AMERICAN LEGISLATIVE EXCHANGE COUNCIL

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April 15, 1997

EX PARTE OR LATE FILED

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street NW - Room 222
Washington, D.C. 20554

RECEIVED

APR 1 5 1997

Federal Communications Commission
Office of Secretary

Re: Ex Parte Meeting
CC Docket No. 96-45, Federal-State Joint Board on Universal Service

Dear Mr. Caton:

On April 14, 1997 Maryland Delegate Martha Klima and Richard Gowdy, representing the American Legislative Exchange Council (ALEC), met with Mr. Daniel Gonzalez, legal advisor to Commissioner Chong, and with Mr. Thomas Boasberg, legal advisor to Chairman Hundt, regarding the above referenced proceeding. Copies of the letter and issue paper used to guide the discussions are attached.

The viewpoints expressed in these meetings were consistent with ALEC's written comments before the Commission. Delegate Klima also expressed her personal concern regarding the possible inclusion of intrastate revenues for the high cost fund portion of federal universal service.

An original and a copy of this Ex Parte, are being filed in the office of the Secretary on April 15, 1997. Please include it in the public record of this proceeding.

Respectfully submitted,

Richard P. Gowdy II
Task Force Director
Telecommunications and Information Technology

cc: The Honorable Martha Klima, Maryland House of Delegates
Daniel Gonzalez
Thomas Boasberg
James Casserly
James Coltharp
Chairman Hundt
Commissioner Chong
Commissioner Ness
Commissioner Quello

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January 10, 1997

Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

RE: Reply Comments of the American Legislative Exchange Council (ALEC)
In the Matter of Federal-State Joint Board on Universal Service
CC Docket No. 96-45

The American Legislative Exchange Council (ALEC), the nation's largest non-partisan membership association representing over 2,900 state legislators, is committed to advancing public policies which assure telephone service is affordable across the nation and which equitably distribute the social responsibility for universal service support among all providers in a neutral manner to ensure universal service is continued. Accordingly, ALEC has both an interest and strong concerns regarding the FCC's current proceeding which is evaluating the recommendations of the Federal-State Joint Board.

Attached, in support of ALEC's position, is the ALEC *State Factor* (policy position paper) entitled "The Impact of Competition on Universal Service in the Local Telecommunications Marketplace." This paper was developed by the ALEC Task Force on Telecommunications in 1994 before passage of the Telecommunications of 1996. Although developed two years in advance of the legislation, the paper still provides underlying tenets that form the basis of ALEC's comments regarding the Federal-State Joint Board's Recommendation and some of the commenters in this proceeding:

1. There is an undue vagueness about the costs involved, the size of the universal service fund and who will ultimately pay the costs. ALEC believes the FCC must consider all costs involved in providing the network, create a fund that is no larger than today's fund and ensure that all providers contribute and make the business and consumer taxation issues absolutely explicit, clear and minimal.

2. Universal Service should not be more than basic local dial tone service which: can interconnect with other citizens; connect and operate with other systems; and provides the ability to be informed and to inform others of emergency situations and to access emergency services.

3. Poverty levels for a given jurisdiction should be used to determine the distribution of the universal service funds for that jurisdiction. The Universal Service Fund should not be expanded to create a new, "Rolls Royce" welfare system.

4. ALEC urges the FCC to carefully examine its final decision to ensure that state's rights are maintained. In no way should the FCC's decision impede or affect a state's ability to regulate and establish rates within its jurisdiction or usurp sources of funding for a state universal service fund if a state elects to institute such a program.

Public policy should continue its commitment to providing federal universal service support at reasonable rates without the creation of a "Rolls Royce" fund. The public policy associated with universal service should insure that all service providers contribute and there is a competitively neutral distribution of the funds, based on need.

Respectfully Submitted,

Duane Parde
Executive Director

cc: Chairman Hundt
Commissioner Chong
Commissioner Ness
Commissioner Quello

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

The State Factor

Volume 20, Number 9 November 1994

THE IMPACT OF COMPETITION ON UNIVERSAL SERVICE IN THE LOCAL TELECOMMUNICATIONS MARKETPLACE

by the
Telecommunications Task Force

Volume 20, Number 9
The State Factor: The Impact of Competition on Universal Service in the Local Telecommunications Marketplace

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The State Factor: The Impact of Competition on Universal Service in the Local Telecommunications Marketplace was written by the Telecommunications Task Force of the American Legislative Exchange Council, and has been published as part of ALEC's mission to discuss, develop and disseminate public policies which expand free-markets, promote economic growth, limit government and preserve individual liberty. ALEC is the nation's largest bipartisan, voluntary membership association of state legislators, with 2,600 members across the nation. ALEC is governed by a 21 member Board of Directors of state legislators, which is advised by a 23 member Private Enterprise Board representing major corporate and foundation sponsors.

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THE IMPACT OF COMPETITION ON UNIVERSAL SERVICE IN THE LOCAL TELECOMMUNICATIONS MARKETPLACE

Statement of Purpose: Public policy should encourage free and open competition in all forms of telecommunications services and distribute the social responsibility of universal service among all providers of telecommunications services in a neutral manner to ensure the commitment of access to universal service is continued.

The Administration's *National Information Infrastructure Agenda for Action* "... is a carefully crafted governmental action which will complement and enhance the efforts of the private sector and assure the growth of an information infrastructure available to all Americans at reasonable cost. In developing our policy initiatives in this area, the Administration will work in close partnership with business, labor, academics, the public, Congress and state and local government."

Excerpted from *National Information Infrastructure Agenda for Action*
Issued September 1993

If there is a theme to telecommunications today, it must be "convergence and competition." The last two decades have been characterized by an unrelenting march towards technology convergence in the telecommunications field as all forms of communication--voice, data and video--are migrating towards the all digital world. In the process, the traditional technological and institutional distinction between computers and communications, on the one hand, and among the various methods of communicating, on the other, have all but disappeared.

These changes have enormous implications for the industry. While this technology convergence occurs, the ability to move information within telecommunications networks increases geometrically. The most advanced networks now operate at speeds that make it possible to transmit literally volumes of information in seconds. As more advanced switching technologies are deployed throughout the networks and use increases, prices are falling. As a result, the technological and economic limitations that once rationalized the need for natural monopolies are being rendered irrelevant.

LOCAL COMPETITION EXPLOSION

The result is a competition explosion. Only a generation ago, a single telephone company provided phone service to an entire community. Today, hundreds, indeed thousands, of companies supply both residential and business consumers with telecommunications equipment and services. Also 25 years ago, America used exclusively one type of telephone and one wire that interconnected consumers and carried only the services of a single telecommunications company. Today, consumers purchase telephones and other equipment from multiple vendors, discount stores, and even catalogs, while many companies vie to provide interconnectivity with the rest of the world.

Even in the local telephone market, what some have called the "enduring local bottleneck," competition is increasingly a fact of life. Such competition will flourish as technology and public policy encourage and enable alternative telecommunications providers to compete with the local telephone companies. Already many consumers have multiple options, including wireless services.

Options for local service are expanding. Competitive Access Providers or "CAPs" operate in well over 100 of the nation's major markets and anticipate expanding many-fold over the next 10 years; scores of telephone service resellers exist in every state in the country and have revenues in the billions of dollars each year; and cellular providers now reach an estimated 13 million subscribers.

A long distance company, MCI, has also announced plans to compete directly with local telephone companies.[1] In partnership with CAPs, cellular, and other wireless providers, long distance companies are working to provide consumers with direct alternative ac-

cess to the long distance network, effectively bypassing local telephone company facilities.

Cable television has entered the competition. Today, cable is accessible to an estimated 98 percent of all homes in the U.S., with approximately 63 percent subscribing.[2] Through strategic alliances, direct investments in switching, shared use of facilities, and other two-way telecommunications technologies, cable television providers are entering the local telephone business.

In addition, electric companies are putting in fiber optic cable to update their energy monitoring capabilities to improve efficiency. Railroad companies are also using the transmission capabilities of fiber optic cable to improve their communications operations. These systems can also be used to offer telecommunications services.

Finally, other companies which resell services, such as pay telephone and shared tenant service providers (resellers of telecommunications services to tenants within a building) compete at the local level. In many instances, these competitors are joined by private networks, owned and operated by corporations or governments that bypass the local telephone company's public switched network. Even local telephone companies are beginning to branch out and will soon offer local services outside their traditional operating areas.

POSITIVE EFFECTS OF COMPETITION ON CONSUMER CHOICE

Competition has brought many benefits to the telecommunications arena. It has resulted in significant and substantial benefits for telecommunications users beginning in the late 1960s when the Federal Communications Commission (FCC) permitted the attachment of non-AT&T equipment to the telephone network; through the 1970s as the FCC ordered AT&T to provide interconnectivity for MCI and other competitive carriers to its long distance lines; through 1980 when resale restrictions were lifted on measured toll services and 800 service provided by AT&T; and finally through 1984 and the break-up of the Bell system. For example, consumers no longer are limited to the black rotary-dial telephone. Instead, competition in the telephone equipment market has accelerated the deployment of speaker-phones, answering machines, fax machines, auto-dialers, and PBX equipment, and is moving towards integrating voice recognition capabilities into telecommunications equipment.

Similarly, competition has spurred investment in telecommunications networks resulting in the more rapid deployment of fiber optic cable and digital switching technologies. Finally and most importantly, competition has lowered most rates and empowered consumers in markets that were once dominated by a select number of firms, leaving phone users with little choice over what types of services they could receive.

The simple fact is consumers benefit the most when robust competition flourishes in the telecommunications marketplace.

MAINTAINING UNIVERSAL SERVICE

At the same time, however, it is essential that public policy maintains this nation's long-standing commitment to universal service. Universal service is the conceptual goal of establishing widely available telephone service at "reasonable rates" as stated in the 1934 Communications Act. Essentially, universal service can be thought of as the ability to provide voice communications through the telephone network infrastructure within and between communities. The minimum set of capabilities needed to effectively access the public switched network represent "basic telephone service at reasonable rates."

In particular, policymakers must be certain that increased competition and more reliance on the market to drive telecommunications policy ensures that citizens have access to information. Sound telecommunications policy must balance the aggressive pursuit of competition, while ensuring that all citizens, regardless of geographic location, have access to basic telephone services at reasonable prices.

In the discussion which follows, two issues are explored in more detail:

(1) Whether the definition of basic telephone service remains a relevant one today in light of advances in technology and the increasing integration of telecommunications applications in day-to-day activities; and

(2) Whether policies that have been designed to achieve universal service objectives in the past can continue to accommodate a rapidly changing technology and marketplace and how to make such policies flexible.

A CHANGING DYNAMIC

Despite a fundamental commitment to the principle of universal service, there is no established definition of what kinds of telecommunication services the public will consider basic in the future. Traditionally, universal service has meant access to dial-tone. Today, as the telephone has become the vehicle to access the information superhighway, universal service has come to incorporate single-party service, high quality standards, and touch-tone as opposed to rotary dialing.

In the future, as technology changes the nature of communications and as information increases in value, the public perception of what services are basic may be expanded to mean video dial-tone and may incorporate access to multiple networks using varied technologies to deliver a full range of voice, data and video information services.

While people's perception of what services are deemed basic may change, regulatory mandates for such services should not be expanded. The best vehicle for delivering services to the public is the free market. In fact, as technology develops and market forces and competition drive the industry, the costs of providing services to rural and other currently high-cost areas could diminish.

Therefore, those services that government decides to mandate should remain minimal. Currently, universal service includes:

1. An ability to interconnect with all other citizens. That means the network(s) must easily connect and operate between systems;

2. An ability to engage in commerce using currently available technology; and

3. An ability to be informed and to inform others of emergency situations and to access emergency services.

PAYING FOR UNIVERSAL SERVICE

Historically, universal service has been achieved through a combination of three general telecommunications policies established both by law and by regulation:

1. Rate averaging

2. Targeted assistance

3. Subsidies--pricing policy that is based more on public policy objectives instead of actual cost. Historically, certain services have been priced higher than their cost to subsidize other telecommunications services that have been priced below cost to ensure widespread affordability and accessibility.

Each of these policies has contributed to the achievement of universal service largely because the regulatory structure was established in a monopoly environment.

Within any given region served by a local telephone company, its "franchise territory," a range of costs exists to serve different consumers based upon the location of those consumers. Rural or otherwise isolated areas, with low population densities, tend to cost more to provide phone service than high-density urban areas. If the rates for services reflected the full costs, differentials would exist based on population density (among other factors), and rural residents could be denied access to telephone service at reasonable rates. Statewide rate averaging assures that all consumers generally pay the same rates, which means the total costs to serve the franchise area were divided equally among all consumers in the area regardless of geographic location and the specific costs to serve each customer. This rate averaging helps assure that all citizens had access to telephone service at reasonable rates, and thus promoted the goal of universal service.

Other examples of such subsidies include higher rates for businesses than for households for identical services and rates for calls that exceed the costs to the telephone company for providing that service. In each case, the regulatory system established higher than necessary rates for some services to ensure that rates for basic telephone service were set artificially low.[3] By subsidizing basic telephone service, the regulatory system, once again, furthered the goal of universal service.

Finally, for those citizens who cannot afford even the subsidized rates, targeted assistance is available. The regulatory system established special rates designed to ensure that basic telephone service would be within

the financial reach of all citizens. Generally, these special rates, often called "life-line" in some states, are subsidized through higher rates charged to other phone users.

THE PUBLIC POLICY CHALLENGE

The effect of these policies is noteworthy. According to the most recent Federal Communications Commission study, the number of households with telephones has increased steadily since the passage of the 1934 Communications Act and now exceeds 93 percent, exceeding 95 percent in some states. The concern is that it will become increasingly difficult to continue to ensure universal service through these policies as competition increases in the local telephone market.

The fundamental problem is that new entrants into the telecommunications marketplace are not regulated in the same manner as local telephone companies. The ability of the unregulated entrants to "cream-skim" or otherwise selectively provide services to certain consumers significantly diminishes the revenue base of the local telephone company. As a result, its ability to continue to support the universal service goal through rate averaging, implicit subsidies, and targeted assistance programs is affected. Accordingly, as the revenues of the local telephone company are reduced, universal service becomes endangered. Therefore, to continue the commitment to universal service, all telecommunications providers, including new entrants, should equitably contribute to the support of universal service.

OPEN MARKETS AND EQUAL RESPONSIBILITY

In today's competitive market, subsidies that developed in agreement with regulators and policy makers to achieve universal service objectives should no longer be embedded in the telephone rates of a few providers. Rather, the cost of providing universal service must be borne by all providers.

At the same time, barriers to entry into the various aspects of the telecommunications industry must be removed so that potential providers do not face higher costs associated with artificial regulatory and statutory barriers to entry. Policy objectives should be to achieve both minimal levels of regulation to achieve policy goals as well as "regulatory parity" among all telecommunications providers so that the marketplace and not the regulatory process determines the services and prices which are offered to consumers. Those service providers who are obliged to be the carrier of last resort for their areas should be assured recovery of their investment.

In short, public policy should encourage free and open competition in all forms of telecommunications services and distribute the social responsibility of universal service among all providers of telecommunications services in a neutral manner to ensure the commitment of access to universal service is continued.

To accomplish this objective, the regulatory structure itself will have to change. Regulation must shift its focus away from rate of return (regulating profits) and move toward pricing flexibility, and oversight of service quality, network compatibility, and the relationships among telecommunications providers. This change will stimulate the development and introduction of new and enhanced services and increase customer options.

STATEMENT OF PRINCIPLES

1. In the telecommunications markets, as in other markets, consumers receive the most benefit when robust competition flourishes.

2. Telecommunications policy must remain committed to assuring universal service at reasonable rates for all citizens.

3. The national telecommunications network will consist increasingly of a multitude of networks. These diverse networks should be seamlessly interconnected, so that the national network provides interconnectivity and interoperability to all users.

4. Private networks will play a major role in the future telecommunications infrastructure; however, public policy should not encourage such development at the expense of public networks, which are available to all users.

5. Federal and state legislators and regulators should define telecommunications policy goals and objectives, but should not attempt to manage the telecommunications marketplace nor use public funds to finance new commercial networks in competition with existing networks.

6. Regulators should develop competitively neutral regulations to ensure that all telecommunications firms are treated equally. A primary objective of regulation should be the goal of "parity" for all existing and future providers.

7. Once the market becomes competitive, local telephone companies will be unable to use their historic monopoly position to achieve social objectives. Rather, these objectives must be openly and explicitly defined. If the universal service goals are to be achieved through subsidies, all participants in the telecommunications industry must be treated equally. Further, to the extent that subsidies continue to be used to achieve universal service objectives, they should be well-targeted and be funded by all telecommunications providers, minimize economic distortion, and be sensitive to the changing conditions in the telecommunications marketplace.

8. All telecommunications services, including access charges, ultimately must be market based. All providers must be given the same opportunity to offer services at rates that more closely track the cost of providing telecommunications services.

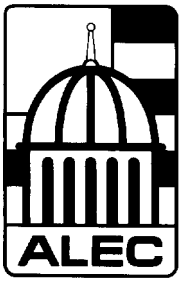
Adopted by the ALEC Telecommunications Task Force
August 5, 1994

ENDNOTES

1. As noted in *U.S. News and World Report*, January 17, 1994, p.56, MCI, the nation's second largest long-distance company, declared that it was invading the monopoly turf of the big regional telephone companies, or Baby Bells. With a $2 billion investment, MCI will bypass local phone systems in 20 of the nation's largest cities to connect businesses directly to its long-distance network. In this way, MCI - and its competitors like AT&T - will be able to avoid the access fees that local phone companies now charge to route long-distance calls to their final destination. The local phone companies, however, use those access charges in part to subsidize low residential rates.

2. *Broadcasting & Cable Magazine*, February 28, 1994, p. 12.

3. According to a Federal Communications Commission (FCC) study conducted by Mr. Peter Huber in 1992, ... providing local exchange service to residential customers costs the telephone company about three times what it charges in basic service fees.



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