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

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

PETITION FOR RECONSIDERATION OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

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SUMMARY

In this petition, the Information Technology Association of America ("ITAA") requests the Commission to reconsider its decision to require entities that provide interstate telecommunications services pursuant to private contracts to make payments to the universal service funding mechanisms "in the same manner" as common carriers. As ITAA demonstrates, this decision suffers from four significant defects:

No finding of significant bypass. The decision imposes universal service payment obligations on private service providers in order to promote the Commission's policy of "competitive neutrality." The legislative history makes clear, however, that the Commission may require private service providers to make universal service payments only if it concludes that bypass of the public switched network has become so significant that contributions from common carriers are not sufficient to generate the revenue necessary to fund universal service. The Commission has made no such finding.

Costs outweigh benefits. Requiring private service providers to make universal service payments "in the same manner" as common carriers will impose significant costs without significantly expanding the program's "funding base." The Commission has completely ignored the fact that private service providers do not structure their operations in the same manner as common carriers. As a result, private service providers will be required to establish costly new accounting systems to determine what portion of their revenue is generated by providing interstate and intrastate telecommunications. Inclusion of private service providers also will require the Commission and the universal service fund administrator to expend considerable additional administrative resources.

Not competitively neutral. The Commission's decision to require telecommunications providers to make payments to the universal service funding mechanism based on the provider's "net telecommunications revenue" will put private service providers at a substantial competitive disadvantage. Private service providers often purchase telecommunications capacity from common carriers without knowing whether they will use it for internal purposes or resale. Consequently, they often will be obligated to pay the underlying carrier's higher "end-user" rates, which "pass on" the carrier's universal service contribution. To the extent that these firms ultimately resell a portion of their capacity to a third-party pursuant to private contractual arrangements, however, they will be required to make a second universal service payment based on revenues generated by that transaction.

Inadequate record. Because the Joint Board erroneously found that private carriers were subject to mandatory universal service contribution requirements, the commenters did not address whether the Commission should impose payment requirements on those entities under its "permissive authority." In the absence of any relevant public comment, the Commission cannot justify imposition -- for the first time ever -- of common-carrier-type obligations on private service providers.

If the Commission continues to believe that private service providers should make such contributions, it should first issue a further notice of proposed rulemaking in order to develop a more adequate record. Pending completion of that rulemaking, the Commission should suspend application of the universal service payment requirement to private service providers.

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INTRODUCTION

The Information Technology Association of America ("ITAA") hereby requests that the Commission reconsider its decision, in the Universal Service Order,[1] to require entities that provide interstate telecommunications services pursuant to private contracts ("private service providers") to make payments to the universal service funding mechanisms "in the same manner" as common carriers.[2]

As demonstrated below, the Commission's decision suffers from four significant defects.

- The decision imposes universal service payment obligations on private service providers in order to promote the Commission's policy of "competitive neutrality." This directly contradicts Congress' decision that these entities should not be required to make such payments, unless the Commission finds that network bypass is so significant that it jeopardizes its ability to fund universal service.

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1 In the Matter of Federal State Joint Board on Universal Service, Report & Order, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997) ("Universal Service Order").

2 Id. at ¶ 795.

- The decision arbitrarily imposes on private service providers a regulatory regime that was designed for common carriers, which will result in significant administrative costs while not significantly increasing the funding base.

- Rather than being "competitively neutral," the Commission's decision to use the "net telecommunications revenue" approach will put private service providers at a substantial competitive disadvantage.

- Because the Joint Board erroneously found that private carriers were subject to mandatory universal service contribution requirements, the commenters did not address whether the Commission should impose payment requirements on those entities under its "permissive authority." As a result, the Commission has not compiled an adequate record to support its exercise of that authority.

In light of the above, the Commission should not require firms that provide interstate telecommunications services pursuant to private contracts to make universal service payments. If the Commission continues to believe that private service providers should make such contributions, however, it should first issue a further notice of proposed rulemaking in order to develop a more adequate record. Pending completion of that rulemaking, the Commission should suspend application of the universal service payment requirement to private service providers.

I. THE COMMISSION CANNOT IMPOSE UNIVERSAL SERVICE PAYMENT OBLIGATIONS ON PRIVATE SERVICE PROVIDERS IN ORDER TO PROMOTE "COMPETITIVE NEUTRALITY"; IT CAN ONLY DO SO IF NETWORK BYPASS JEOPARDIZES ITS ABILITY TO FUND THE UNIVERSAL SERVICE PROGRAM

At the time it enacted the Telecommunications Act, Congress "recognize[d] the distinction between common carrier offerings . . . and private services."[3] Congress embodied this distinction in Section 254, which carefully distinguishes between these two categories of telecommunications providers. Under that provision, only common carriers are obligated to make payments to the universal service funding mechanisms.

While Section 254 does give the Commission "permissive authority" to extend the payment obligation to private service providers, the legislative history makes clear that the agency's discretion is extremely limited. As the Senate Committee Report explains:

> In the event that the use of private telecommunications services or networks becomes a significant means of bypassing networks operated by telecommunications carriers, the bill retains the FCC's authority to preserve and advance universal service by requiring all telecommunications providers to contribute.[4]

Consistent with congressional intent, the Commission may require private service providers to make universal service payments <u>only</u> if it concludes that bypass of the public switched network

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[3] H.R. Rep. No. 104-204, 104th Cong. 1st Sess, at 126 (1995); <u>see</u> Conf. Rep. 104-458 at 115 ("The term 'telecommunications carrier' is defined as those services and facilities offered on a 'common carrier' basis, recognizing the distinction between common carrier offerings that are provided to the public . . . and private services.").

[4] S. Rep. 104-23, 104th Cong. 1st Sess., at 28 (1995). The House bill provided that only common carriers could be obligated to make universal service contributions. <u>See</u> H.R. 1555 § 247(b)(4)(limiting contributions to "telecommunications service providers").

has become so significant that contributions from common carriers are not sufficient to generate the revenue necessary to fund universal service.

At no point in the Universal Service Order did the Commission make a finding that bypass threatens its ability to achieve its universal service goals. Rather, the Commission relied on the principle of competitive neutrality.[5] Under this principle, the Commission reasoned, "[w]hether a business decides to sell telecommunications services to others on a common carrier or a private contractual basis . . . should not determine contribution requirements."[6]

The Commission does not have the authority to substitute its judgment for the intent of the Legislature. Therefore, the agency cannot disregard Congress' decision to preserve the distinction between common carriers and private service providers in order to advance its "competitive neutrality" policy. Because it has made no finding that significant bypass jeopardizes its ability to fund the universal service program, the Commission cannot require private service providers to make payments to the universal service funding mechanisms.[7]

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5 Universal Service Order ¶ 795.

6 Id.

7 The adverse consequences of this approach will go beyond the federal universal service program. Subjecting private service providers to the same payment obligations as common carriers is likely to encourage some States to impose more sweeping forms of common carrier regulation on these entities. Consequently, if the Commission chooses to impose these requirements on private service providers, it should couple this action with an order preempting States from imposing other forms of common carrier regulation on private service providers solely by virtue of their participation in the federal universal service program.

II. REQUIRING PRIVATE SERVICE PROVIDERS TO MAKE UNIVERSAL SERVICE PAYMENTS "IN THE SAME MANNER" AS COMMON CARRIERS WILL IMPOSE SIGNIFICANT COSTS, WHILE NOT SIGNIFICANTLY EXPANDING THE FUNDING BASE

The Commission's decision to require private service providers to make universal service payments is not intended to generate additional revenue. Rather, the Commission seeks to "broaden the funding base" for the universal service program by requiring non-carriers to make payments to the fund, thereby reducing the amount that carriers will be required to contribute.[8]

Contrary to the Commission's assumption, requiring private service providers to make universal service payments will not significantly expand the funding base. Because only a limited number of large private network operators provide stand-alone telecommunications services to third parties for a fee,[9] requiring these entities to make universal service payments will generate only a small amount of the total revenue required to fund the universal service program. The Commission, moreover, has chosen to exclude revenues that these entities pay

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8 Universal Service Order ¶ 795.

9 The Universal Service Order makes clear that universal service contribution requirements will be based solely on revenue generated from the provision of "telecommunications services." Id. at ¶¶ 842-57. Firms will not be obligated to contribute to universal service based on revenues from the provision of enhanced services. See id. at ¶¶ 788-89. Many non-carriers offer enhanced services, such as protocol conversion, to their customers in conjunction with basic telecommunications services. Under long-standing Commission precedent, such providers' entire offering is treated as an unregulated enhanced service. See Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), Phase II Reconsideration Order, 3 FCC Rcd 1150, 1170 n.23 (1988) (subsequent history omitted). The Universal Service Order does not purport to alter this rule. Consequently, ITAA assumes that private service providers will be subject to universal service contribution requirements only to the extent that they provide a free-standing telecommunications service to third parties for a fee.

to common carriers from the carriers' funding base. Consequently, the only addition to the funding base that results from the inclusion of private service providers is the incremental revenue that these entities obtain as a result of reselling service, purchased from common carriers, at a price that is higher than the amount that they pay the underlying carrier.[10] The end-result is that the amount of money to be paid by the carrier is not likely to decrease significantly.

At the same time, requiring private service providers to make universal service payments "in the same manner" as common carriers will result in significant costs. The universal service funding regime is designed for common carriers. Pursuant to Commission regulation, these providers typically separate telecommunications revenue from non-telecommunications revenue, and allocate telecommunications revenue to the interstate and intrastate jurisdictions. The Commission has completely ignored the fact that private service providers structure their operations in response to market forces -- not the Commissions regulatory requirements. Consequently, in order to comply with the Order, these firms will be required to establish costly new accounting systems that will enable them to determine what portion of their revenue is generated by providing interstate and intrastate telecommunications.

In some cases, the cost for a private service provider to set-up the necessary accounting system will exceed the amount of revenue that it will be required to contribute to the universal service fund. These costs may deter many companies with under-utilized private

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[10] For example, assume a situation in which a common carrier sold $100 worth of telecommunications service -- $95 to end-users and $5 to private service providers which, in turn, resell the capacity to end-users for $6. If the contribution requirement is limited to common carriers, the funding base would be $100. Inclusion of private carriers would only increase the funding base to $101.

networks from selling their excess capacity -- thereby impeding the kind of pro-competitive, efficiency-enhancing conduct that the Telecommunications Act seeks to promote. The effect could be especially harsh on small businesses.

The Commission also has ignored the fact that it will be required to expend considerable administrative resources to include private service providers within the program. The agency will need to identify entities subject to private service provider contribution obligations, provide assistance in complying with its regulations, audit the accuracy of private service providers' payments, and take necessary enforcement action. There is little benefit to be gained from incurring additional costs to include private carriers in the contribution mechanism, when the ultimate result will be to generate the same amount of revenue.[11]

III. THE ORDER WILL NOT PROMOTE COMPETITIVE NEUTRALITY; IT WILL PLACE PRIVATE SERVICE PROVIDERS AT A SUBSTANTIAL DISADVANTAGE

The Commission has sought to justify the imposition of universal service contribution requirements on private service providers by asserting that doing so will promote "competitive neutrality." The approach adopted by the Commission, however, is not competitively neutral. To the contrary, as shown below, the Commission's approach will put entities that provide telecommunications services pursuant to private contracts at a serious competitive disadvantage.

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[11] The cost to the fund administrator caused by requiring private service providers to make payments to the universal service fund may actually exceed the revenue that these providers contribute. Were this to occur, common carriers would be required to make higher contributions than they would have had to make had private service providers been excluded from the program.

The Commission Order requires telecommunications providers to make payments to the universal service funding mechanism based on the provider's "net telecommunications revenue." Under this approach, common carriers will base their universal service contribution on revenues derived from the provision of service end-users, but will not be obligated to make a contribution based on revenues from resellers. The Commission anticipates that carriers will provide telecommunications services at two distinct prices. End-users will pay a higher rate, which reflects the fact that the carrier is passing on some (if not all) of its universal service contribution costs. Resellers, in contrast, will "get a lower price that does not reflect universal service contribution requirements."[12]

While this approach may sound competitively neutral in theory, it will not be so in practice. Private service providers often purchase telecommunications capacity from common carriers without knowing whether they will use it for internal purposes or resale. Consequently, they often will be obligated to pay higher "end-user" rates.[13] To the extent that these firms ultimately do resell a portion of their capacity to a third party pursuant to private contractual arrangements, however, they will be required to make a second universal service payment based on revenues generated by that transaction.

Private service providers will suffer from a second competitive disadvantage. Under the Filed Rate Doctrine, the binding rate in effect between a common carrier and its customer is the rate on file at the Commission. Carriers have broad discretion to unilaterally

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12 Universal Service Order at ¶ 848.

13 Indeed, even if a private service provider knows that it is purchasing capacity for resale, there is no guarantee that the underlying carrier -- against which it seeks to compete -- will provide it with the "lower price" theorized by the Commission.

alter these rates by filing a superseding tariff. Many carriers are likely to use this method to promptly pass on to their customers the increased costs resulting from their new universal service contributions.

Private service providers, in contrast, do not provide service pursuant to tariffs. Rather, they provide service pursuant to contractual agreements negotiated with their customers. Such agreements are often for a significant period of time, and typically cannot be altered without the consent of both parties. As a result, private service providers will not be able to pass on the cost of their universal service contributions to their end-user customers. Rather, they will be obligated to absorb these until the expiration of the contract period.[14]

IV. BECAUSE OF THE INADEQUACY OF THE RECORD, THE COMMISSION SHOULD SUSPEND IMPLEMENTATION OF THE PRIVATE SERVICE PROVIDER PAYMENT REQUIREMENT, AND ISSUE A FURTHER NOTICE OF PROPOSED RULEMAKING

The existing record plainly does not provide a basis for the imposition of universal service payment obligations on private service providers. In the Recommended Decision, the Joint Board erroneously concluded that private service providers fell within the definition of

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[14] The competitive disadvantage imposed on private service providers in the Universal Service Order compounds the competitive disadvantage previously imposed on them in the Interconnection Order. Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 15499 (1996). In that decision, the Commission ruled that only common carriers can obtain unbundled network elements and TELRIC prices, and that common carriers alone are eligible to exercise the newly granted interconnection and collocation rights. If the Commission is to adopt a regulatory regime that is competitively neutral, it cannot impose common-carrier-type obligations on private service providers, while denying them the opportunity to enjoy the benefits granted to common carriers.

"telecommunications service providers" and, therefore, are required to make payments to the universal service funding mechanism. In their comments, ITAA and other parties demonstrated that private service providers do not fall within the definition of telecommunications service providers. Because the Joint Board recommended that the Commission not use its "permissive authority" to require "other telecommunications providers" to make universal service payments, the commenters did not address whether the Commission should use that authority to reach private service providers.

In the absence of any relevant public comment, the Commission cannot justify imposition -- for the first time ever -- of common-carrier-type obligations on private service providers. Thus, if the Commission wishes to impose universal service payment obligations on private service providers, it must issue a further notice of proposed rulemaking, which will allow it to obtain information on several crucial issues. Among the issues on which further comment is required are the following:

- Does the Commission have legal authority to require private service providers to make universal service payments in order to advance its goal of "competitive neutrality"?

- Has network bypass become so significant that it jeopardizes the ability of the Commission to adequately fund universal service?

- How much revenue would be generated by requiring private service providers to make universal service payments? To what extent would this reduce the contribution rate necessary to generate sufficient revenue to fund the universal service program?

- How much would it cost private service providers to establish the accounting mechanisms necessary to determine the amount of their universal service payments?

- How much would the inclusion of private service providers in the universal service payment mechanism increase the administrative cost of the program? Would the incremental cost exceed the revenue generated from private carriers?

- To what extent is the funding mechanism adopted for common carriers suitable for private service providers? Would application of this funding mechanism to private service providers be competitively neutral? Should a different payment mechanism be developed for private service providers?

Pending completion of a further rulemaking, ITAA recommends that the Commission suspend application of the universal service contribution requirements to firms that provide telecommunications service pursuant to private contracts. Because these entities' revenues represent only a small portion of the total contributions, and because of the administrative savings that will result from the exclusion of these entities, such an action should have little effect on the contributions paid by common carriers, and no effect on the Commission's ability to adequately fund the universal service program.

CONCLUSION

For the foregoing reasons, the Commission should not require firms that provide telecommunications service pursuant to private contracts to make payments to the universal service funding mechanism. If the Commission continues to believe that private service providers should make such contributions, however, it should first issue a further notice of proposed rulemaking in order to develop a more adequate record. Pending completion of that

rulemaking, the Commission should suspend application of the universal service payment requirement to private service providers.

Respectfully submitted.

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