commission more carefully review proposed

[1] 47 U.S.C. Paragraph 254(d)

[2] Comment Letter of TracFone, Inc. CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, and 98-170, February 28, 2003

changes to the universal service funding and request that the Commission discard the proposal for a connection-based funding system.

Sincerely,

DERRICK SPAN, *National President*
Community Action Partnership
KEN MCELDOWNEY, *Executive Director*
Consumer Action
ANDREW J. IMPARATO, *President and CEO*
American Association of People with Disabilities
CLEO FIELDS, *General Counsel*
Rainbow/PUSH Coalition

LEAGUE OF UNITED LATIN AMERICAN CITIZENS
April 18, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Federal-State Joint Board on Universal Service, CC Docket 96-45; and CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

DEAR MS. DORTCH: The League of United Latin American Citizens (LULAC) appreciates this opportunity to provide additional comments in the aforementioned proceedings. In particular, we would like to reemphasize our view that adoption of a connection based proposal will have negative consequences for Hispanic consumers who are low volume long distance customers and those that utilize prepaid wireless services. We believe that a radical shift in the universal service contribution methodology from one based on interstate revenues to one based on connections or telephone numbers is not only ill-conceived, it is unwarranted.

The assertion that interstate revenues are on decline does not entirely ring true when one considers that interstate communication is simply shifting from wireline to wireless, instant messaging, e-mail and voice-over Internet. Indeed, even the FCC acknowledged this shift in the December 13, 2002 Interim Rule when they lifted the wireless safe harbor from 15 percent to 28.5 percent. LULAC supports this revenue-based refinement and looks forward to assessing the outcome of this change on universal service contributions when data becomes available. We encourage the FCC to continue along this path and to explore other refinements to the current methodology.

As we mentioned in our earlier filing, LULAC takes a special interest in this proceeding because we want to ensure all Hispanic Americans have access to affordable wireless telephone service. While, almost half of U.S. Hispanics, or approximately 16 million Latinos, have mobile phones, according to Cheskin Research; we also know that there is a unique population of the Hispanic market that relies on prepaid wireless service as their only wireless option. These types of individuals include:

- young people who cannot meet credit or security deposit requirements;
- migrant and seasonal workers without a permanent address or other institutional prerequisites;
- people who are unwilling to enter into a long-term contractual commitment;
- senior citizens or public assistance recipients who are on fixed incomes;
- individuals who want to control their telephone costs; and
- women and others who use them primarily for emergency or security purposes.

Since this population tends to be low-volume, low cost customers, they are often overlooked by wireless carriers who prefer high volume, high cost customers. Yet, we understand, there are nearly 10 million pre-paid wireless customers nationwide that are being served by companies such as TracFone and Verizon Wireless thereby documenting the critical role pre-paid service plays in meeting the needs of consumers. LULAC urges the FCC to pay particular attention to how the connection-based proposals will adversely affect pre-paid telephone providers who serve this unique audience. The goal of universal service must include fostering a marketplace that encourages providers to serve all customers; and the FCC must prevent obstacles from being erected. In addition, changes to the universal service funding mechanism must not impose a regressive charge for universal service on low-volume customers such as those mentioned above.

LULAC notes that a number of other public interest groups that represent large constituencies of low-income consumers, such as the Community Action Partnership, Rainbow-PUSH and the NAACP, share our concern about negative consequences of abandoning the revenue-based methodology. We also note industry groups, including mobile wireless carriers, small local exchange carriers, and state public utility commissions find fault with the various connection-based proposals on different grounds. Consequently, we urge the FCC to conclude that retention of the revenue based system, with the interim changes of December 13, 2002, is the correct path to follow.

Thank you for taking our views into consideration and please do not hesitate to call upon us if we can be of further assistance.

Sincerely,

HECTOR M. FLORA,
LULAC National President

NAACP
April 18, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Reply Comments to Federal-State Joint Board on Universal Service, CCDocket 96-45; and CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

DEAR MS. DORTCH: I am writing this letter to reiterate my concern regarding proposed reforms to the contribution methodology for the Universal Service Fund (USF). As I mentioned in my February 27, 2003 letter, the NAACP's principal objective is to ensure the political, educational, social and economic equality for racial and ethnic minority groups of United States and to eliminate race prejudice. The USF has been instrumental in ensuring that all Americans have access to affordable, comprehensive telecommunications services, particularly consumers in high-cost service areas, low-income consumers, schools, libraries and rural health providers.

Presently, telecommunications firms are required to use a percentage of their interstate revenue to support the Universal Service Fund. The fund is used to help compensate telephone companies for providing access to services at reasonable and affordable rates throughout the country, including rural, insular and high cost areas, and to public institutions. Many of the consumers who benefit from the USF are our constituents.

We strongly support the Federal Communications Commission's (FCC) laudable goal of maintaining the viability of the USF. However, the new proposal to shift from a revenue-based system to one based on connections—**meaning USF contributions would be based on a flat monthly connection fee**—raises concerns. Under this proposal, consumers who make few or no interstate calls would be assessed the same as consumers, especially businesses, who make more interstate calls. Low-volume and primarily residential customers could unfairly bear the burden of contributing to the universal service fund. Additionally, studies have concluded that telephone providers who service the low-volume population will be at a competitive disadvantage under a connection-based methodology.

Consumers who utilize products such as pre-paid wireless services could be adversely affected by the connection-based proposals. As the FCC is aware, pre-paid wireless provides service to portions of the African American community, including: low-income users or young people who cannot meet credit or security deposit requirements; migrant and seasonal workers without a permanent address; people who are unwilling to enter into a long-term contractual commitment; senior citizens or public assistance recipients who are on a fixed incomes; individuals who want to control their telephone costs; and women and others who use them primarily for emergency or security purposes among others. The connection-based methodology would significantly raise the cost of this particular type of telephone service at the expense of consumers such as those mentioned above.

I urge the FCC to carefully weigh the impact of any intended reforms to the universal service funding methodology to our nation's most vulnerable as we work together to find better ways to increase funding to such a valuable program.

If there is anything I can do to help advance this process, I can be reached by telephone at (202) 638-2269.

Sincerely,

HILARY O. SHELTON
Director

BEFORE THE FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, DC 20554

April 16, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Reply Comments on Federal-State Joint Board on Universal Service CC Docket 96-45 CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

To: The Commission

REPLY COMMENTS OF THE NATIONAL GRANGE OF THE ORDER OF PATRONS OF HUSBANDRY

The National Grange of the Order of Patrons of Husbandry (the "Grange") hereby submit these reply comments to encourage the Commission to adopt equitable and non-discriminatory regulations related to assessments for the Universal Service Fund.

The Grange is the oldest general farm and rural public interest organization in the United States. Founded in 1867, today the Grange represents nearly 300,000 individual members affiliated with 3,000 local, county and state Grange chapters across rural America. More than 70% of all local Grange chapters are located in communities of 2,500 persons or less.

The Grange recognizes the importance of the Universal Service Fund (USF) to the public welfare, especially in rural communities. In rural America, there is an admitted lack of overall communications services. Rural areas with many small towns and villages are considered to be on the wrong side of the "last mile" of telecommunications services. A major purpose of the USF is to help rural areas achieve parity in telecommunication standards that is comparable to the more densely populated metropolitan areas of the United States. The National Grange also believes that full and fair competition is the only way to provide state-of-the-art telecommunications services to rural populations, especially those contained within the "last mile."

Section 254(d) of the Communications Act requires 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.]"

Today, all telephone companies that provide telephone service between states or internationally contribute to the USF. The exact amount is adjusted every quarter, based on the projected universal service needs and the projected revenues generated by interstate and international calls. Currently, each company makes a business decision regarding whether and how to assess customers, in order to recover their USF costs. Wireless service providers have a special provision that is based on a flat rate calculation of estimated total revenues rather than actual revenues generated by interstate telephone calls. The Study estimates that wireless connections will grow by more than 50 million between 2002 and 2007 while land line connections are expected to grow by fewer than six million over the same time period.

Current, proposals that have been submitted to the FCC suggest that major changes are necessary in the collection of universal service funds. One comment period for that topic has already passed. Following that, the FCC issued a public notice seeking reply comments on a staff study (the study) regarding alternative contribution methodologies. The study undertakes to project the effects that alternative collection based methodologies would have on the universal service fund.

The Grange strongly disagrees with the assumptions that major changes are necessary in the revenue-based methodologies used to currently collect funds for the USF. The following observations and comments are submitted by the Grange in response to the study and in support of our position.

Various methodologies used by the Commission staff project significant shifts in the burden of payment among long distance carriers, local exchange carriers and wireless carriers. Under the baseline projection for revenue based methodology the share of contributions by industry segment would shift from 59% for long distance carriers, 26% for local carriers and 15% for wireless carriers in 2002 to 41%, 32% and 27%, respectively, by 2007. However, all baseline projections for connection or telephone number based methodologies shift a disproportionate share of the USF funding responsibility away from long distance carriers to local carriers and wireless carriers. In 2002 the long distance carriers were responsible for 59% of USF revenues. Under Proposals 1, 2, and 3, respectively, that responsibility would fall to 22%, 29% or 13%. The financial responsibility for maintaining the USF would shift dramatically to local carriers and wireless carriers under any of the connection based methodologies examined in the study. With this shift would come significant shifts in the financial burden on individual consumers, especially in rural areas, with no apparent benefit to consumer populations that are dependent on USF funding to maintain telephone service.

In contrast, The National Grange believes a modified revenue based methodology is the most reasonable alternative for funding the USF because it will result in the fewest disruptions in the long-standing relationships among various companies and their consumers.

We do not see how any of the connection or phone number based methodologies fit the intention of the Telecommunications Act of 1996 Act or Section 254(d). Connection based methodologies would fail to meet the requirement that every telecommunications carrier contribute to the USF. Connection based methodologies will disproportionately affect low volume long distance callers, residential customers, and customers on fixed incomes. All of these customer groups are disproportionately represented in rural communities. Since one of the major purposes of the USF is to provide or enhance telephone services in high cost rural residential areas the Grange do not see the logic in any methodology that would effectively increase USF contributions from consumers who already reside in high cost rural areas.

Connection based methodologies would also significantly reduce the responsibility of high volume, business users of long distance telephone services to financially support the USF by effectively imposing additional USF charges on intrastate telephone calls.

Connection based methodologies would remove the current responsibility that each company has to decide whether and how to assess customers to recover USF costs. Instead it would replace those business decisions with de facto USF surcharges on every telephone connection. In the best interest of fairness in competition, the consumer-driven marketplace should dictate the success or failure of a business plan, not the manner in which the government structures its fees. To shift the burden of payment from one type of business model to another in a seemingly arbitrary manner would be inequitable and unfair treatment of private business entities.

On December 12, 2002, the Commission issued an interim rule regarding modest changes to the current revenue based methodology. The interim rule modified the current revenue base to increase the minimum assessment that wireless carriers pay USF charges on from 15% to 28.5% of revenues. This change better captures the industry wide proportion of wireless calls that involve long distance service, but is still an imperfect measure of the contribution that the individual wireless carriers make to overall interstate service. The interim rule also changed the assessment base from "revenues accrued" to "projected revenues" to address concerns by some long distance carriers related to the declining customer base that some carriers are experiencing. Finally, the interim rule prohibits telecommunications carriers from charging customers any "mark-up" above their relevant contribution factor for their USF assessments. The National Grange believes that these changes are sufficient to maintain the solvency of the USF for several years on a basis that is equitable and nondiscriminatory to the various segments of the telephone industry.

As a group whose membership is overwhelmingly from rural America, the National Grange views the universal service fund as a necessity in the achievement of parity of services to all segments of the United States. Therefore, we support the current revenue-based methodology as the most fair and least market intrusive manner in which funds are collected.

The National Grange encourages the Commission to continue to study the issues surrounding this proceeding and to make small changes to correct minor inefficiencies or inequities, as done in the recent past. For example, the Commission should move away from "safe harbor assessments" for the wireless carrier industry and replace them with methodologies that accurately reflect each wireless company's proportion of the long distance market. In addition, we respectfully urge the Commissioners to allow an adequate passage of time between implemented changes, to allow valid observations of the results.

For the reasons explained in these comments, the Grange urges the Commissioners to reject the connection-based methodologies to fund the USF. We oppose any drastic changes to the method of collection of universal service funds. Instead the Grange urges the Commission to retain the basic structure of the current revenue based methodology for assessing USF contributions. In addition, the interim changes put in place in December of 2002 should be given a chance to work. Additional modifications to fine-tune the existing revenue based methodology should be explored to assure both sufficient USF revenues and an equitable distribution of USF fees across various segments of the telephone industry as well as across the various segments of the consumer population, including rural consumers.

Respectfully submitted,

LEROY WATSON, *Director of Legislative Affairs*
The National Grange

NATIONAL INDIAN EDUCATION ASSOCIATION
April 18, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Federal-State Joint Board on Universal Service, CC Docket 96-45; and CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

DEAR MS. DORTCH: The National Indian Education Association submits this letter as a reply comment to express our trepidation about the Federal Communications Commission's (FCC) consideration of an alternative funding mechanism for universal service. Under the proposed mechanism, contributions would be based on a flat monthly connection fee as opposed to the current system based on a percentage of interstate revenue.

The National Indian Education Association (NIEA) supports traditional Native cultures and values, to enable Native learners to become contributing members of their communities, to promote Native control of educational institutions, and to improve educational opportunities and resources for American Indians, Alaska Natives, and Native Hawaiians throughout the United States. NIEA has promoted the interests of Native Americans in telecommunications to Congress, before the FCC and in the courts.

Because the majority of Native Americans live, work, and learn in rural areas, many participate in the Lifeline and Link-up programs. Additionally, many Native American libraries, schools, and universities are beneficiaries of the E-rate program. E-rate is a vital program providing numerous Native American K-12 public schools and libraries with significant discounts on telecommunications services, Internet access, and internal connections costs; thereby ensuring our teachers, students and families have access to the richness of the world wide web. Hence, NIEA is an avid supporter the Universal Service Fund, and the need to generate reliable sources of funding for universal service programs.

NIEA is instrumental in working with Native American schools and libraries to apply for E-rate discounts, and we support the FCC's goal of ensuring the USF is positioned to meet future demands. We advocate not only for the continuance of the USF but also for the expansion of base contributors as well. An expanded base of contributors will assure the availability of affordable, accessible telecommunications services. However, in the case of the connection-based proposal, NIEA is concerned that prepaid wireless carriers that service rural localities, such as TracFone, Inc., would be disproportionately impacted, resulting in a higher fee assessment for Native American consumers of such services. Prepaid wireless service offers Native Americans an affordable accessible communication option. Prepaid wireless service is an off-the-shelf, pay-as-you-go, service that offers consumers wireless service with no contracts, no credit checks, no monthly fees, no activation fees, no security deposits and no age limits. Such features provide Native Americans with true costs for services. Because of living in rural localities, many calling plans hit Native Americans with hidden roaming fees and various other charges that are financially burdensome. With prepaid wireless services, there are no surprises. Native Americans pay for minutes that are expended.

As iterated in our previous comments on this matter, under this new connection-based proposal, carriers whose services are designed for customers that make fewer calls would carry a greater payment burden. Such a burden would also be levied on the prepaid wireless customers. In short, customers who make few interstate calls would be assessed the same cost as customers who make many interstate calls. This would be a major financial cost to Native Americans, who generally are low-volume interstate callers. The result would be low-volume, residential customers disproportionately contributing to the universal service fund. The connection-based proposal does not live up to a primary statutory principle that guides universal service fund policy: quality services should be available at just, reasonable, and affordable rates.

NIEA urges the FCC to consider alternative modifications to the contribution methodology. We would like to point out that other commenters have identified additional contribution methodologies—such as, eliminating the wireless safe harbor and ensuring that broadband Internet access services contribute to the Universal Service Fund—as viable alternatives. We agree that such changes could possibly provide significant additional resources for universal service programs. Additionally, these suggested changes would most likely not have a negative effect on Native Americans.

NIEA asks that the FCC take a closer look at the connection-based proposal. We are confident that you will find that it is not in the interest of consumers, especially Native American prepaid wireless consumers. Nor do we believe that adoption of this methodology is necessary to ensure a robust USF. We, instead, encourage the FCC to retain the current revenue-based mechanism and to carefully explore fair and equitable ways to expand the base of contributors as a means for generating additional revenues.

JOHN CHEEK, *Executive Director*
National Indian Education Association

ORGANIZATION CONCERNED ABOUT RURAL EDUCATION
July 17, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Ex Parte Comments to FCC Staff on Study of Universal Service Fund CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No L-00-72

DEAR MS. DORTCH: The achievement of parity in telecommunications standards in rural America is a major purpose of the universal service fund (USF). Rural schools, libraries and homes deserve to have equal access to telephones and other telecommunications services when compared to those located in more densely populated areas of the United States. In rural America, some great strides have been made in the delivery of telecommunications services. For example, it is estimated that 89% of rural homes have wireline telephone service and the e-rate program, paid for by the Universal Service Fund, has made some progress in bringing services to our rural schools and libraries.

The very formation of the Organization Concerned about Rural Education (OCRE) was predicated on the belief of equality in educational standards with respect to the condition of physical structures, quality teachers and the access to technology. As a result, OCRE has long been a staunch advocate for the sustainability of the universal service fund. Yet, recently, some concerns have been expressed that the future holds a decline in funds available to sustain the universal service fund. Among the reasons cited for this trend are a decline in interstate revenues, the bundling of local and long distance calling packages and customer demand for universal service programs.

Consequently, there are those who believe that the current collection system simply needs minor modifications while others believe a major change in the collection methodology is necessitated. To that end, and much to the credit of the FCC, a Staff Study was done that attempted to project the effects various proposals would have on the universal service fund. The FCC seeks to ensure the full funding of the USF by changing collection methodology. Three of the four proposals would drastically change the method of collection from a revenue-based system to a connection-based system.

In all of the connection-based proposals presented in the study, there seems to be a significant shift in the burden or payment from interstate and international business community calls to the residential customer base. Can such a radical change in the formula for collection methodology be justified if the people, including families with school-aged children, who are to benefit from the universal service fund are those who must shoulder the greatest burden of payment? In addition, the ever-protected reserve fund, considered to be an absolute necessity by industry and consumer groups, although briefly mentioned, is conspicuously absent from the staff study. This leads to questions revolving around the reserve fund, and its subsequent condition if this radical change in collection is made.

As an organization whose focus is on the success of rural education, OCRE views the universal service fund as a necessity in the achievement of parity of services to all segments of the United States. Therefore, we support the current revenue-based methodology as the most fair and least market intrusive manner in which funds are collected. In that way, the FCC avoids taking the inevitable blame for capriciously changing collection methodologies that disproportionately affect customers who make few or no long distance calls. With that in mind, OCRE suggests that the FCC seriously considers an expansion in the base of contributors to the USF. This would be more inclusive of all types of telecommunications providers, would solve the existing concern of decline in interstate revenues, as well as thwart the potentially inequitable result that a connection-based methodology will cause. Furthermore, it certainly would conform with market trends.

In another decision, the FCC increased the safe-harbor rate used as the basis for wireless providers to contribute to the USF from 15% to 28.5%. OCRE commends the Commission for its ability to timely recognize shifting market trends and act accordingly. As time progresses, this will likely prove to be a wise decision on the part of the FCC that will help the USF to remain sustainable and predictable.

OCRE views the proposed connection based changes as unnecessarily extreme, and opposes any drastic changes to the method of collection of universal service funds. We encourage the Commission to make small changes to correct minor inefficiencies or inequities, as done in the recent past. In addition, we respectfully urge the Commissioners to allow an adequate passage of time between implemented changes, to allow the results to be observed fully.

We urge the Commissioners to retain the current revenue based mechanism for assessing universal service fund contributions.

Sincerely,

DALE LESTINA
President

TELECOMMUNICATIONS RESEARCH & ACTION CENTER
April 18, 2003

MARLENE H. DORTCH
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Reply Comments to Federal-State Joint Board on Universal Service, CC Docket 96-45; and CC Dockets 98-171, 90-571, 92-237, 99-200, 95-116, 98-170

DEAR MS. DORTCH: The Telecommunications Research & Action Center (TRAC) submits these reply comments to the Federal Communications Commission (Commission) to express once again its concern regarding the above-captioned proceedings. As noted in our February 27, 2003, letter to the Commission, TRAC is a non-profit membership organization based in Washington, DC, that, since its inception in 1983, has promoted the interests of residential telecommunications customers. TRAC staff researches telecommunications issues and publishes rate comparisons to help consumers make informed decisions regarding their long distance and local phone service options. TRAC can be found on the web at http://www.trac.org.

TRAC strongly urges the Commission to carefully measure the adverse impact on residential consumers before the Commission drastically alters how it assesses contributions to the universal service fund (USF). TRAC notes that other Commenters and even Commission's staff have found that should the Commission change from the current revenue-based methodology (RBM) to a connection-based methodology (CBM), "such a change would shift much of the responsibility for USF funding from business users to residential users, and would increase USF rates for many average-use and low-use residential customers."[1]

TRAC highly recommends that the Commission consider how the proposed CBM runs afoul of the clear mandate of the Telecommunications Act of 1996 (1996 Act) to assess *every telecommunication carrier for USF contributions.* Under the CBM, the assessment would shift from the carriers to the end-users. As TRAC previously remarked, the Commission is tasked with assessing contributions in an equitable and non-discriminatory manner. Under the proposed CBM, high-volume and low-volume consumers would be charged the same flat fee. This is hardly equitable or nondiscriminatory, given that business consumers, who typically make many interstate calls would be assessed the same as residential consumers, many of whom are low-income and low-volume callers. Low-volume residential consumers would have to contribute the same to the USF as high-volume residential or business consumers.

Finally, TRAC stresses the twin hardship faced by low-income and low-volume users who use pre-paid wireless services should the Commission adopt the CBM. Low-income users of pre-paid wireless services are ineligible to receive the FCC's "Lifeline" exemption from USF contributions. Sadly, low-income and low-volume consumers will be charged a flat connection fee regardless of the number of calls they make as well as being ineligible for the Lifeline exemption.

The connection-based methodology disparately impacts low-income and low-volume residential consumers. In addition, the CBM is contrary to aims of the 1996 Act. Accordingly, TRAC highly recommends that the Commission abandon any further consideration of the proposed connection-based methodology.

Sincerely,

DIRCK A. HARGRAVES, *Esq., Counsel*
Telecommunications Research & Action Center

[1] See Comments of Consumers Union, Texas Office of Public Utility Counsel, Consumer Federation of America, Appalachian People's Action Coalition, Center for Digital Democracy, Edgemont Neighborhood Coalition and Migrant Legal Action Program at page I (April 22, 2002). See also Projected Assessments under Proposal 2 of Connection-Based Methodology published in Federal Communications Commission Public Notice FCC 03-31, *Commission Seeks Comment On Staff Study Regarding Alternative Contribution Methodologies,* February 26, 2003.

NADO

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September 2, 2003

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Marlene H. Dortch, Secretary
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Washington, DC 20554

Re: Ex Parte Comments to FCC Staff Study of Universal Service Fund CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72

Dear Ms. Dortch:

On behalf of the National Association of Development Organizations (NADO), I am pleased to submit these *ex parte* comments regarding proposed changes to the collection methodology of the universal service fund.

There should be no doubt that the role of universal service in helping to fund services for otherwise ignored or neglected portions of America has been a successful one. In the United States it is estimated that telephone service has an 89% penetration rate in low-income and rural households. While the digital divide is still in existence, there are statistics that indicate some improvements toward ending digital disparity.

Lately, there have been disconcerting announcements that a depletion is taking place in the universal service fund. According to some reports, the changes that have been occurring in the world of telecommunications, through technology advances and customer demand, have decreased some business profit and increased other types of profit. Some projections foretell a continuing trend in a downward direction. Whether or not those prognostications are correct is anyone's guess. Upon careful consideration, no one really knows what the trends or the newest inventions actually will be in the telecommunications market. Who among us knew 10-12 years ago that so many teenagers would have beepers, cell phones, or computers? Just 5 years ago, did we know that Wi-Fi was going to exist, let alone become a hot consumer item? It seems that the one thing we can count on is the constant state of fast-paced change, and a wider array of choices for people to communicate with each other.

Because of consumer demand, companies are offering bundled telecommunications services. With bundling, or the grouping together of services at discounted rates (the more you buy, the more you save), it is more difficult to differentiate between intrastate and interstate usage. There is less emphasis on that need based upon consumer response. Between consumer driven selections and the 1999 court decision removing FCC jurisdiction over intrastate service, there is less motivation for the companies to differentiate between interstate and intrastate connections.

With all of the major advances in technology, consumer demands, changes in business policy that have evolved over the recent lifetime of telecommunications, there is a strong temptation for the FCC to focus on so many more details of the telecommunications infrastructure.

A fine example of this detail is in a recently published FCC Staff Study that changes the formulation of contribution into the fund to a connection based system. Upon closer examination, the study reveals some very disconcerting numbers. By the year 2007, under a connection based system, between 67 and 68% of the contribution to the fund will come from residential users. By changing the onus of responsibility from one type of carrier to another, the placement of the burden of responsibility of payment transfers squarely onto the shoulders of the end-user, residential customers who are small home owners, or renters, apartment dwellers, and regular folks. This is unacceptable and is a direct affront to the '96 Telecommunications Act itself.

The major fluctuations in the telecommunications industry have the FCC and the Congress continually and repeatedly scrutinizing the USF formulas to make them work with current market conditions. Every time the FCC examines the various nuances, the collection methodology is tweaked into
conformity with the conditions of the moment. Sometimes it works for a brief period of time, most often it must be revisited.

Here is a suggestion that the FCC takes a more common sense approach to this situation. A fund collection system based upon revenue to the phone companies is a consumer oriented methodology. It is based upon the service that any given consumer can afford to pay for the prearranged service plan provided by a telecommunications company. Companies contribute to the Universal Service Fund based upon the projected payments received from their end-user customers. This is a fair and equitable collection of funds by any standard. And it is the current means of collection.

If the FCC stays the course of revenue based collection methodology, and is allowed to collect USF fees based upon a percentage of the total combined revenue stream of each and every telecommunications company, then the problem of depleting USF funds is already solved.

A revenue-based system to which all telecommunications companies contribute is the most reasonable because: it is less intrusive to the business details; it treats all companies equally; and it complies with the original intent of the law. A revenue based system with moderate changes has the best chance to remain equitable and non-discriminatory. Even in the most volatile market environments with major shifts in customer base, a "specific, predictable, and sufficient" Universal Service Fund is more assured.

We respectfully suggest that the FCC retain its revenue based collection methodology and reject the connection based proposals.

Sincerely,

Aliceann Wohlbruck

Aliceann Wohlbruck
Executive Director