a unified federal-state approach is developed for the high cost and low-income support mechanisms, is consistent with the public interest.

217. We note that some commenters raise related issues on which the Commission continues to deliberate. For example, members of the wireless industry are concerned about the difficulty of distinguishing their interstate revenues from their intrastate revenues, given the mobile nature of wireless technologies, the inability to determine precisely the point of origin of calls, and the difficulty of matching phone numbers with points of origin.[497] Wireless carriers have also raised issues regarding revenue reporting requirements,[498] including issues perceived to be particular to their industry concerning itemizing roaming revenues, special resale issues, bundled offerings, and fraud-related uncollectibles.[499] We also note that wireless providers have challenged state decisions that they should be subject to state universal service mechanisms.[500] These are difficult issues, and we are committed to working with the wireless industry and the state commissions to resolve these issues.[501]

218. Recovery. For similar reasons, we conclude that it is appropriate to allow carriers to recover contributions to the support mechanisms for high cost areas and low-income consumers through rates for interstate services only. The Joint Board concluded that the "role of complementary state and federal universal service mechanisms require[d] further reflection," but did not address the issue of the recovery of these contributions. Accordingly, we reaffirm the conclusion that this approach to recovery promotes comity between the federal and state governments because it allows the Commission and the states to develop compatible universal service mechanisms. This approach also promotes the statutory goal of affordable basic residential service because it avoids a blanket increase in charges for basic residential dialtone service. We find that it is reasonable and in the public interest to maintain, for the present time, the historical approach to recovering universal service support contributions for high cost areas and low-income consumers. We note, however, that the Commission concluded in its *Fourth Order on Reconsideration* that CMRS providers may recover their universal service contributions through rates charged for all services.[502] The Commission concluded that the reasons that generally warrant permitting contributors to

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[497] *See, e.g.*, Comcast comments at 10-11; CTIA comments at 2-3; PCIA comments at 14; Vanguard comments at 6; Nextel reply comments at 5.

[498] Some wireless providers are concerned that the Commission's "good faith" estimation process will result in competitive inequities. *See, e.g.*, Comcast comments at 11-15; CTIA comments at 3; Comcast reply comments at 7. *See also Order on Reconsideration, Second Report and Order, and Further Notice of Proposed Rulemaking*, CC Docket No. 97-21 and No. 96-45 at para. 21 (rel. August 15, 1997).

[499] *See, e.g.*, CTIA comments at 2; Comcast comments at 11-12; PCIA comments at 13-16.

[500] *See Cellular Telecommunications Industry Association v. FCC, et al.*, Case No. 97-160 and consolidated cases.

[501] We note that these issues are before the Commission on reconsideration and we do not wish to prejudge those petitions.

[502] *Fourth Order on Reconsideration* at para. 309.

recover contributions to the federal universal service mechansisms through rates on interstate services, such as ensuring the the continued affordability of residential dialtone services and promoting comity between the federal and state governments, do not apply to CMRS providers.[503]

B. Percentage of Federal Funding

219. As noted above, the Commission is responsible for ensuring that there are specific, predictable, and sufficient federal and state mechanisms to preserve and advance universal service. Upon further review, we conclude that a strict, across-the-board rule that provides 25 percent of unseparated high cost support to the larger LECs may have the result of withdrawing some federal explicit universal service support from some areas. The Commission will work to ensure that states do not receive less funding as we implement the high cost support mechanisms under the 1996 Act. We find that no state should receive less federal high cost assistance than it currently receives. We emphasize again that the following discussion concerns only non-rural local exchange carriers. High cost support for rural carriers will continue to be provided in accordance with the plan adopted in the *Universal Service Order*, which contemplates no changes earlier than January 1, 2001.

1. Background

220. Section 254(b)(5) establishes the principle that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[504] Additionally, section 254(i) provides that "the Commission and the States should ensure that universal service is available at rates that are just, reasonable and affordable."[505] The Commission has stated that section 254 continues the historical partnership between the federal and state jurisdictions in advancing and preserving universal service mechanisms.[506] Similarly, the Joint Board stated in its *Recommended Decision* that the 1996 Act "reflects the continued partnership among the states and the Commission in preserving and advancing universal service.[507]

221. The Commission, in its *Universal Service Order*, decided initially to fund 25 percent of the difference between a carrier's forward-looking economic cost of providing

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[503] *Fourth Order on Reconsideration* at para. 309 ("Because section 332(c)(3) of the Act alters the 'traditional' federal-state relationship with respect to CMRS by prohibiting states from regulating rates for intrastate commercial mobile services, allowing recovery through rates on intrastate as well as interstate CMRS services would not encroach on state prerogatives. Further, allowing recovery of universal service contributions through rates on all CMRS services will avoid conferring a competitive advantage on CMRS providers that offer more interstate than intrastate services.").

[504] 47 U.S.C. § 254(b)(5).

[505] 47 U.S.C. § 254(i).

[506] *Universal Service Order*, 12 FCC Rcd at 9194, para. 818.

[507] *Id.* at 9189, para. 806 *citing Recommended Decision*, 12 FCC Rcd at 500, para. 819.

supported services and a revenue benchmark in order to approximate the portion of the cost of providing the supported network facilities that historically have been recovered by local telephone companies from their charges for interstate services.[508] The current separations rules, which were developed through a Federal-State Joint Board process and have been in place since 1984, allocate 25 percent of loop costs to the federal jurisdiction and 75 percent to the states.[509] Because local loop costs are likely to be the predominant cost that varies between high cost and non-high cost areas, the Commission determined, on a preliminary basis, that this factor approximated the interstate portion of universal service costs.[510] Consistent with the decisions to fund 25 percent of total universal service high cost support from the assessment and recovery from interstate revenue alone and to eliminate the special jurisdictional separations rules implementing the pre-1996 Act universal service mechanisms, the Commission also directed incumbent LECs in the companion *Access Reform Order* to use federal universal service support received under the new mechanisms to reduce interstate access charges. In that way, the Commission rendered explicit the universal service support formerly implicit in interstate access charges that has traditionally helped keep local rates affordable. In addition, the Commission decided to delay the transition to a universal service mechanism based on forward looking economic costs for rural LECs until no sooner than January 1, 2001.[511] Until that time, eligible rural LECs will continue to receive support based on existing mechanisms.

222. This issue has generated extensive attention including a significant number of comments in this proceeding. Some commenters argue that the high cost universal service program should be 100 percent federally funded.[512] In general, these parties contend that section 254(e) refers only to the federal responsibility for ensuring sufficient mechanisms, without imposing parallel state funding obligations.[513] Several parties argue that the discretionary language in section 254(f) permits, but does not compel, the states to choose whether or not to establish their own universal service funds.[514] Many commenters express concern that the proposed 25-75 split between federal and state funding will not be sufficient to ensure that rural rates are affordable or reasonably comparable with urban rates.[515] Most of

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[508] *Universal Service Order*, 12 FCC Rcd at 8925, para. 269.

[509] *Id.* at 8925, para. 270.

[510] *Id.* at 8926, para. 271.

[511] *Id.* at 8889, paras. 203-204.

[512] Alabama, Alaska, et. al comments at 4; Alaska comments at 11-15; Colorado PUC comments at 1-4; Local and State Gov't Advisory Committee comments at 2-3; USWEST comments at 6.

[513] 47 U.S.C. § 254(e).

[514] 47 U.S.C Section 254(f) ("a State may adopt. . ." a universal service program.).

[515] *See, e.g.*, Alabama, Alaska, et. al. comments at 3; Alaska comments at 5-6; Colorado PUC comments at 2; Iowa comments at 4-5; Kansas CC comments at 1; Mississippi comments at 2; Nebraska PSC comments at 3; New Mexico AG comments at 1, 2-4; North Dakota PSC comments at 1-2; North Dakota RRRC

these concerns are based on the assumption that the 25 percent funding level will reduce the amount of existing support.[516]

223. In addition to the comments, the Commission heard a broad range of viewpoints from presenters at an *en banc* meeting on this issue held on March 6, 1998.[517] In particular, the Commission heard presentations from proponents of alternatives to the 25-75 approach. The state of Maine has proposed, and the states of Vermont and New York have expressed support for, an approach under which federal support would only be provided to states that have average costs that exceed a national average.[518] In addition, US West has proposed a plan that would retain the Commission's 25-75 split for providing support needed between a basic benchmark and a "super-benchmark," but would require all costs above this higher benchmark to be assigned to the federal jurisdiction.[519] These and other proposals are on record before the Commission and are under active review. These two proposals are the product of significant effort on the part of many state commissions and the industry to develop a modified approach to high cost funding. It is also possible that, in the coming weeks, the Commission will be presented with variations on these proposals or other possible methods of funding high cost areas. Because we will conduct a reconsideration of the high cost funding mechanism prior to its implementation, scheduled to go into effect on January 1, 1999, we do not evaluate here the merits of possible alternative high cost funding proposals. Nonetheless, we wish to commend the spirit of cooperation and compromise that has characterized the development of these proposals. Those efforts encourage us to redouble our efforts to work with states and others toward a solution to the high cost funding problem that

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comments at 1; Oregon PUC comments at 1; Richland Economic Development comments at 1; South Dakota PUC comments at 2; Texas PUC comments at 3; Transportation Committee of the Nebraska Legislature comments at 1; US West comments at 4- 6; Utah comments at 1-2; Washington UTC comments at 7, 11-13; Western Governors' Association at 1; Wyoming PSC comments at 2-3; Arizona CC reply comments at 5; Iowa Telecom Ass'n. reply comments at 4; Wyoming PSC reply comments at 1-4. *See also* Letter from Secretary Larry Irving, NTIA to Chairman Kennard (April 9, 1998) ("We are simply not convinced that this approach will provide funding sufficient to achieve the desired result.").

[516] *See, e.g.*, Alaska comments at 11-13; Colorado PUC comments at 3; Local State and Gov't Advisory Committee at 2-3; New Mexico AG comments at 2; North Dakota RRRC comments at 1; Oregon PUC at 1; Richland Economic Development comments at 1; RTC comments at 3-5 (25 percent ignores the existing implicit support from averaging access costs and high cost fund, Long Term Support, and DEM Weighting); SBC comments at 5-6 (existing mechanisms often assist rural telephone companies with a larger share of universal service cost recovery).

[517] The first panel of government officials consisted of North Dakota Public Service Commissioner Bruce Hagen, District of Columbia Public Service Chairperson Marlene Johnson, Maine Public Utilities Commission Chairman Thomas L. Welch, and Christopher McLean, deputy administrator of the Rural Utilities Service. The second panel of industry representatives consisted of: Thomas Tauke, Senior VP-government relations at Bell Atlantic, Joan Mandeville, assistant manager at Blackfoot Telephone Cooperative in Missoula, Montana, Joel Lubin, Regulatory VP-AT&T Corp. Law and Public Policy, Jim Smiley, Regional VP-US West Communications, Inc., and Haynes Griffin, chairman of Vanguard Cellular Systems, Inc.

[518] *See* Statement of Thomas Welch, Maine Public Utilities Commission, at March 6, 1998 *en banc* Commission meeting, transcript at 24-25.

[519] US West submission at March 6, 1998 *en banc* Commission meeting.

serves the interests of all affected parties. We are committed to building on the ideas and proposals expressed in the comments and at the *en banc* hearing to work toward a consensus on this issue. We believe that additional dialogue among the Commission, the states, and the affected industries will lead to an approach that both fulfills the mandates of section 254 and is acceptable to the various interested parties.

224. Specifically, we are in the process of taking several important steps to further review the suitability of the 25-75 approach. First, we are committed to issuing a reconsideration order in response to the petitions filed asking the Commission to reconsider the decision to fund 25 percent of the required support amount. This reconsideration order will be issued prior to the date that the Commission begins providing high cost support to non-rural carriers based on forward-looking economic costs. In addition, we will consult with the Joint Board to address the viability of the 25-75 approach as well as the alternatives that are on record with the Commission, including the holding of an en banc hearing with participation by the Federal-State Joint Board commissioners. The Commission has anticipated that the Joint Board would play a continuing role in assessing the mechanisms established to ensure the preservation and advancement of universal service.[520]

2. Discussion

225. Although there appears to be no consensus among the states as to an alternative to the Commission's so-called 25-75 approach,[521] there is substantial opposition in this record to this approach.[522] This issue is currently pending before the Commission on reconsideration and has been appealed.[523] Further, this issue, along with the related issues of the use of explicit federal universal service support to reduce implicit federal support and of the formulation and distribution of universal service support among the states, is raised in a recent petition filed by the state members of the Joint Board requesting that these issues be referred

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[520] *See, e.g.*, Federal-State Joint Board on Universal Service, *Order on Reconsideration*, CC Docket No. 96-45, 12 FCC Rcd 10095, para. 28 (rel. July 10, 1997) (*July 10th Reconsideration* Order).

[521] *See, e.g.*, Alaska comments at 11-15 (federal fund should at least provide support sufficient to maintain current rates and should preferably provide 100 percent funding); Colorado PUC comments at 3-5 (100 percent federal funding would be the simplest solution, 75 percent would be acceptable, but other options could be viable to address varying circumstances among states); North Dakota PSC comments at 1 (joint federal and state fund to cover at least 75 percent); PSC of Wisconsin comments at 1-4 (any level of federal support can be justified, proper amount should be based on impact).

[522] *See, e.g.*, Iowa Utilities Board comments at 4; Kansas CC comments at 1-2; Mississippi PSC comments at 1-2; Nebraska PSC comments at 3; New Mexico AG comments at 2-4; PRTC comments at 8-11; RTC comments at 3-6; Senator Burns and Stevens comments at 12; State Members comments at 9; Texas PUC comments at 3-4; USTA comments at 7-9; Utah Governor's office comments at 1-2; Western Governors' Association comments at 1-3; Wyoming PSC comments 1-7; Arizona CC reply comments at 5; Wyoming PSC reply comments at 1-5.

[523] *Texas Office of Public Utility Counsel et al. v. FCC*, No. 97-60421 (5th Cir.) (filed June 25, 1997).

to the Joint Board for further recommendations.[524] Without prejudging these ongoing proceedings, we here examine, as required by section 623(b)(5) of the Appropriations Act, the Commission's initial decision to provide 25 percent of the required support amount through federal support mechanisms. Since the May 8, 1997 *Universal Service Order* was released, the Commission has repeatedly articulated its intent to continue to work with the states to ensure that support amounts are sufficient.[525] We believe that this Commission decision is aptly characterized as a "place holder" to which we must return.

226. One of the overriding goals of section 254 is to make universal service support explicit. Section 254(b)(5) provides that: "There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service." The Commission has attempted to make explicit the collection and distribution of existing federal universal service support provided through the interstate high cost loop fund, dial equipment minutes weighting, Long-Term Support, and Lifeline and Link Up programs. The Commission also proposed a mechanism to identify implicit universal service support currently in interstate access charges and to make that support explicit and portable among competing eligible carriers. Similarly, states should take actions to make intrastate mechanisms compatible with competitive local markets by making those support mechanisms explicit and portable.

227. A state may require greater assistance than it presently receives from interstate explicit and implicit mechanisms in order to maintain affordable rates. As states develop plans to make existing intrastate implicit mechanisms explicit, additional federal support may be required to ensure that quality services remain "available at just, reasonable, and affordable rates." For example, where a state proposes to reform its own universal service mechanisms and would collect as much of what is currently implicit intrastate universal service support as is possible consistent with maintaining affordable rates, additional federal universal service support should be provided to any high cost areas where state mechanisms, in combination with baseline federal support, are not sufficient to maintain rates at affordable levels. In the pending reconsideration proceeding, the Commission will consider any other circumstances under which additional federal support would be appropriate. This approach will permit the Commission to fulfill its responsibility to ensure support is sufficient.

228. Further, we expect to consult with the Joint Board regarding the sufficiency of universal service support mechanisms. We are confident that the state commissions will work with us to ensure that "specific, predictable and sufficient" universal service support

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[524] Formal Request for Referral of Designated Items by the State Members of the section 254 Federal-State Joint Board on Universal Service, filed March 11, 1998 (by Commissioners Johnson, Schoenfelder, and Baker and consumer advocate Hogerty).

[525] For example, in its *sua sponte* reconsideration order, the Commission noted that the issue of shared responsibility for ensuring the sufficiency of universal service support is critical to the preservation and advancement of universal service and will be an important subject in future consultations between the Commission and the Joint Board. *July 10 Reconsideration Order* at para. 28.

mechanisms are established, consistent with Congressional intent.[526] We recognize that the state commissions themselves are not aligned on one side of this issue. For example, the State Joint Board Members indicated that all Joint Board members "have concerns with *either* the inclusion of intrastate revenues in the proposed funding sources *or* the 75-25% split proposed" by the Commission.[527] In addition, NARUC is involved in an ongoing effort to develop a plan for high cost and rural areas that differs from the 25-75 proposal.[528] NARUC has not endorsed any specific proposal, but has identified six principles as a basis of future action.[529] We encourage NARUC members in their efforts in this regard and welcome the submission of an alternative that is supported by so-called "high-cost" states and "low-cost" states alike. We remain committed to working with proponents of every viewpoint.

229. In our efforts to reform universal service, we and the state commissions must be mindful that only the minimum amount of support necessary to achieve statutory goals should be collected. Just as collecting insufficient support would threaten the availability of universal service, collecting more support than is necessary would increase rates for all subscribers, creating a similar threat to universal service principles. In addition, in order to enhance competition, both federal and state support mechanisms should collect contributions in a competitively neutral manner. Moreover, federal and state universal service support mechanisms should encourage efficient investment in new plant and technologies by all eligible telecommunications carriers and should promote service to historically underserved areas. We are convinced that following these principles will guide this Commission and the states to achieve the goals Congress has set out in the 1996 Act.

230. We note that there appears to be some confusion about the Commission's decision in the *Access Reform Order* to require incumbent local exchange carriers to reduce the revenues they receive from interstate access charges by an amount equal to the support they receive from federal high cost universal service support. As noted above, the plan adopted by the Commission in the *Universal Service Order* is designed to remove federal high cost support from implicit interstate mechanisms and recover that support from an explicit support mechanism. In that event, a carrier would no longer need to recover that support from implicit mechanisms. Since implicit interstate high cost assistance has been provided by incumbent local exchange carriers through interstate access charges, the Commission directed those carriers to remove from those charges the support received from the new universal service support mechanism. Otherwise, carriers would recover high cost assistance twice: from both implicit mechanisms, as well as the new explicit mechanisms. Thus, it is not the case that the explicit support is being used to lower access charges. Rather, the support is still being used to support high cost lines, but now the support is coming from explicit high-cost mechanisms and, accordingly, no longer needs to be obtained from implicit access charge subsidies. To the extent that, upon reexamination, we decide upon a new or different

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[526] *Universal Service Order*, 12 FCC Rcd at 9198, para. 824.

[527] State Joint Board Members comments at 9.

[528] NARUC comments at 8-9.

[529] NARUC comments at 8-9.

allocation of universal service funding responsibilities between the two jurisdictions, we would plan to modify that directive accordingly.

231. The Commission's initial decision to fund 25 percent of the total requirement was tied to the shift of universal service support for high cost areas from the access charge regime to the new section 254 support mechanisms.[530] The total support requirement will be determined by a revenue benchmark and a forward-looking economic cost methodology that have not yet been established.[531] As we and the state commissions evaluate these new mechanisms, we will be able to determine the amount of support needed to maintain affordable rates. We emphasize that the Commission's implementation of section 254 is progressing and we pledge to continue to work with the states to address this important issue.

C. Methodology for Assessing Contributions

232. Section 254(d) states that "[e]very telecommunications carrier that provides interstate telecommunications service shall contribute on an equal and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[532] The Joint Board recommended that contributions be based on gross revenues derived from telecommunications services net of payments to other carriers for telecommunications services.[533] In recommending this approach, the Joint Board sought to resolve three concerns: (1) avoiding double-payment problems; (2) assessing contributions on a value-added basis, and; (3) finding a method that is familiar to the Commission and the industry.[534] In the *Universal Service Order*, the Commission deviated from the Joint Board's recommendation and concluded that contributions should be based on end-user telecommunications revenues.[535] Nevertheless, the Commission found that its decision addressed each of the Joint Board concerns, was based on information that had not been available to the Joint Board, and was more administratively efficient than the Joint Board's recommendation.[536]

233. Basing universal service contributions on end-user telecommunications revenues is competitively neutral because it eliminates the problem of counting revenues derived the

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[530] *Universal Service Order*, 12 FCC Rcd at 8792, para. 26.

[531] *See, e.g.*, Ameritech comments at 4-5; BellAtlantic comments at 1, 7-8; BellAtlantic reply comments at 1-3; Vanguard reply comments at 1-3.

[532] 47 U.S.C. §254(d). *See also* 47 U.S.C. §254(b)(4).

[533] *Recommended Decision*, 12 FCC Rcd at 495, para. 807.

[534] *Universal Service Order*, 12 FCC Rcd at 9206, para. 842 *citing Recommended Decision*, 12 FCC Rcd at 495, para. 807.

[535] *Universal Service Order*, 12 FCC Rcd at 9206, para. 843.

[536] *Universal Service Order*, 12 FCC Rcd at 9206, para. 843.

same services twice.[537] This approach also eliminates the double-counting problem and the market distortions created by assessing based on gross revenues because transactions are counted only once at the end user level. Moreover, the Commission's method is easy to implement. Carriers already keep track of their revenues, and, although they would have to distinguish between sales to end-users and sales to resellers, doing so shall not be complicated because resellers have an incentive -- reduced rates -- to identify themselves.[538]

234. Some commenters argue in general that universal service support should be assessed as a flat charge on all end users.[539] This argument, however, does not consider the problem articulated by the State Joint Board members that "state commissions should have the discretion to determine if the imposition of an end-use surcharge would render local rates unaffordable."[540] The Commission correctly concluded that a federally prescribed end-user surcharge would impermissibly dictate how carriers recover their contributions and would violate Congress' mandate and the wish of the state members of the Joint Board."[541] Carriers are not precluded from attempting to recover their contributions from end users, but may not make false, inaccurate, or misleading statements regarding their contribution obligations. Further, because carriers will know exactly how much they are contributing to the support mechanism, basing contributions on end-user telecommunications revenues satisfies the requirement in Section 254 that support mechanisms be "explicit."[542]

VIII. CONCLUSION

235. At the direction of Congress, we have reviewed many of the major decisions related to the implementation of the universal service provisions of the 1996 Act. We appreciate the enormous importance of our decisions; no less than the preservation and advancement of the nation's universal service system is at stake. We have attempted to balance competing concerns, predict how new and emerging technologies will affect universal service in the near and distant futures, and forecast universal service support requirements,

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[537] Double counting occurs when resellers buy and sell service. Assuming a 10 percent contribution rate, if X sells $200.00 worth of telecommunications services directly to a customer its contribution would be $20.00. IF reseller buys $180.00 of wholesale service from A, adds value, and sells the same service for $200.00 in competition with A, then B would have to contribute $20.00 for selling $200.00 of service and would probably also be required to recover a portion of the $18.00 contribution that A would most likely pass on. *See Order*, 12 FCC Rcd at 9207, para. 845.

[538] *Universal Service Order*, 12 FCC Rcd at 9208, para. 848.

[539] *See, e.g.*, Airtouch comments at 23-24; Sprint comments at 3; AT&T reply comments at 3.

[540] *Universal Service Order*, 12 FCC Rcd at 9210, para. 853 (citing State Members of the Federal-State Joint Board on Universal Service Comments on Recovery Mechanism for Universal Service Contributions, dated April 8, 1997, at 1).

[541] *Id.* at 9210, para. 853.

[542] *Id.* at 9211, para. 854.

while at all times adhering strictly to the statutory language. We have delved into the complex technological structure of the Internet and the Internet industry. This examination leads us to conclude that excluding from the universal service contribution pool revenues derived from the provision of pure transmission capacity to Internet service providers does not comport with the language and goals of the 1996 Act. Similarly, should we conclude that specific "phone-to-phone" IP telephony services qualify as "telecommunications services," providers of such services would fall within section 254(d)'s requirement to contribute to universal service mechanisms.

236. This Report represents the result of deliberate consideration of the issues and extensive public feedback in the form of thousands of pages of comments and two Commission en banc meetings. We recognize, however, that additional outreach, especially consultation with state commissions, is essential. We and the states must ensure that jurisdictional issues, including the 25-75 issue, are resolved in a manner that guarantees that universal service mechanisms are specific, predictable, and sufficient. We view the issuance of this Report as a turning point in our efforts to engage states in a sustained and meaningful dialogue.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas

Magalie Roman Salas
Secretary

Appendix A

PARTIES FILING COMMENTS ON REPORT TO CONGRESS CC: 96-45

Commenter	Abbreviation
Access Authority, Inc.	Access
AirTouch Communications, Inc.	AirTouch
Alabama, Alaska, Arkansas, Georgia, Idaho, Kentucky Maine, Montana, New Hampshire, New Mexico, North Carolina, South Carolina, Vermont and West Virginia State Regulatory Agencies	Alabama, Alaska et al.
Alaska, State of	Alaska
Aliant Communications Co.	Aliant
America Online, Inc.	AOL
Ameritech	
AMSC Subsidiary Corporation	AMSC
AT&T Corp.	AT&T
Beehive Telephone Companies	Beehive
Bell Atlantic Telephone Companies	Bell Atlantic
BellSouth Corporation	BellSouth
Business Networks of New York	Business Networks
Bybee, Dennis L., PhD.	
Carolina Connection, Inc.	
Cellular Telecommunications Industry Association	CTIA
City Council and Mayor of the City of Norfolk Nebraska	City of Norfolk
Coalition of Independent Internet Service Providers of Utah	CUIISP
Colorado Public Utilities Commission	Colorado PUC
Comcast Corporation	Comcast
Commercial Internet Exchange Association	CIX
Community Internet Systems, Inc.	
CompuServe Incorporated	CompuServe
American Council on Education American Association of Community Colleges Association of American Universities Association of College University Telecommunications	Education Parties
Council of Chief State School Officers	CCSSO
Education and Library Networks Coalition	EDLINC
Florida Department of Management Services	Florida DMS
General Communications, Inc.	GCI
GTE Service Corporation	GTE
Internet Access Coalition	Internet Access Coalition
Information Technology Industry Council and Information Technology of Association of America	ITI/ITAA
Iowa Utilities Board	Iowa

John Staurulakis, Inc.	JSI
Kansas City Corporation Commission	Kansas CC
Local and State Government Advisory Committee	LSGAC
Low Tech Designs, Inc.	LTD
MCI Telecommunications Corp.	MCI
Mississippi Public Service Commission	Mississippi PSC
Missouri Public Service Commission	Missouri PSC
National Association of Regulatory Utility Commissioners	NARUC
National Cable Television Association	NCTA
National Railroad Passenger Corporation	Amtrak
Nebraska Public Service Commission	Nebraska PSC
Nevada, Public Utilities Commission	Nevada PUC
New Mexico Attorney General	New Mexico AG
Nielsen, Mary	
North Dakota Public Service Commission	North Dakota PSC
North Dakota Regulatory Reform Review Commission	North Dakota RRRC
Oregon Public Utility Commission	Oregon PUC
Pennyslvania Public Utility Commission	Pennsylvania PUC
Pennsylvania Public Utility Commission, Pennsylvania Department of Education, Office of Information Technology, Pennsylvania Rural Development Council, Office of Rural Health of Pennsylvania State University	Pennsylvania Agencies
Personal Communications Industry Association	PCIA
Puerto Rico Telephone Company	PRTC
Reuters America, Inc.	Reuters
Richland Economic Development	
Rural Telephone Coalition	RTC
SBC Communications	SBC
SmarTalk TeleServices, Inc.	SmarTalk
South Dakota Public Utilities Commission	South Dakota PUC
Southwest Microwave, Inc.	
Sprint Corporation	Sprint
Sprint Spectrum L.P.	Sprint PCS
State Members of the Federal-State Joint Board on Universal Service	State Members
TDS Telecommunications Corporation	TDS
Telecommunications Resellers Association	TRA
Teleport Communications Group, Inc.	TCG
Texas Public Utility Commission	Texas PUC
Transportation Committee of the Nebraska Legislature	
United States Internet Providers Association	USIPA
United States Telephone Association	USTA
United States Senate, Senators Snowe, Rockefeller and Kerrey	
United States Senate, Senators Stevens and Burns	
U S WEST, Inc.	US WEST

UTC, The Telecommunications Association	UTC
Utah, State of	
Vanguard Cellular Systems, Inc.	Vanguard
Washington Utilities and Transportation Commission	Washington UTC
Western Governors' Association	
Wisconsin Public Service Commission	Wisconsin PSC
WorldCom, Inc.	WorldCom
Wyoming Public Service Commission	Wyoming PSC

Appendix B

PARTIES FILING REPLY COMMENTS ON REPORT TO CONGRESS CC DKT. 96-45

Commenter	Abbreviation
Ad Hoc Telecommunications Users Committee	Ad Hoc
America Online, Inc.	AOL
American Mobile Telecommunications Association, Inc.	AMTA
American Public Power Association	APPA
Ameritech	
Arizona Corporation Commission	Arizona CC
Association for Local Telecommunications Services	ALTS
AT&T	
Bell Atlantic	
BellSouth Corporation	BellSouth
Business Networks of New York, Inc.	Business Networks
Comcast Corporation	Comcast
Commercial Internet Exchange Association	CIX
Education and Library Networks Coalition	EDLINC
GTE Service Corporation	GTE
GVNW, Inc./Management	GVNW
Internet Service Providers Consortium	Internet Service Providers
Iowa Telecommunications Association	Iowa Telecom. Assoc.
MCI Telecommunications Corporation	MCI
National Association of State Telecommunications Directors	NASTD
NEXTEL Communications Corporation	Nextel
National Telecommunications and Information Administration	NTIA
Rural Telephone Coalition	RTC
Sprint Corporation	Sprint
Telecommunications Resellers Association	TRA
United States House of Representatives, Rep. White	
United States Senate, Senators Ashcroft, Ford John F. Kerry, Abraham and Wyden	
United States Senate, Senator McCain	
United States Senate, Senators Rockefeller and Snowe	
US Satellite Companies	
US West, Inc.	US West
Vanguard Cellular Systems, Inc.	Vanguard
Washington State Department of Information Services	Washington DIS
Wyoming Public Service Commission	Wyoming PUC

Separate Statement of Chairman William E. Kennard

Universal service is an American success story. For the better part of this century, our commitment to universal service has made telephone service affordable for Americans living in all corners of the Nation. And indeed about 95% of American households have basic local telephone service. While it is easy to take this level of penetration for granted, it is, by world standards, a remarkable achievement. Our responsibility is to sustain and improve upon this record, especially in areas and for portions of our communities that do not have or cannot afford service.

To be sure, the notion of universal service must continue to change, to keep pace with the technology that it supports. In the Telecommunications Act of 1996, Congress described universal service as "an evolving level of telecommunications that the Commission shall establish . . ., taking into account advances in telecommunications and information technologies and services."[1] In the 1996 Act, Congress also included within the concept of universal service discounted services to schools, libraries, and rural health care providers. The evolving nature of universal service is essential to keeping our Nation connected as technology, innovation, and investment produce ever greater, faster, and more efficient media of communications.

As we enter the twenty-first century, our duty is to maintain and improve upon the successes of universal service in an environment that differs markedly, in any number of ways, from the communications world of the past. The new communications world is different not only because of stunning advances in technology, but also because of a shift in the competitive and regulatory paradigms, as foretold by the 1996 Act. These changes present us with some formidable challenges.

First and foremost, this Commission and our colleagues at the various state commissions must reform universal service mechanisms that were designed to work in an environment of regulated monopolies, but that must now be adapted if we are to pave the way for robust competition while continuing to safeguard and advance universal service. In the world of the regulated monopolist, it was easy enough to keep basic residential phone service affordable, even if it meant pricing that service below the carrier's cost of providing it, since the monopolist could be permitted to make up the difference in other ways, such as through higher rates for long distance and business services. In this way, phone companies could earn a reasonable overall return, while basic residential phone service was kept affordable even in high cost, hard-to-serve areas.

Such implicit forms of universal service support must be reformed at the federal and state levels if competition is to succeed without sacrificing universal service. The first

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[1] 47 U.S.C. § 254(c)(1).

impact of competition will be to put downward pressure on the above-cost rates that now subsidize residential local phone service. This Commission has set into motion a process for removing universal service support that is implicit in the interstate access charges that long distance carriers pay to local exchange carriers, and replacing that form of support with an explicit universal service support recovery mechanism. I am encouraged by those States that have begun the same process within their jurisdictions, and I pledge my full support and cooperation.

We have the ultimate responsibility to assure affordable rates throughout the country. When this Commission first undertook to reform universal service last year, we observed that, through the process of separations, approximately 25% of universal service support historically had been funded through federal support mechanisms. What was not expressly recognized, however, was that some areas of our country currently receive much more than 25% federal universal service support. In these areas, it makes little sense to limit federal support to 25%. Even beyond these baseline levels, I believe we all recognize that in some instances the proportion of federal support will have to increase. It is my intention to see to it that such additional support is forthcoming. The hard question this Commission must step up to in the coming months, in close cooperation with the States, is what is the best manner in which to proceed to ensure that these are "specific, predicable and sufficient Federal and State mechanisms to preserve and advance universal service."[2]

I believe that we will all be better off if both we and the States act expeditiously to preserve existing sources of universal service support by converting existing implicit sources of support into explicit sources of support. Rates today are affordable and universal service today is supported. States and the FCC together ought to be able to restructure today's support to continue to ensure affordable rates. But doing this will mean that States determine the extent to which existing, implicit intrastate subsidies can be converted to explicit subsidies. This process of reform by the States should not increase the amount of universal service support that the States raise within their own jurisdictions. When a state cannot restructure existing universal service support and maintain affordable rates, we should further help maintain affordability. I do not envision that States complete their reform efforts before additional federal support is provided. Nor do I mean to imply that States must raise local phone rates in order for additional federal support to be available. Indeed, I seek only to follow the principle articulated by Congress that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[3] And where a State can demonstrate that, despite reasonable efforts, it will be unable to convert its existing intrastate support system into a specific and predictable universal support mechanism that will maintain affordable rates, the difference must and will be made up from the federal support mechanism.

As we pursue this reform, it is also our responsibility to ensure that all telecommunications carriers contribute to the universal service support in the manner

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[2]47 U.S.C. § 254 (b)(5).

[3]47 U.S.C. § 254(b)(5).

contemplated by the Communications Act.[4] As our Report to Congress shows, application of the statutory terms "telecommunications carrier"[5] and "telecommunications service,"[6] which we must undertake if we are to identify those whom the statute directs to make universal service contributions, will not always be an easy task. And as our Report further shows, there are those who believe it is in this regard that our maintenance of a robust universal support mechanisms poses a threat to another American success story, the Internet. I disagree. For I believe that the continuing success of universal service can not only co-exist with the maintenance of a "hands off" regulatory approach to the Internet, I believe that universal service support can and will benefit from such an approach.

We already have witnessed the symbiotic relationship between universal service and the Internet. Universal service has given millions of Americans affordable access to the public switched telephone network and, through that network, access to all of the wonders and knowledge of the Internet. In this way the Internet benefits from the maintenance of universal service. By the same token, the growth of the Internet leads to increased support of universal service. This is because an enormous amount of pure telecommunications is purchased by the businesses that make the Internet available to the 40 million American homes with personal computers. While Internet service providers, for example, do not incur, or pass on to their subscribers, direct universal service obligations, their purchase of telecommunications does lead to an increase in universal service support from the providers from whom they purchase telecommunications services. Thus, as we refrain from treating Internet service providers as telecommunications providers, we promote the growth of Internet services; this growth in turn sparks demand for telecommunications, which then increases the amount of universal support.

In sum, I view the relationship between universal service and the Internet like a couple at the beginning of a long-lasting marriage -- inevitably there will be occasional signs of tension, but in the end they will always need each other.

I believe our Report to Congress exemplifies this approach. I have yet to see an Internet service that appears to fall within the definition of a telecommunications service. As the Report indicates, however, there are other services that seem to do so. In the Report, we discuss IP telephony, a service that seems virtually indistinguishable from traditional long distance telephone services. While a more definitive determination demands that we have a better factual record, I note that even in this regard we are not proposing the possibility of "regulating the Internet" or imposing universal service contribution obligations on Internet service providers. We are simply identifying a very narrow category of service -- IP telephony -- that shares many of the characteristics of a telecommunications service.

I do not seek to understate the concern of some that the migration of traffic from the

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[4] 47 U.S.C. § 254(d).

[5] 47 U.S.C. § 153(44).

[6] 47 U.S.C. § 153(46).

public switched network to other networks could threaten the viability of universal service. I am committed to ensuring that no such threat materializes, whatever its source. Simply put, this Commission can have no higher priority than the preservation and enhancement of universal service. As I have outlined above, I believe that services provided by the Internet and IP telephony have provided, and will continue to provide, support for universal service, even as we avoid regulation of the former and begin to examine the telecommunication-like characteristics of the latter. But this Report is in some respects simply a snapshot. Our federally-mandated commitment to preserve and protect universal service did not begin with the 1996 Act and it does not end with this Report. It is ongoing. I look forward to continuing to work with the state commissions and with Congress to honor this commitment.

The very first sentence of our organic law states that the fundamental mission of this Commission is "to make available, so far as possible, to the all the people of the United States, without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[7] The Commission has fulfilled this mission for the last seven decades of the twentieth century, and will continue to do so as it enters the twenty-first century.

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[7] 47 U.S.C. § 151.

Separate Statement
of
Commissioner Susan Ness

Re: Report to Congress on Universal Service

Today's Report to Congress reaffirms the institutional commitment of the Commission to the statutory goals of universal service. For me, this is a matter of personal commitment as well.

Americans are a heterogeneous people, but we comprise one nation. Rich or poor, black or white, rural or urban, each of us benefits from the availability of affordable telephone service -- not just for ourselves but for everyone else. That's why Congress made universal service a cornerstone of the Telecommunications Act of 1996, and that's why the Commission has worked so diligently with the state commissions, our partners, to promote telecommunications access for low-income consumers and consumers in remote, insular, and high-cost areas, as well as for eligible schools, libraries, and rural health care providers.

Universal telephone service has long been a national goal, and it is a goal we have generally achieved. Today, having the opportunity to use the telephone network is more essential than ever before for participation in our nation's society, culture, and economy. That's why Congress has so clearly stated its intention that telephone service be ubiquitously available and affordable. To achieve this goal in a marketplace in which additional competition is developing, and desirable, Congress called for universal service support that is "specific," "predictable," "sufficient," "explicit," and collected in an "equitable and nondiscriminatory" manner.

This Report is far from a final answer to all of the questions surrounding universal service. The Commission has devoted a great deal of time to universal service over the past two years, and it will continue to do so in the future. Major issues remain to be worked through, but our work on this Report to Congress has moved us forward.

I have appreciated the opportunity to take a fresh look at these critical issues. Preparation of this Report has afforded all of us an opportunity to concentrate intensively on the vital importance of universal service -- enabling a new group of Commissioners to evaluate, on a fresh record, the decisions of the former Commission members, to assess present circumstances, and to lay the groundwork for the decisions that will be necessary in the future. And, of course, this Report will assist Congress in its oversight of the Commission, and facilitate informed judgments about whether to provide

additional legislative guidance on any of the myriad issues that have arisen in the implementation of the Telecommunications Act of 1996.

High-Cost Support

On universal service support for consumers in high-cost areas, the most important message we are sending today is one of reassurance. Contrary to the impression that may have been created by elements of the decision last May, the Commission does not contemplate diminishing the support that currently is provided from the interstate jurisdiction to maintain affordable telephone service. Although the statute calls for "Federal and State mechanisms to preserve and advance universal service," we don't yet have the answer to all the questions about how best to coordinate the respective roles of the state and federal commissions. But we can and do make clear that this Commission is not contemplating any precipitous action to reduce the high-cost support that is currently supplied by the interstate jurisdiction.

Rural telephone companies will operate essentially under the existing support system for years to come. The large telephone companies will continue to receive many billions of dollars of intrastate and interstate support, though implicit mechanisms will be converted to explicit ones. The specifics need to be worked through in partnership with the states, including universal service "contributor" states and "recipient" states, to forge a mutually agreeable solution that will be enduring. I will redouble my efforts to bring to a successful conclusion the long-pending efforts to forge a workable consensus. In doing so, it is my firm intention to continue to deliberate, and strive for consensus, with state commissioners and staff, through the Joint Board, the NARUC Communications Committee, and all other available channels.

Telecommunications Services and Information Services

This Report has given us an opportunity to review the legal analysis, and the practical consequences, of our prior determinations regarding the statutory definitions of "telecommunications," "information services," and related terms. As a legal matter, the Commission is renewing its determination that the Telecommunications Act should be read to affirm the *unregulated* status of information services, including Internet access services. I firmly believe that this decision is supported by the statute and the legislative history, and that it has stimulated and will continue to promote desirable investment and innovation. As a practical matter, the Commission has learned that the relationship between information services and telecommunications is symbiotic. The explosion in information services in general, and Internet usage in particular, is stimulating demand for underlying telecommunications services, thereby ensuring the sufficiency of sources for universal service support.

The relationship between telecommunications and information services is a topic that will require further rulemakings or adjudications, for example, to examine such matters as IP-based telephone services (as distinguished from Internet access services which we have not regulated and do not intend to regulate). We need to make sure we have all the facts, and

have considered all of the potential ramifications, before we make any particularized determinations. We will also need to consider issues relating to "bundled" offerings that include both telecommunications services and other services. Definitive answers on these topics are not at hand. But, because of the continuing growth of the telecommunications market and the success of the policy of *non*-regulation of information services, I am confident that it will in fact be possible to (1) safeguard universal service support, including that needed for high-cost areas, and simultaneously (2) avoid stifling the development or deployment of innovative new information services.

Schools, Libraries, and Rural Health Care Providers

This Report does not address the low-income support mechanism, but it is important to note that this mechanism -- like pre-existing high-cost support -- is continuing; in fact, federal support has been increased. Meanwhile, the Commission has launched the new support mechanisms called for by the Snowe-Rockefeller-Kerrey-Exon provisions (Sec. 254(h)) of the statute, for schools, libraries, and rural health care providers. As a result, *all* phases of universal service support -- high-cost, low-income, and Snowe-Rockefeller -- are now operational.

I remain convinced that implementation of Section 254(h) will bring extraordinary benefits to children, to rural health care patients, and to library patrons across the nation. I know there have been criticisms of certain decisions that have been made in the course of implementing this visionary, but in some respects ambiguous, provision of the law. I stand ready to work with Congress to explain our past decisions, or to assist in assessing alternatives. If new legislative guidance is to be provided, I hope that it can be effectuated without unduly disrupting the plans of thousands of schools, libraries, and rural health care providers across the nation who are eager to seize the opportunities the legislation created.

I look forward to an active and constructive dialogue with Congress, as well as with the state commissions, as we continue our efforts to implement the universal service provisions of the Telecommunications Act of 1996 for the benefit of all.

SEPARATE STATEMENT OF COMMISSIONER MICHAEL K. POWELL, CONCURRING

Re: Report to Congress, Federal-State Joint Board on Universal Service (CC Docket No. 96-45).

I welcome the opportunity provided by this Report to Congress, both to underscore my strong support for the goals of the universal service provisions of the 1996 Act and to share my current views regarding some of the principles I believe should guide the Commission's implementation of these provisions. I write separately (1) to highlight the challenges the Commission and Congress face as technological convergence erodes the foundations of our balkanized regulatory framework, and (2) to express my growing concern that we need to modify our universal service programs, particularly the Schools and Libraries (S&L) program, in order to more accurately meet demand and to limit their distorting effect on competition and consumer prices.

I. Internet Protocols and the Strain on Our Statutory and Regulatory Framework.

A. The Problem of Convergence

Congress has asked that we re-examine our interpretation of the critical terms "telecommunications," "telecommunications carriers," and "information service providers" contained within the universal service section of the 1996 Act.[1] At bottom, the question is whether these terms are mutually exclusive. That is, can a single service provider be offering both "telecommunications services" and "information services"? Or, as the Commission has previously held with respect to its treatment of "basic" and "enhanced" services, is a provider either one or the other.

I believe the Report rightly concludes that Congress intended to maintain the dichotomy between telecommunications services and information services that originated in the Commission's *Computer* decisions and was utilized in large measure by the court in the context of the divestiture of AT&T. Though I concede that there is merit in the views advocated by some that Congress intended to redefine telecommunications so as to capture information service providers within the snare of Title II and other regulation, I believe the express language of the Act and its legislative history prove otherwise, as the Report demonstrates.

Clearly, how the Commission chooses to categorize a provider under the statute significantly affects its regulatory treatment. A telecommunications carrier is subject to the full panoply of common carrier regulation and must contribute to universal service. A

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[1] *See* 47 U.S.C. § 254.

provider of telecommunications (one not offering telecommunications on a common carrier basis) may have to contribute to universal service if the Commission finds that it is in the public interest to do so. And, finally, an information service provider is neither subject to regulation nor, in my current view, should it be required to contribute to universal service.

Even though we are convinced that Congress in fact adopted a categorical "either/or" scheme in 1996, we are left with the difficult task of categorizing service offerings that do not fit neatly in either category, unless and until Congress makes a change in this scheme. This difficulty arises because the definitional dichotomy does not fully account for the explosion in innovation brought about by the Internet and its underlying network architecture. That dichotomy is premised on a network in which the nature of the service and the underlying infrastructure are highly integrated. Basic voice service was (and largely still is) distributed on networks constructed and optimized for that service, and the brains of that network resides within the central switches, signalling systems, and databases of the intelligent network owned by the operator, usually a Bell Operating Company (BOC). The Internet and the Internet protocol (IP) represent a dramatic paradigm shift in network architecture. A variety of services can be overlaid on an IP network and the intelligence of those services rests not centrally, but at the edges of the network -- in the case of the Internet, in the computers owned by the millions of users and information service providers throughout the world. Anyone with the right computer and software can offer and distribute new and innovative goods and services.

The advent of IP networks has placed great strain on the categorical definitions first set out by the Commission and adopted by Congress. Previously, we assumed that one could categorize a service by the degree to which the transmission was "processed" or altered by computers on the network. Basic service (assumed to be voice) traveled without manipulation or change in form to its destination. Thus, it was said to flow on a "transparent transmission path." This definition is being strained today even for voice networks. For example, in modern digital voice networks, such as the new cellular and PCS networks, advanced digital signal processing means the voice signal is being processed and manipulated between origin and destination. More importantly, information service (assumed to be data) involved the additional manipulation by computer of the transmitted information.

The infinite flexibility of IP switched-packet networks, has blurred these distinctions, making them difficult, if not impossible, to maintain. As we are seeing, one now can transmit voice, in addition to data, using a protocol that allows for a significant degree of computer processing and other advanced capabilities. Yet, from the perspective of a user who does not use those capabilities, the service may look nearly identical to traditional basic service. Were such a service to be classified permanently as an information service it should not, in my current view, be required to contribute to universal service. If innovative new IP services were all thrown into the bucket of telecommunications carriers, we would drop a mountain of regulations, and their attendant costs, on these services and perhaps stifle innovation and competition in direct contravention of the Act.

Therefore, the challenge we face is how to categorize the growing number of hybrid services, in light of the Act's twin objectives of promoting competition and advancing universal service. Hybrid services are those that have components of both a basic service and an information service (as traditionally defined). On one end of the spectrum, for example, may be some forms of IP telephony that resemble traditional basic service in nearly every way, except that they have at their core a network and protocol that makes it possible to substantially enhance the basic voice service (for example, speak French and have it come out in English or have some users choose higher fidelity sound than others). On the other end of the spectrum are service providers whose fundamental function is to offer access to information to its customers using computer intelligence, but whose service rests on a transmission network fully capable of providing a clear path for basic transmission (same thing in, same thing out). Sorting hybrid services into their appropriate regulatory bin is difficult, yet something we will be forced to do more and more as new and innovative services explode from the fuel of IP networks. This reflects the growing challenge of adapting a balkanized regulatory structure to a world of technological convergence.

Congress is right to be both buoyed and fearful of this development. On the up-side, the arrival of digital technology and IP networks mean infinite possibilities for new and innovative services. The arrival of broadband digital networks promise to connect the world to an endless sea of information, significantly advancing how we buy and sell, communicate, create, and educate. Moreover, this technology will produce more competitive choice for consumers by eroding the traditional barriers between services and lowering the costs of entry. This hopeful state of affairs was born and has flourished in a deregulated and competitive atmosphere, the very type we are striving to achieve in communications services generally. On the down-side, these alternative network systems may present a threat to our universal service goals. Carriers that presently pay to support universal service may migrate more of their traffic to IP networks in a rational effort to avoid the cost of government regulation. Congress, will have to watch these developments vigilantly and take action if it becomes necessary, but until that day, what is an agency to do?

B. A Call for Case-By-Case Evaluation

As long as our universal service obligations require us to consider whether difficult-to-classify entities are "telecommunications carriers," provide "telecommunications," or are "information service providers" I think we should resolve those questions on a case-by-case basis. If the Commission is to preserve the dichotomy between information services and telecommunications, as the statute and legislative history appear to require, we will need to make highly fact-specific inquiries about whether particular entities provide transmission of information "without a change in the form or content" or whether the entities offer the capability of manipulating that information.

Attempts by this agency to set down its own prophylactic rules for categorizing classes of IP-based service will be, in my current view, futile if not dangerous for a number of reasons: First, the English language is no match for the infinite flexibility and innovation

potential of an IP network. I am confident that any attempt to craft a rule to cover a class of IP-based service will be almost immediately frustrated by innovative changes to the service and technology that these advanced networks allow. I fear we would find ourselves in a never-ending chase for regulatory clarity. Second, adopting a rule that invades on a broad front the Internet field and its underlying technology is likely to chill, if not freeze, innovation in broadband digital services, and constrain the flow of capital investment in these growth industries, out of fear that the regulator and the tax-man cometh. Third, any rule will likely be over-inclusive and mire the Commission in waiver proceedings. What will undoubtedly result is a perforated rule -- one besieged by exceptions. Fourth, if we adopt broad rules, we wrong-headedly move in the direction of expanding the onerous body of regulations, rather than staying on the path of deregulation the Act commands us to take. Fifth, we risk serious loss of credibility internationally, having fought hard to win world trade concessions (e.g., international settlements, classifying the Internet as an information service).

These considerations favor resolving these matters (which I believe encompass the classification of Internet and IP telephony) on a case-by-case basis, rather than through rulemaking. It is for these reasons, I question the wisdom of even suggesting conclusions in the Report. Such conclusions, no matter how gingerly or narrowly drawn, signal a move toward developing a body of rules for classifying Internet-based services. I urge the Commission to seek comment on the appropriate method of designating new contributors to universal funds in the context of a future proceeding.

C. The Pitfalls of Competitive Neutrality Analysis

Some will argue that it is competitively unfair to subject competing communications services to regulation and not Internet companies. I constantly hear the mantra that we must "level the playing field," because exempting Internet service providers constitutes a massive subsidy. While this argument has some superficial appeal, I strongly caution against extending regulations solely on this basis.

I simply disagree with those who argue we are massively subsidizing the Internet by letting it operate in a free market while other companies labor under the yolk of government regulation. That seems to be an ironic characterization in light of the Act's stated goal of fostering a pro-competitive, deregulatory environment. The way to level this disparity, if at all necessary, is not to extend government imposed costs and regulations to the Internet, it is to take further actions to liberate those subject to regulation.

Moreover, competition is not a game of equally matched players. Competitors have different mixes of competitive advantages and burdens. It is too simple to focus on a single competitive inequity and then declare the game unfair, without examining the totality of advantages and disadvantages among competitors. Let me be clear: I believe it is entirely appropriate for the Commission to consider the extent to which its decisions will have a distorting effect on the market. We should not lose sight, however, of the fact that we can