

never avoid all such distortions so long as we regulate the market.

Further, we should recognize that competitive advantages are not limited to whether or not companies must contribute to universal service support. For example, while telecommunications carriers must contribute to universal service, they also enjoy significant benefits under sections 251 and 252 of the Act. Likewise, incumbents often have significant advantages over new entrants, such as capital, business and marketing savvy and technical expertise, such that declining to require new entrants to contribute to universal service may not give the new entrants an appreciable advantage over the incumbent. Leveling the playing field, when the players do not start from the same place, only institutionalizes the advantage of the stronger, better equipped, experienced players. We and the Congress regularly and consciously provide incentives for innovation and market entry.

Again, we should recognize that competitive advantage is not always an evil to be stamped out; the market is designed to reward companies for finding and exploiting their competitive advantages over other companies. Our goal should be to ensure that our policies do not have a significant impact on the overall competition between entities.

For these reasons, I am troubled by the discussions in which the Report suggests that new types of entities (e.g., ISPs that use their own transmission facilities, phone-to-phone Internet telephony providers) should be required to contribute to universal service based, at least in part, on "competitive neutrality." I am concerned that these discussions, among other things, may overstate the potential effect of declining to designate new contributors to universal service support and, in any event, oversimplify the competitive context. The danger here is that, as new technological and marketing innovations bring new entrants to the market, we will continue to expand the pool of contributors, whether or not we need additional contributors to keep the fund sufficient. Even worse, by continuously expanding the pool of contributors to encompass new entrants, we may discourage such entry.

I want to emphasize that we do have a duty to maintain a sufficient base of funds to support universal service. We can and will do so. As I explain below, however, we also must not throw our net out farther than is necessary, because unnecessarily expanding the scope or size of the contribution base for universal service would distort and inhibit competition and would put significant pressure on consumer prices for services subject to the government levy. In short, we should address these issues with a surgeon's scalpel and not a butcher's cleaver.

II. Tailoring Universal Service Programs to Sufficiency

One of the hallmarks of the Commission's implementation of the Act's universal service mandate should be that the funds must become and remain "sufficient" within the meaning of section 254(e). Section 254(b) requires that the Commission preserve and advance universal service and the Commission must establish mechanisms to meet that goal. At the same time, it would defy common sense, as well as the pro-competitive, deregulatory

thrust of the Act, for the Commission to expand either the size or the scope of universal service programs unless necessary to fully-fund these programs or to otherwise satisfy the requirements of the Act. Thus, "sufficiency" under the statute is in essence a question of balance: our universal service funds must be sufficient to preserve and advance universal service, but these funds must not become larger than is necessary to achieve those goals. If we do not balance these contending objectives, we will unduly distort competition and add to the cost of service, which will likely result in higher rates to consumers.

I am concerned that the Report does not focus directly enough on the importance of maintaining the sufficiency of universal service funding. As the Report indicates, the Commission does not yet know how much any of the programs will cost; we will not know the demand for the Schools and Libraries program until the window for filing applications closes later this month, and we will not even decide the *method* for determining high cost support until later this year. With respect to Schools and Libraries, in particular, I am troubled that we continue to operate and collect based on initial assumptions about the demand and scope of the program. I fear the eagerness to keep this program moving, which I fully understand, may lead us inadvertently to overcollect or unnecessarily expand the program.

I am concerned that, by not squarely re-evaluating the question of sufficiency, we exacerbate a perception among many critics of our universal service implementation that somehow these programs are out of balance. This perception, paradoxically, is perhaps the most significant threat to the sufficiency of universal service funding. If we cannot find a way to make critics in Congress and elsewhere *believe* that we are working to preserve and advance universal service in a prudent and responsible manner -- that the funds will be sufficient but not too large -- I fear that support for these beneficial programs will erode in the minds of both legislators and consumers.

With respect to the Report's review of Commission actions taken in and subsequent to the *Universal Service Order*,² questions of sufficiency and, conversely, overcollection are central. Congress has expressed its concern regarding the sufficiency of universal service programs in the Appropriations Amendment, which required the Commission to review its determinations regarding who is required to contribute to universal service, as well as the revenue base from which universal service support is derived. More generally, concern for sufficiency and overcollection are evidenced in several critiques of current universal service programs.

Specifically, in my current view, much of the concern regarding the size and scope of the S&L program centers around the perception that, intentionally or not, the Commission has cast its net broadly to capture substantial funding and taken more and quicker steps to

² See *In re Federal-State Joint Board on Universal Service, Report & Order*, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997) (hereinafter "*Universal Service Order*").

ensure that that program will be sufficient than it has taken with respect to the high cost and other programs. Indeed, one could argue that the S&L program may be poised to overcollect: First, the Commission concluded that, despite the fact that States may establish their own S&L programs, the federal S&L program would be funded out of both interstate and intrastate revenues, whereas high cost and low income support would be based only on the former.³ Second, the Commission set the cap for the S&L program at \$2.25 billion, even though projected first-year demand for the program is substantially less than that amount.⁴ Third, the Commission directed the establishment of a separate corporation to administer aspects of the S&L program, rather than allowing the fund administrator to run the entire program, as is the case for the high cost and low income funds.⁵ Fourth, as a general matter, critics point out that the S&L program is already collecting funds, whereas the high cost program will not be fully fleshed out until later this year and will not begin collecting money until next January. Indeed, many states clamor, and the Report concedes, that the percentage of federal funding adopted by the Commission in the *Universal Service Order*,⁶ if not modified on reconsideration, would ensure that some high cost states will receive substantially less federal support than they do currently.

While these decisions, taken individually, constitute a reasonable exercise of the Commission's discretion, the overall picture sketched by these decisions suggests to some critics that the Commission has taken more pains to ensure that the S&L program is sufficient than it has taken with respect to the high cost and low income programs. It is not lost on these critics that section 254 provides no basis for the Commission to favor certain classes of recipients over others with respect to the level or timing of universal service support flows.⁷ Thus, I have become increasingly concerned that, from the standpoint of sufficiency, the S&L program is, or at least appears to be, out of balance.

I support a vigilant approach to ensuring that the sufficiency of universal service be kept in balance, as a general matter and with respect to particular programs, such as the S&L program. As general matter, the Commission should establish an "early warning system," whereby we regularly assess whether the funds and the pool of available contributors are sufficient to satisfy statutory requirements. These efforts could build on the work already begun by the Common Carrier Bureau pursuant to the monitoring authority delegated to it in

³ See *Universal Service Order*, ¶ 823; compare *id.*, ¶ 831.

⁴ See *id.*, ¶ 425.

⁵ See *NECA Report & Order*, ¶ 57.

⁶ See *Universal Service Order*, ¶ 269.

⁷ See generally 47 U.S.C. § 254.

the *Universal Service Order*.⁸ In establishing such a monitoring system, we could request comment on whether specific new technologies or types of providers are contributing indirectly to the funds by, for example, generating new revenues for carriers that are required to pay into the funds.

With respect to Schools and Libraries, I believe that the Commission must quickly commit itself to a modest modification of the program if it wishes to maintain crucial political support for it. To be blunt, I fear that if we do not move quickly to modify our approach to implementation of this and other programs, we will fail to carry out adequately our universal service duties, endanger the pro-competitive and deregulatory goals of the Act and make it necessary for Congress to step in to show us what the public interest requires. With respect to the S&L program, some have raised substantial questions regarding whether the Commission has jurisdiction to assess contributions based on intrastate revenues, as well as important policy concerns. On this basis, and in light of the perception that the Commission has somehow favored the S&L program, I would support limiting that program to assessment of contributions based on interstate revenues only. Likewise, I would favor reducing the cap on the S&L program so as to bring it down to current demand levels. Further, I would support moving the functions performed by the S&L Corporation to the fund administrator, both to remove the appearance that the Commission is favoring the S&L program and to resolve serious questions raised by the General Accounting Office regarding whether the Commission was authorized to direct the establishment of the S&L Corporation.⁹

III. Conclusion

In closing, I remind my colleagues that the Commission is not alone in the effort to promote universal service. I, for one, believe that if we reach a point where there is a potential shortfall in universal service funds, Congress could craft additional legislation narrowly tailored to assess universal service contributions without the accompanying risk of heavy regulation (perhaps to include express preemption of State efforts to regulate the Internet). In the meantime, I urge the Commission to be mindful of the threats to competition and innovation if we do not keep the sufficiency of universal service funds "in balance" both as to their size and scope. By following some of the approaches I have described here, I believe we would greatly benefit the development of competition and innovation by refraining from imposing contribution obligations on entities that do not fit neatly into the traditional categories. Just as importantly, by taking swift action to ensure that the funds are sufficient to preserve and advance universal service, but are no larger than is necessary, we will do much to quell the criticisms that threaten to undermine support for these beneficial programs.

⁸ See *Universal Service Order*, ¶ 869.

⁹ See Feb. 10, 1998 Letter from Robert P. Murphy, General Counsel, General Accounting Office to Senator Ted Stevens.

Separate Statement of Commissioner Gloria Tristani

Re: Federal-State Joint Board on Universal Service, Report to Congress

Today's Report to Congress makes a number of important observations regarding the preservation and enhancement of universal service. I write separately to identify several areas of particular interest to me.

While I support this Report, I have not yet concluded whether last year's decision concerning the share of federal high cost funding (the 25/75 issue) is the best approach. Many people, especially a number of state commissioners, have worked diligently since adoption of last year's *Universal Service Order* to consider how the FCC and state commissions could achieve our shared goals in ways that may vary the current approach. The participants in those efforts have actively sought to build consensus among those with different viewpoints on the 25/75 issue. I strongly support those efforts and encourage all interested parties, especially state commissions, to participate in this dialogue over the next few months. The thinking on this issue continues to advance, and all parties would be well-served by re-engaging the Commission and each other in this dialogue. Disagreement over policy is expected, but I would hope that criticism of the current approach will be accompanied by alternative solutions.

I also support the manner in which the Report addresses phone-to-phone IP telephony and the issue of self-provisioned telecommunications. The Commission has historically favored policies aimed at fostering the growth of enhanced services, including Internet access. The Commission's decisions affecting the Internet -- most notably the ESP exemption and the *Computer Inquiry* line of decisions -- have to be considered among the agency's greatest contributions to the public interest. As we continue our evaluation of this issue in the near future, I will keep firmly in mind the enormous benefits that have resulted from the philosophy underlying those decisions. I am confident that the Commission can continue that philosophy while being faithful to the letter and spirit of the universal service provisions of the Act.

I believe this proceeding has been a valuable undertaking by the Commission. I believe the Commission's understanding of IP telephony as it relates to the framework of the Telecommunications Act of 1996 has been greatly enhanced by our work on this Report. And as a result of this Report, the Commission expects to take additional action in the near future that would address whether specific types of IP telephony fall within the Act's definition of "telecommunications service." In addition, as a result of this Report, we have opened an important discussion that will consider whether entities that self-provide telecommunications should be required to impute the value of that telecommunications and contribute to universal service based on those revenues. These are important steps in fulfilling the goals of section 254.

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DISSENTING STATEMENT OF COMMISSIONER HAROLD FURCHTGOTT-ROTH

Re: Federal-State Joint Board on Universal Service, Report to Congress, CC Docket 96-45.

Introduction

The majority has worked hard to make this report a success. Comments have been received from the public. En banc hearings have been held. Many staff members have invested countless hours in preparing this report. Everyone involved has had the best of intentions.

I wish that there were a way that I could vote with the majority on this report. Efforts and intentions are commendable. They were also commendable in the May 1997 order on universal service. But efforts and intentions alone are not sufficient to lead to a good order or a good report on universal service.

Priorities matter. Rural, high-cost universal service is not just one of many objectives of Section 254; it is the *highest* priority. Rural, high-cost universal service issues should not be resolved and implemented in some dim and distant future after all other universal service issues have been resolved; rural, high-cost universal service issues should be resolved and implemented *first*. Rural, high-cost universal service should not be viewed as the residual after enormous amounts for other federal universal service obligations have been promised; rural, high-cost universal service should receive the *lion's share* of any increase in the federal universal service fund.

New federal universal service policy should not discard prior programs through a revolutionary process; new federal universal service programs should develop through a careful *evolutionary* process. Federal universal service programs should not be funded by unlimited, hidden taxes and fees, negotiated behind closed doors, that harm all consumers of telecommunications services through ever increasing prices; federal universal service programs must be funded by prudent mechanisms that allow for *lower, and consequently more affordable*, telecommunications rates for all Americans. Federal universal service programs should not stifle innovation and competition; they must *encourage* them. Federal universal service programs should not be based on creative and expansive readings of the law; they should be based on *narrow* readings of the law. Federal universal service programs should not ignore Congressional intent; they must *reflect* it.

For these and other reasons explained below, I must reluctantly and respectfully dissent from the majority opinion today.

Congressional Intent Regarding Federal Universal Service Programs

For many years, a universal service funding mechanism, based on federal collection of fees from interstate service revenues, has defrayed the costs of service in rural, high-cost areas. It has been a system of subsidies with neither great efficiencies nor great excesses. It has evolved with little fanfare or controversy.

The Telecommunications Act of 1996 placed in statute what had largely evolved by regulation. Section 254 is an evolution of preexisting programs, not a revolution that endangers those programs to create entirely new ones. The clear emphasis of Section 254 is to preserve and enhance universal service in rural, high-cost areas of the country. There are other goals of Section 254, but it is difficult to read Section 254 in its entirety and understand how a federal universal service fund program could have as its primary emphasis anything other than rural, high-cost support; and it is even more difficult to understand how any portion of this section could proceed piecemeal before the rural, high-costs issues are resolved and in a fashion that jeopardizes support for rural, high-cost areas. And it is still further difficult to read Section 254 to lead to funding mechanisms that make telecommunications services less affordable to all Americans on the pretext of supporting non-telecommunications plant, equipment, and peripheral services. Even a few conversations with Members and staff reveal that Congress intended primarily to make telecommunications services more -- not less -- affordable through support of rural, high-cost areas under Section 254; many conversations make the point more forcefully.

Somewhere between Capitol Hill and 1919 M Street, N.W., the intention of Congress seems to have been lost. Last May, the Commission issued an order on universal service that was more revolutionary than evolutionary. Much thought and care went into this revolutionary order; it was intellectually sophisticated and established novel interpretations of the law and Commission authority; but, in the process, it seems to have inadvertently lost sight of both the intent and the letter of the law.

The failure of the Commission on universal service was not lost on Congress; it decided to give the FCC a second chance to redeem itself. Congress requested a report from the FCC not because Congress was pleased with the earlier universal decision; Congress requested the report precisely because it was displeased.

The report that the Commission submits to Congress is a missed opportunity. We could correct past mistakes, but we do not. We could affirm a commitment to Congressional intent, but we do not. Senator Dorgan eloquently suggested that, if the FCC has made a mistake, it should now make a "U-turn."¹ Instead, we largely reaffirm past decisions.

¹ Statement of Sen. Byron Dorgan at a Hearing before the Subcommittee on Communications of the Senate Committee on Commerce, Science, and Transportation, March 25, 1998.

Untenable Taxes

The federal government has had universal service programs for rural, high-cost areas and for low-income Americans for many years. These programs have been quietly met with a tax of approximately 3 percent on interstate telecommunications services.

Section 254 sets forth goals that emphasize rural, high-cost support as well as low-income support and other objectives. The Commission must be nimble and energetic to meet all of those goals. Instead, we have made costly promises for some services without making promises for increases in rural, high-cost programs. How much will all of these promises cost? No one can say with certainty.

Commission orders last year set caps of \$2.25 billion annually for schools and libraries. For the second quarter of 1997, we have imposed a 0.71 percent tax on all telecomm services, both interstate and intrastate, to support schools and libraries programs for an amount of \$1.3 billion annual rate. The \$2.25 billion annual rate would require a 1.22 percent tax on all telecommunications. Moreover, as I explain below, I have substantial doubts about our authority to tax intrastate services directly or even to use them as a basis for taxes. To support fully the promised schools and libraries program with just interstate telecommunications service revenue would require a tax rate of 3.2 percent.

The Commission has thus set about to promise a schools and libraries program that can only be funded with a 3.2 percent tax. New programs for rural health care providers and for low-income programs add another 1 billion, or a tax rate of 1.4 percent on interstate services for a cumulative incremental tax rate of 4.6 percent on interstate telecommunications services. These promises have been made before any incremental expansion of the federal high-cost program is decided. It is difficult for me to imagine how Congress intended the FCC to spend less on any incremental new rural, high-cost support than on the other universal service programs. It is thus possible that, to meet Congressional intent without reducing the promises already made for other universal service programs will require an incremental federal tax rate of 10 percent on interstate telecommunications services on top of the preexisting 3 percent tax.

The specific parameters in the preceding paragraph are only illustrative. They may be higher or lower than actual values, but any incremental rate close to 5 percent, much less 10 percent, would be punitive as it would lead to substantial price increases in interstate telecommunications services and would harm the very consumers that universal service is intended to help. The interstate telecommunications service market would shrink in response to over-taxation. Fewer firms would invest in the industry; fewer firms would innovate; American leadership in world markets would erode. The greater the taxes on interstate telecommunications services, the greater the economic pressures for both consumers and

businesses to seek to avoid these taxes through unregulated technologies.

Congress did not envision substantial new taxes on interstate or other telecommunications services as a result of the Telecommunications Act of 1996, nor did it envision price increases -- much less substantial price increases -- in any telecommunications market.² The harm to consumers from increases in universal service taxes is not just the direct expense of the taxes themselves. Prof. J. Hausman of MIT has estimated that consumers lose a total of more than \$2 in consumer benefits for every dollar paid in taxes on long-distance services.³ Do American households really want to lose approximately \$14 billion annually in consumer benefits -- or approximately \$140 annually per household -- to support Section 254?⁴

Preserving Universal Service

The proper path for the FCC to interpret Section 254 is not an easy one. But we should begin with the old adage: Do no harm. We should seek to do no harm to the consumers who currently benefit from federal universal service programs, and we should build on that program in a prudent manner that does not overtax and harm telecommunications consumers.

The Commission has compounded untenable policy and taxes with untenable promises. Some potential universal service beneficiaries have been "promised" enormous and unending benefits, long before there are actual revenues for these programs and long before other potential universal service beneficiaries have voiced their concerns. What has ensued is an unfortunate confrontation among various potential beneficiaries from universal service. Simply stated, the potential pot of revenue that the FCC can collect for universal service from fees on interstate services is limited. And the potential beneficiaries are locked in a struggle to see who will receive the lion's share of the benefits. Yet some parties have been promised in advance large and unsustainable amounts of money to the exclusion of other parties.

² See for example, the comments of Sen. Slade Gorton, at a Hearing before the Subcommittee on Communications of the Senate Committee on Commerce, Science, and Transportation, March 25, 1998; and the comments of Rep. Michael Oxley at a Hearing before the Telecommunications, Trade, and Consumer Protection Subcommittee of the House Committee on Commerce, March 31, 1998.

³ Jerry Hausman, "Taxation by Telecommunications Regulation," National Bureau for Economic Research, Working Paper Series 6260, November 1997.

⁴ These figures are based on an incremental tax rate of 10 percent applied to a \$70 billion dollar base for interstate services, and a \$2 loss in consumer welfare for each dollar of tax.

Authority To Establish The Size And Funding Mechanisms For Universal Service

The May 1997 universal service order promises the Schools and Libraries Corporation, an entity of questionable legal status,⁵ \$2.25 billion annually. This target is not written in statute nor is it an amount that was demonstrably contemplated by Congress. Moreover, it is an arbitrary target, one that the FCC could equally well, and with equal legal authority, have set at \$22.5 million, or \$225 million, or \$22.5 billion, or \$225 billion.⁶ Does the FCC acting alone have the legal authority to set arbitrary targets for SLC spending and then establish tax schemes to fund those targets? Sadly, despite the enormous political, economic, and technological consequences of these decisions, the answer appears to be "yes."

These decisions would be large ones even for Congress, much more for the FCC, to make. The FCC must be prudent in making these decisions, and extraordinarily cautious about making promises. Our only legal means of fulfilling large promises is to impose devastating "fees" on the interstate telecommunications markets. Congress, in contrast, has other means of financing programs and fulfilling large promises. In many ways, perhaps it would be better for Congress rather than the FCC to make many of the large decisions about the contours of universal service. Current law, however, appears to place these decisions with the FCC. We should work within the law of Section 254, prudently, and with the close advise of Congress. Only in that way can Section 254 work.

The FCC has enormous power under Section 254. The wisest exercise of power, whether in this section, or in other areas of law, is self-restraint rather than profligacy. We must have a plan to implement Section 254 that makes sense. It must preserve universal service without imposing devastating taxes. It must focus on high-cost, rural issues. It must have clearly more benefits than harm. All of this the FCC can and should do on its own. To the extent that more ambitious and costly programs are required, the FCC should work with Congress to find appropriate funding mechanisms rather than developing them on our own.

⁵ Letter from Robert P. Murphey, General Counsel, United States General Accounting Office (GAO), to The Honorable Ted Stevens, United States Senate, February 10, 1998.

⁶ Rep. Joe Barton has suggested that a substantially smaller fund of approximately \$40 million annually would be adequate. See comments of Rep. Barton at a Hearing before the Telecommunications, Trade, and Consumer Protection Subcommittee of the House Committee on Commerce, March 31, 1998.

Specific Legal Concerns

Before elaborating on my legal concerns with the majority's universal service plan, I would like to make one point clear. I am committed to the full and proper implementation of all sections of the Communications Act, including Section 254. I understand the great interest of Congress and the American people in universal service. I am not persuaded, however, that the steps the Commission has taken to date meet all of the requirements of Section 254.

Below I describe in more detail a few of my specific concerns about how the Commission has not fully met the requirements of Section 254. The discussion below is not intended to be exhaustive of all of the shortcomings of past Commission interpretations of Section 254. The discussion, however, is a sample of issues that should be -- but are not -- addressed in the report to Congress. The specific topics below answer, in part, one or more of the questions the Commission is required to answer in its report to Congress.

I. THE DEFINITION OF TELECOMMUNICATIONS -- FLOATING "UNSINKABLE" PROPOSALS

In the current report, the majority introduces vague proposals to increase the number of entities that would be required to contribute to universal service. Not only are these suggestions -- each of which involves the Internet -- not based on a thorough record, they are inherently premature given the FCC's inadequate treatment of broad universal service policies and the nascent state of IP telephony. Further, each suggestion is problematic in its own right; they have been floated, and now they will sink.

There is merit, of course, to the concern that the Internet could affect universal service and our general regulatory policies. The FCC must, however, first develop a viable plan for universal service and, then, work closely with Congress to implement long-term public policy solutions that take the Internet into account.

Specifically, the FCC suggests that contributions could be collected from some providers of so-called "phone-to-phone" IP telephony service and self-providers of Internet backbone transmission capacity. These proposed "solutions," however, are mere band-aids for a dying patient. I am concerned that such rules, could be technically infeasible, could discourage further facilities build-out, and could seriously undermine our international telecommunications policies.

Under one suggestion, the Commission implies that it would classify providers of phone-to-phone IP telephony as telecommunications carriers. Such a regulatory framework is not only artificial and fragile, but also exposes the futility of assessing fees on specific Internet content. Because this framework would be inconsistent with current treatment of similar services, consumers and industry quickly would develop methods to avoid any new fees.

In the first place, the Commission's definitions of "phone-to-phone" IP telephony (which would be subject to the tax) and "computer-to-computer" IP telephony (which would go tax-free) beg the question: what is a phone and what is a computer? On one hand, the FCC suggests that the key criterion would be transparency to the consumer: if a consumer believes he is using a phone and making a phone call, then it's a phone and he's making a phone call. This analysis ignores, however, the fact that devices that look and function like telephones already are capable of converting voice to IP packets; a conversion that, under the FCC's proposed framework, would make these devices "computers." In essence, these new "phones" are computers on the inside. But it is absurd to impute to consumers knowledge of the technology inside CPE. Consumers buy for function, not internal technology.

At base, the Commission's analysis hinges on *where* the conversion to IP packets takes place. Neither can this construct withstand close scrutiny. A "conversion" already occurs in ordinary phones: sound energy is converted into electrical energy. In most phones, the signal exiting the phone varies analogously to variations in the input sound. In ISDN phones, the signal is further converted from an analog electrical signal into a PCM encoded digital bit stream before being sent to the network. As noted above, it would be a trivial technical matter for a new breed of phones to convert the analog signals to IP packets, instead of a PCM encoded digital bit stream. Such phones could look like and, for the consumer, behave exactly like ordinary ISDN telephones. Under the FCC's definition, however, these new IP packet devices would be "computers."

Thus, if it emits a PCM encoded digital bit stream, it's a phone and it's taxed; if it emits a stream of IP digital packets, it's a computer and it's not taxed.

The results of rules based on this framework are easy to predict. A new market for IP phones will spring up and replace today's phone-to-phone IP telephony service, which relies on remote "gateways" to make the voice-to-IP conversion. The proposed rules simply would force the conversion to IP packets further out in the network, from a limited number of gateways to all CPE.

Are these results inherently bad? Perhaps not, if they had been reached through consumer choice in the market. Consumers simply would have spoken in favor of distributed IP protocol conversion in much the same way they spoke in favor of distributed computing a decade ago. But in this case, arbitrary FCC policy and regulatory fiat, not consumer choice, would control.

The majority also suggests that the FCC might require universal service contributions from ISPs that build their own backbone facilities. The Commission, however, has questionable statutory authority to reach this result. The Act says that only "telecommunications carriers" or "other providers of interstate telecommunications" may be required to contribute, but ISPs -- which are not carriers -- are not in the business of selling telecommunications capabilities to third parties and, thus, it is difficult to understand how they could be required to contribute.

From an international telecommunications perspective, assessing specific telecommunications service fees on IP telephony would have severe consequences for our international policy and market goals. Not only would we invite burdensome Internet regulation from all over the world, we would destroy our most powerful weapon against excessive settlement rates.

For over a year now, the United States has made it a matter of national policy to encourage other nations to eschew Internet regulation and taxation. Ira Magaziner, on behalf of President Clinton, won broad bipartisan support for the report in which he concluded that the Internet should remain free of such burdens. To introduce our own form of Internet regulation and fees at this point would be the height of hypocrisy and would set a terrible precedent for other countries to follow.

Almost immediately, IP telephony would be eliminated as a competitor to foreign telecommunications monopolies that hold international settlement rates so high in so many countries. Like international call-back, IP telephony could have drive down costs much faster than inter-government negotiations and would have been perhaps the best lever to bring rates down to benchmark levels. The United States sends billions of dollars abroad as a result of unfavorable international settlement rates. IP telephony could save American rate-payers billions of dollars, possibly a significant portion of the size of a federal universal service fund.

In sum, serious issues have been raised regarding the impact that Internet applications have on public policy regulation that should be explored more fully. But the majority's plans for IP telephony regulation would not be technically feasible, and would have a serious detrimental effect on our international telecommunications agenda. Similarly unfounded, the majority's plan to assess fees on the self-provisioning of capacity would discourage transmission capacity build-out and would cause administrative burdens. I am concerned that what motivates the majority to these conclusions is a desire to prevent industries from "escaping their obligations" to be regulated. Majority Report, at 4. As I have indicated elsewhere, concerns of competitive neutrality should urge us to further deregulate the burdened industries already before us. This report is not a call for this agency to slap its old regulations on new technologies but, rather -- as a matter of utmost urgency -- to reevaluate seriously its universal service policies to meet all legal, policy, and technical requirements.

II. IN ESTABLISHING THE CURRENT UNIVERSAL SERVICE STRUCTURE, THE COMMISSION HAS FAILED TO MEET ITS STATUTORY MANDATE AND HAS EXCEEDED ITS LEGAL AUTHORITY.

Under the 1996 Act, the Commission's primary universal service responsibility was to establish an explicit and sufficient universal service fund for rural America. The Commission's failure to establish such a fund while creating a complex administrative structure for the schools and libraries and rural health care programs violated the Act's clear

focus and intent. Moreover, the Commission exceeded its legal authority by creating the Schools and Libraries and Rural Health Care Corporations.

A. In their zeal to implement a new universal service program for schools and libraries, the Commission failed to meet its statutory mandate of developing an explicit and sufficient support system for rural and high cost telephone users in a timely manner.

Under the 1996 Act, the Commission's primary universal service responsibility was to develop an "explicit and sufficient" support system that would ensure support for local telephone users in high cost and rural areas to replace the complex system of implicit subsidies that could exist in a world without local competition.⁷ The expeditious creation of a new subsidy system was not only critical for preserving the goals of universal service, but also necessary to provide for a fair transition to competition in the local markets. As such, Congress set a strict time-frame for developing this plan -- the Joint Board was required to make a recommendation within 9 months of enactment, and the Commission was then required to complete its "proceeding to implement the recommendations" within 15 months after enactment.⁸

Despite this strict timetable, the Commission decided it needed further time to address this aspect of universal service. The Commission needed more time to develop complex models and complicated plans to provide federal support, postponing until January 1, 1999, the start of any new subsidy system. In so doing, the Commission also failed to make explicit all implicit support. Indeed, in this proceeding, the majority now refer to the Commission's somewhat arbitrary decision to provide federal support for only 25% of costs as merely a "placeholder" and announce their intention to initiate a new proceeding, seeking additional proposals and comments on alternatives to the 25/75 high cost regime. I support the Commission's acknowledgement that this placeholder, and the accompanying complex modeling process in which we have been engaged, is not tenable. I also support reexamining these issues. But I fault the majority for failing to acknowledge that the prior Commission's adoption of this mere "placeholder" and the ensuing commitment of this Commission to continue to work with the states to develop a plan and our openness to new options more than two years after the passage of the Act was not what Congress envisioned or required. Rather, Congress intended -- and the 1996 Act required -- the Commission to focus their efforts on resolving this problem *first*, as opposed to finding sufficient support for new programs.

⁷ See 47 USC 254(e) (establishing that universal service support devised by the Commission "should be explicit and sufficient to achieve the purposes of this section.")

⁸ 47 USC section 254(a)(2).

Indeed, this problem has only been made worse by the Commission's emphasis on other pieces of the universal service puzzle. It would be bad enough if the FCC had simply failed to address all universal service issues in the time frame required by Congress. But instead, the Commission has addressed some universal service issues but not others, and certainly not the pieces of universal service that were of primary concern to Congress. For example, the Commission has earmarked \$2.25 billion for the new schools and libraries program and has ensured that that program start at the "earliest feasible date."⁹ In contrast, the FCC has yet to finalize new rules addressing the larger and more complicated universal service program for all high-cost areas.

By implementing these entirely new programs before establishing the explicit support mechanisms, the Commission has increased the pressure on the current implicit subsidy system without justification. I believe that the Commission's desire to establish the schools and libraries program, but not the other aspects of universal service, as quickly as possible was at best arbitrary. While having certain political benefits, it was certainly not what the 1996 Act required or what Congress intended.

In effect, I believe that the Commission may have "put the cart before the horse" by failing to address the rural, high cost issues in a timely manner. The failure of the Commission to address these high cost issues may also have adverse market effects. By failing to make all subsidies explicit, the Commission continues to hinder the development of local competition. Moreover, to the extent that competition in the local markets erodes the implicit state subsidies prior to the Commission implementing a final universal service fund, it will place unintended additional pressure on some local rates.

In that vein, I also remain concerned that some of the actions that the Commission has taken have not only failed to address the rural, high cost issues, but may have may have threatened the integrity of the high cost fund. In responding to the first two quarters contribution rates, I objected to the Commission's continued failure to take into account the reality of uncollectibles. Since the first of the year, the Universal Service Administrative Company ("USAC") has had difficulty collecting all of its billed amounts for universal service. In a memorandum to the USAC Board of Directors dated February 24, 1998, Ed English, USAC Secretary and Treasurer estimated that, based on collections received through February 23, 1998, there was a shortfall for the high cost fund distribution to be made on Friday, February 27, 1998, in excess of \$10,000,000.¹⁰ This shortfall was primarily due to some instances of nonpayment and the Common Carrier Bureau's decision last December to reduce the estimate of uncollectibles to zero. USAC originally recommended, and the contribution factors initially set forth in the Common Carrier Bureau's November 13 Public

⁹ Chairman Kennard's response to Chairman Bliley, December 3, 1997.

¹⁰ Later estimates placed the shortfall for the high cost fund at closer to \$5 million.

Notice included, an adjustment for possible uncollectible contributions. Such a minor adjustment was reasonable for these new programs. The final Order released December 16, 1997, however, included no adjustments for uncollectibles. Despite the fact that the First Quarter has had total uncollectibles in excess of \$12 million, the Bureau's Second Quarter recommendations followed the December First Quarter Order that expressly "includ[ed] no adjustments for uncollectibles."

Why would the Commission continue with this fallacy of 0% uncollectibles? Because the reduction of uncollectibles to zero was part of a larger scheme by the Commission to "reduce the [universal service] charges after the carriers said the fee could lead to higher rates and after AT&T and MCI threatened to specify the charge on the bills they send to customers."¹¹ I am concerned that, in the Commission's zeal to implement the schools and libraries program on January 1, 1998, despite specific Congressional requests that we delay commencement until the impact of our actions could be more fully assessed, the Commission has taken actions that have adversely impacted the high cost fund.

In conclusion, I would agree with one recent commentator who observed, that, the Commission "should set a majority of the universal service funds aside for furnishing basic telephone service to areas of high cost and poverty. It is more important for all Americans to have access to basic telephone services than for a student to have limited Internet capabilities."¹²

B. The Commission exceeded its legal authority and the intent of Congress by creating the Schools and Libraries and Rural Health Care Corporations.

On February 10th, 1997 in response to a request from Senator Stevens, the General Accounting Office ("GAO") released an analysis of the Commission's actions in establishing the Schools and Libraries and Rural Health Care Corporations.¹³ GAO concluded that the Commission lacked the statutory authority to create these corporations and that, by requiring NECA to establish these corporations without specific statutory authority, the Commission violated the procedural requirements of the Government Corporation Control Act.

The Government Corporation Control Act requires that agencies have specific legislative authority in order to "establish or acquire" a corporation to act as an agent. The

¹¹ *Fund to Aid Technology in Schools Facing Big FCC Cuts*, New York Times, December 15, 1997 at D-1.

¹² Christine Mason, "Universal Service in the Schools: One Step too Far?" 50 Fed. Comm. L. J. 1, at 252 (1997).

¹³ Letter from Robert P. Murphey, General Counsel, United States General Accounting Office, to The Honorable Ted Stevens, United States Senate, February 10, 1998. ("GAO Report")

purpose of this requirement was to restrict the creation of all government-controlled, policy-implementing corporations.¹⁴ According to GAO, the legislative history indicates that Congress was attempting to make all such corporations more accountable.¹⁵

There can be little doubt that the schools and libraries and rural health care entities act as agents for and at the direction of the Commission. The Commission ordered that these entities be created and established their specific purpose; the Chairman of the Commission selects or approves the entities' boards of directors; the size and composition of the board and the terms of office for its members are set by the Commission; the FCC Chairman must approve the removal of any director as well as a resolution to dissolve the corporations; the CEO must be approved by the Chairman; and the authority to enter into contracts must be in compliance with Commission rules.

The Commission unsuccessfully attempted to persuade GAO that it did not actually create these corporations, but merely directed another entity to do so pursuant to its general authority under section 4(i) of the Act. As GAO concluded, however, "the Control Act's requirements cannot be avoided by directing another entity to act as incorporator."¹⁶ Moreover, I would point out that it is this type of expansive reading of section 4(i) that seems to lead this Commission astray from its clear statutory duties and limitations. If section 4(i) provided such a general exemption from the Control Act, then what limitations on the Commission's authority would the Control Act provide -- or could the Commission merely delegate any of its functions to a separate corporation without explicit Congressional approval?

Finally, GAO also noted that, as private corporations, these entities are not subject to the types of federal obligations imposed on other entities in such areas as employment practices, procurement and contracting, lobbying and political activities, ethics, and the disclosure of public information. If these entities had been authorized by statute, Congress would have had the opportunity to specify which federal laws should apply. But, without such an opportunity, Congress has no direct oversight over these corporations.¹⁷ It was just

¹⁴ *Lebron v. National Railroad Passenger Corporation*, 513 US 374 (1995).

¹⁵ GAO Report at 6-7.

¹⁶ Statement of Robert Murphey, General Counsel of GAO, Before the Subcommittee on Telecommunications, Trade and consumer Protection, Committee on Commerce, House of Representatives, March 31, 1998.

¹⁷ It is also unclear to what extent the Commission even has direct oversight over these corporations. For example, in response to questions before the House Telecommunications Subcommittee, it was unclear whether or not the Commission had authority to approve -- and also disapprove -- of these entities budgets including the salaries of specific positions. See Transcript of Hearing before the Telecommunications, Trade, and

this type of lack of accountability that lead Congress to enact the Control Act. Recently, the House Judiciary Committee also expressed its concerns about whether the corporations were established legally, and whether the administration of these programs "raises questions of accountability."¹⁸

In addition, a revised administrative structure would be administratively more efficient. In the most recent Public Notice announcing the Second Quarter contribution factors, the Commission also released the administrative expenses proposed by the USAC, the Schools and Libraries Corporation ("SLC") and the Rural Health Care Corporation ("RHCC"). In objecting to the December Contribution Order, I noted that in the first quarter SLC and RHCC "were each allocated more than twice as much money to administer certain aspects of those support mechanisms than is allocated to administer the substantially larger high cost fund." In the current Notice, this disparity continues to grow, with the SLC being allocated almost four times as much money for administrative expenses. Indeed, the SLC's administrative budget increases from \$2.7 million to \$4.4 million or by 65% in just one quarter. This change is the equivalent of an additional \$18,000 every day for the next 90 days. I cannot endorse this disparity, or this magnitude, while knowing that many members of Congress are equally concerned with high cost areas as with schools and libraries and rural health care.

In conclusion, I believe that the Commission should have acknowledged already these problems with its current administrative structure and moved to restructure the administration of universal service to comply with the law.

C. To the extent that the universal service program is requiring contributions based on telecommunications service revenues but using the funds raised to provide support for non-telecommunications services (i.e. inside wiring and internet services), the Commission has established a fee to promote the general welfare (i.e. a "tax") and in so doing has exceeded its legal authority.

I am concerned that the universal service contributions, at least to the extent they are providing support for non-telecommunications services, may not even be fairly characterized as mere "fees." In general, taxes can be distinguished from administrative fees by the determining who is the recipient of the ultimate benefit. Taxes are levied in disregard of the benefits they may bestow on the taxpayer. As the Supreme Court has held, and the D.C. Circuit has further explained, a "fee" is a payment "incident to a voluntary act, *e.g.*, a request that a public agency permit an applicant to practice law or medicine or construct a

Consumer Protection Subcommittee of the House Committee on Commerce, March 31, 1998.

¹⁸ Letter from Members of the Judiciary Committee's Subcommittee on Commercial and Administrative Law to Chairman Bliley, March 31, 1998.

house or run a broadcast station. The public agency performing those services normally may exact a fee for a grant which, presumably, bestows a benefit on the applicant, not shared by other members of society."¹⁹

To the extent that the telephone network can be considered a single telecommunications system, all users benefit from that system being capable of serving others. What good is it to be able to make calls if no one can receive them? There are no such direct benefits to telephone customers, however, from the provision of Internet services to and inside wiring of schools and libraries. With respect to the schools and libraries program, the funds raised may be used to support general services that are not classified as telecommunications. Given the lack of a *quid pro quo* between the service providers and the Government in the context of universal service, there may not be a "sufficient nexus between the agency service for which the fee is charged and the individuals who are assessed."²⁰ In addition, these contributions do not meet the traditional definition of a fee because they are premised not on the use of some identifiable government service but rather purely on ability to pay. According to the Supreme Court, taxation is marked by the calculation of liability "solely on ability to pay, based on property or income."²¹ Here, of course, the contribution amounts are based *entirely* on revenues. In addition, because they are not related to any benefits conferred, they carry the Commission "far from its customary orbit and puts it in search of revenue in the manner of an Appropriations Committee of the House."²²

The Supreme Court has stated that only Congress may levy taxes.²³ I agree with the concerns recently expressed by several members of the House Judiciary Committee that

¹⁹ *National Cable TV Ass'n v. United States*, 415 U.S. 336, 340-41 (1974)(construing Independent Offices Appropriations Act); *see also National Cable TV Ass'n v. FCC*, 554 F.2d 1094, 1106 & n.42 (D.C. Cir. 1976) ("A 'fee' is a payment for a special privilege or service rendered, and not a revenue measure.") (citing cases).

²⁰ *National Cable TV Ass'n v. FCC*, 554 F.2d at 1104.

²¹ *National Cable TV Ass'n v. United States*, 415 U.S. at 340; *see also National Cable TV Ass'n v. FCC*, 554 F.2d at 1107 ("[A] fee, in order not to be a tax, cannot be justified by the revenues received. . . .").

²² *National Cable TV Ass'n v. United States*, 415 U.S. at 341.

²³ *See National Cable TV v. United States*, 415 U.S. at 340 ("Taxation is a legislative function, and Congress . . . is the sole organ for levying taxes."); *see also Air Transport Ass'n of America v. Civil Aeronautics Board*, 732 F.2d 219, 220 (D.C. Cir. 1984)("[T]axes . . . generally may be levied only by Congress.").

Congress retain "direct authority over and responsibility for any tax burden on the public."²⁴

III. THE COMMISSION ERRED BY ALLOWING UNIVERSAL SERVICE SUPPORT TO BE PROVIDED FOR NON-TELECOMMUNICATIONS SERVICES AND TO NON-TELECOMMUNICATIONS CARRIERS.

The majority's opinion affirms the prior Commission's finding that, under the Act, direct financial support can be provided for non-telecommunications services, such as inside wiring and Internet service. Such an interpretation is at odds with the clear reading of the statute. The 1996 Act defines universal service in general as "an evolving level of *telecommunications services*."²⁵ Although subsection c(3) does allow the Commission to designate additional special services for support to schools and libraries, that provision is still limited by the overriding definition of c(1). Moreover, subsection c(3) expressly limits these additional designations as only applicable "for the purposes of subsection (h)."²⁶ As subsection (h) is itself entitled "Telecommunications Services For Certain Providers,"²⁷ the Act's intention to limit universal service discounts to some form of telecommunications service seems self-evident.²⁸ In addition, one of the fundamental principles that Congress identified as necessary for the preservation of universal service was "Access to Advanced Telecommunications Services for Schools, Health Care, and Libraries."²⁹ Thus the clearest reading of the statute is that Congress intended that the subsequent reference to "services" in section 254(c)(3) refers to the general reference to "telecommunications service" in b(6), c(1) and (h).³⁰

²⁴ Letter from Members of the Judiciary Committee's Subcommittee on Commercial and Administrative Law to Chairman Bliley, March 31, 1998.

²⁵ 47 USC 254(c)(1) (emphasis added).

²⁶ 47 USC section 254(c)(3).

²⁷ 47 USC section 254(h).

²⁸ *See, United States v. Wallington*, 889 F.2d 573, 577 (5th Cir. 1989) ("section heading enacted by Congress in conjunction with statutory text is considered to 'come up with the statute's clear and total meaning.'") (citations omitted).

²⁹ 47 USC section 254(b)(6).

³⁰ *See also*, 47 USC 254(c)(1) ("The Joint Board in recommending, and the Commission in establishing, the definition of the *services* that are supported by Federal universal service support mechanisms shall consider the extent to which *such telecommunications services* . . .")

I acknowledge that the definition of universal service for schools and libraries is broader pursuant to section c(3) than for other aspects of universal service. But even this broader definition must still come within the rubric of *telecommunications* services. Thus, for example, the Commission could designate ISDN lines or other types of advanced telecommunications facilities that include expanded bandwidth as a telecommunications service that would not qualify for general universal service support, but might come within the special telecommunications services contemplated by Congress for schools and libraries under section (c)(3).

In addition, limiting the Commission's discount program to telecommunications services is consistent with Commission regulatory precedent. Internal connections are owned and maintained by the customer -- the telecommunications carrier is not responsible for them. The Commission has previously indicated that such internal connections are not telecommunications services and deregulated these facilities -- including their purchase, installation, and maintenance.³¹ Similarly, as I discussed earlier, Internet access has been traditionally treated as an information service by the Commission.

Similarly, the Commission erred by allowing non-telecommunications carrier to receive support payments from the discount program established under sections 254(h)(1)(B) and 254(h)(2). The Commission's decision violates the plain language of the statute. Section 254(h)(1)(B) unambiguously states that "a telecommunications carrier providing service under this paragraph shall . . ." offset the discount from their universal service contribution obligation or receive reimbursement.³² Thus, Congress expressly specified that only telecommunications carriers could receive support for providing discounted services to schools and libraries. Some have argued that not allowing other entities who can provide a similar service to receive support is inequitable. Congress explicitly adopted this distinction, however, and for good reason -- because Congress only obligated telecommunications providers to contribute to the discounted service program in the first place.

The majority also argues that the competitive neutrality demands of 254(h)(2), along with section 4(i), require that the Commission allow non-telecommunications carriers to receive support. There are several problems with this argument. First, typical statutory construction requires that specific directions in a statute trump any general admonitions. Section 254(h)(1)(B) expressly limits recipients of the schools and libraries fund to telecommunications carriers, and as it is more specific than 254(h)(2) it direction should take precedence. In addition, the provisions of section 254(e) -- which require that only eligible

³¹ See, *Detariffing Customer Premises Equipment and Customer Provided Cable/Wiring*, 48 Fed. Reg. 50534 (FCC 1983); *Detariffing and the Installation and Maintenance of Inside Wiring*, 51 Fed. Reg. 8498 (FCC 1986), recon. 3 FCC Rcd. 1719 (1988). See also, *NARUC v. FCC*, 880 f.2d 422 (D.C. Cir. 1989).

³² 47 USC section 254 (h)(1)(B).

telecommunications carriers be able to receive federal universal service support -- apply fully to section 254(h)(2). Thus, the requirements for being able to receive funds in conjunction with section 254(h)(2) are actually stricter -- a recipient would have to be designated an eligible telecommunications carrier.

In addition, the majority argues that reading section 254(e) to limit section 254(h)(2), when it does not apply to section 254(h)(1)(B), appears inconsistent with the relative directives of those provisions. The majority further argues that to "allow support for Internet access and internal connections only when provided by a telecommunications carrier would reduce the sources from which schools and libraries could obtain these services at a discount." However, the majority's entire competitive neutrality argument is built upon a misreading of section 254(h)(2)(a)'s mandate. That provision permits the Commission to establish competitively neutral rules "to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services."³³ It does not provide for an explicit discount program like the one envisioned in section 254(h)(1)(B). Indeed, if both provisions were meant to establish a single discount program for both telecommunications and non-telecommunications providers for telecommunications and non-telecommunications services, Congress would not have differentiated between the two. Instead, Congress specifically provided for something less than a discount program -- competitively neutral rules for enhanced *access* -- in section 254(h)(2)(A).

IV. IN ESTABLISHING THE REVENUE BASE FOR CONTRIBUTIONS TO THE UNIVERSAL SERVICE FUND AND DICTATING THE DISCOUNT RATE, THE COMMISSION IMPERMISSIBLY ENCROACHED ON STATES' RIGHTS AND OBLIGATIONS.

Section 2(b) of the Communications Act creates a system of dual federal-state regulation for telecommunications. In essence, the Act establishes federal authority over interstate communications services while protecting state jurisdiction over intrastate services. I believe that the Commission's decision to look to *intrastate* revenues to determine federal universal service support and to establish a minimum discount for *intrastate* telecommunications services for schools and libraries impermissibly encroaches on state's rights and violates the Act's federal-state dichotomy.

- A. The Commission erred in assessing contributions to the schools and libraries and rural health care programs based on intrastate revenues because any federal assessment on intrastate revenues is beyond the Commission's authority.

I object to the majority's decision to endorse the disparate funding of schools and libraries over the high cost fund. I cannot support the fact that the contributions for the

³³

47 USC section 254(h)(2)(A).

schools, libraries, and rural health care support mechanisms are based not only on *interstate* but also on *intrastate* revenues. The legality of this approach to calculating contributions is highly questionable. As I read the Communications Act, it does not permit the Commission to assess contributions for universal service support mechanisms based on intrastate revenues. Rather, the Act makes clear that charges based on such revenues are within the exclusive province of the States.

In the Communications Act, Congress explicitly set forth a jurisdictional principle to govern its application. Section 2(b) of the Act provides that "*nothing* in this Act shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier."³⁴ The Supreme Court has explained that by this section the Act "not only imposes jurisdictional limits on the power of a federal agency, but also . . . provides its own rule of statutory construction."³⁵

By "fenc[ing] off from FCC reach or regulation intrastate matters,"³⁶ section 2(b) works, together with other provisions, to establish the Act's system of dual federal-state regulation for telecommunications. In essence, the Act creates federal authority over interstate communications services while protecting state jurisdiction over intrastate services.³⁷ To be sure, there are exceptions to section 2(b)'s jurisdictional limitation.³⁸ These exceptions are explicit. Section 254, however, is not included in that group and nothing else in the Act exempts section 254 from the operations of 2(b).³⁹ The statutory prohibition against federal jurisdiction over intrastate communications thus fully applies to

³⁴ 47 U.S.C. section 152(b)(emphasis added).

³⁵ *Louisiana PSC v. FCC*, 476 U.S. 355, 377 n.5 (1986).

³⁶ *Id.* at 370.

³⁷ *See id.*, at 359 (internal citations omitted) ("[T]he Act grants to the FCC the authority to regulate 'interstate and foreign commerce in wire and radio communication' while expressly denying that agency 'jurisdiction with respect to . . . intrastate communications service.'").

³⁸ *See* 47 U.S.C. section 152(b) ("Except as provided in sections 223 through 227, inclusive, and section 332, and subject to the provisions of section 301 and title VI . . .").

³⁹ In fact, as the dissenting state members of the Joint Board explained, Congress considered and rejected language that would have added section 254 and neighboring provisions to the list of exceptions to 2(b). *See* Dissenting Statement of Commissioners Kenneth McClure, Missouri Public Service Commission and Laska Schoenfelder, South Dakota Public Utilities Commission, April 21, 1997, at 2.

section 254.

The Supreme Court has squarely held that the specific limit on the Commission's jurisdiction contained in section 2(b) trumps other parts of the Act that confer undifferentiated grants of substantive authority to the Commission. In *Louisiana PSC v. FCC*, the Commission argued that, notwithstanding section 2(b), it could require states to follow federal depreciation rules for purposes of intrastate ratemaking because section 220 authorized the Commission to set depreciation rates and did not expressly prohibit the application of such rates to intrastate pricing.

The Court disagreed. It ruled that the Commission was powerless to extend its rules into the intrastate context: "While it is, no doubt, possible to find some support in the broad language of the [depreciation provision] for [the Commission's] position, we do not find the meaning of the section so unambiguous or straightforward as to override the command of section 152(b) that 'nothing in this chapter shall be construed to apply to or give the Commission jurisdiction' over intrastate service."⁴⁰

The analogy to this situation is clear. Just as section 220's general grant of authority over depreciation rates did not empower the Commission to regulate intrastate aspects of depreciation, neither does section 254's authorization to establish a universal service fund allow the Commission to assert jurisdiction over intrastate revenues in implementing that fund. In short, it is irrelevant, under *Louisiana PSC*, that section 254 does not itself forbid the Commission from reaching into matters relating to intrastate service. That is why Congress included section 2(b) in the Act.

Nothing in section 254 of the Act, the provision that deals with the substance of universal service, trumps the express limitation on the Commission's authority in section 2(b). Quite the contrary, section 254 replicates the general scheme of dual federal-state power that characterizes the Act as a whole.

Section 254(d) speaks to federal authority over universal service, authorizing the Commission to establish a federal universal service fund subsidized by interstate carriers: "Every telecommunications carrier that provides interstate telecommunications services shall contribute on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."⁴¹ Section 254(f), in turn, addresses the role of the states in universal service. It carefully preserves state authority to create support mechanisms not inconsistent with any federal program and leaves to the states the regulation of intrastate carriers: "Every telecommunications carrier that provides intrastate telecommunications services shall

⁴⁰ *Louisiana PSC v. FCC*, 476 U.S. at 377.

⁴¹ 47 U.S.C. section 254(d).

contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State."⁴² Both the language and the structure of sections 254(d) and 254(f) clearly indicate that Congress intended that both federal and state governments have complementary, but separate, roles in providing universal service.

This view of dual federal and state roles is further supported by section 254(h). That provision expressly provides states with the responsibility of determining the rates schools and libraries would pay for discounted *intrastate* services: "The discount shall be an amount that the Commission, with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities."⁴³ Section 254(h) provides no specific authority to overturn section 2(b)'s general federal-state division; nor does it contemplate a separate federal fund that draws on intrastate revenue. Rather, 254(h) indicates that Congress envisioned a separate state fund, which must draw on intrastate revenues, to provide the discounted rates for intrastate telecommunications services to schools and libraries.⁴⁴

Nowhere in section 254 did Congress require carriers providing intrastate services to contribute to any federal support mechanism. Thus, section 254, read in light of the express directive of section 2(b), precludes the Commission from asserting jurisdiction over revenues based on intrastate activities. Although section 254 does not explicitly prohibit the Commission from calculating the contributions of interstate service providers based on intrastate revenues, such a practice would undermine the dual scheme established in section 254 and, in any event, violate section 2(b).

The assertion of federal authority over intrastate revenues impinges upon the states' ability to establish their own universal service funds, which Congress expressly provided for in section 254(f) and envisioned in Section 254(h). If the federal government has first rights to intrastate revenues, there will be a smaller pool of resources for the states to draw upon in establishing their own universal service programs. Although in theory federal and state regulatory bodies could tax away all intrastate revenues in order to support universal service, the reality is that the amount of intrastate revenue that can be allocated for this purpose is limited. When Congress went to the trouble to authorize state universal service plans, it clearly meant for those plans to be fiscally viable and, therefore, to have an independent funding base.

⁴² *Id.* section 254(f).

⁴³ 47 U.S.C. section 254(h).

⁴⁴Section 254(k) similarly provides an express division of authority between "the Commission, with respect to interstate services, and the States, with respect to intrastate services" regarding cost allocation rules and accounting safeguards. 47 U.S.C. section 254(k).