Conversely, as long as the federal program applies to intrastate revenues, any state plan that relies on that source of funding would violate section 254(f). That section requires that state plans cannot "rely on or burden federal universal service mechanisms." Surely Congress did not mean to prohibit states from drawing on intrastate revenue; indeed, they expressly authorized it in Section 254(f). But as long as there is overlap between funding sources for federal and state service plans, any state plan interferes with one of the federal sources of revenue, thus "burdening" the federal mechanisms. Limiting the Commission to interstate revenues and eliminating the overlap, however, solves this problem.

Apart from undermining the purpose of section 254 to allow for viable state plans that complement federal universal service efforts, as described above, the Commission's exercise of jurisdiction over intrastate revenues contravenes the plain language of section 2(b).

B. The Commission's decision to assess contributions to the schools and libraries and rural health care programs based on intrastate revenues, but allow recovery only on interstate services, is also in error as it fails to meet the Commission's mandate of equity and nondiscrimination.

In addition, I believe that the manner in which the FCC has implemented these provisions violates the statutory requirement that the funding mechanisms for universal service be equitable and nondiscriminatory. Section 254(b)(4) embodies the general principle that contributions to universal service must be equitable and nondiscriminatory. But the federal assessment of intrastate revenues creates a competitive disadvantage for interstate telecommunications carriers that provide intrastate services. It does so in two ways.

First, these carriers also compete, in local markets, against purely intrastate carriers. The interstate carriers, however, are forced to pay more in universal service fees because they have federal obligations that their intrastate competitors do not. As the dissenting state members of the Joint Board explained, "a carrier with intrastate revenues of a billion dollars a year would be subject to no federal USF assessment at all, while a carrier with $999,999,999.00 of intrastate revenue and one dollar of interstate revenue would be subject to assessment for the whole billion dollars of its revenue."[45]

In addition, the carriers that have both interstate and intrastate revenues are also at a competitive disadvantage vis-a-vis their purely interstate competitors. While the Commission bases the universal service contribution on both interstate and intrastate revenues, it limits a carrier to recovering the entire contribution through interstate revenues. As it has no jurisdiction over intrastate rates, the Commission cannot ensure that carriers would be able to recover the intrastate portion of the contribution in their intrastate rates. Thus, a carrier is

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[45] Dissenting Statement of Commissioners Kenneth McClure, Missouri Public Service Commission and Laska Schoenfelder, South Dakota Public Utilities Commission, April 21, 1997.

required to recover assessments on its intrastate revenues in its prices for interstate services. This recovery mechanism discriminates against carriers who derive a significant amount of their revenues from intrastate activities, as their recovery rates for interstate services would be higher than their purely interstate counterparts.

Thus, the scheme that the FCC has established adversely effects the ability of interstate providers of intrastate services to compete with purely intrastate providers and with purely interstate providers. Such disparities cannot meet the section 254 requirements that contributions to universal service be equitable and nondiscriminatory.

In conclusion, I reiterate my support for the need to find funding sufficient to support the federal universal service fund. I recognize that respecting State authority over intrastate revenues may make this responsibility more difficult; the ends, however, cannot justify the means.

C. The Commission impermissibly encroached on the rights of states to set discounts for intrastate telecommunications services.

Section 251(h)(1)(B) unambiguously places the role of establishing discounts for eligible intrastate telecommunications services in the hands of the states:

> The discount shall be an amount that . . . 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.[46]

Congress plainly envisioned the continued federal-state jurisdictional divide embodied in section 2(b) to be followed in establishing discount rates for telecommunications services to schools and libraries. Never the less, the Commission has mandated a particular discount that states are required to adopt.

In the May 7, 1997, Order, the previous Commission required "states to establish intrastate discounts at least equal to the discounts on interstate services as a condition of federal universal service support for schools and libraries in that state."[47] Section 254 does not provide this Commission with such express authority. Indeed, the explicit language of the statute reserves this authority to the states. Moreover, such a reservation of state authority to establish intrastate discounts is the best policy, for it is the states, not Washington bureaucrats, who are in the best position to determine what discounts are needed to address each state's educational needs and goals.

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46 47 U.S.C. section 251(h)(1)(B).

47 Universal Service Order at Para. 550.

I believe the previous Commission acted illegally in coercing states into adopting a federal discount schedule and would have redressed that issue here. I would favor allowing states to exercise the authority Congress clearly provided to them.

V. THE COMMISSION ERRED IN ESTABLISHING A PROCESS THAT INEVITABLY LED TO THE ISSUE OF A 25/75 SPLIT FOR THE PERCENTAGE OF FEDERAL FUNDING.

Neither Section 254 nor Section 214 requires the Commission to establish a national cost model for high-cost support. Such a model inescapably invites the question of who should cover those costs: local customers, state universal service mechanisms, or federal universal service mechanisms. As long as a national cost model remains the central analytical tool for high-cost support under Section 254, disputes will arise about responsibilities for covering those costs. Any allocation of those costs to the federal government not covered by local consumers is inherently arbitrary, whether 25 percent, 100 percent, or 0 percent.

These allocation disputes are in addition to the unending debate about whether and what form of forward-looking cost assumptions to use. Costs models are simply estimates and approximations of actual costs. Cost models are useful tools for many purposes, but I am deeply concerned about relying on such models as the primary, if not only, basis to allocate federal universal service funds. Models may approximate accurately the costs of service for the vast majority of Americans, but approximate poorly for Americans living in unusual, low-density, geographic areas. Yet it is precisely the unusual circumstances -- the tundra of Alaska, the bayous of Louisiana, the remote reaches of Montana and North Dakota, -- that may most likely require universal service support.

A better starting basis for federal high-cost, universal support may well be past specific federal universal support. Past support may not have been perfect or efficient; indeed, it may well have been arbitrary. But past support has, in its own way, worked quietly and well. The current Commission order starts with past support as a safety net, but only for a few years after which all carriers are to be placed on a national model with all of the associated allocation disputes. Past support need not and should not last into perpetuity independent of changed circumstances of technology, markets, and competition. But carriers may reasonably seek greater certainty than is currently offered by an impending end of current support to be replaced by cost models and allocation schemes shrouded in mystery, legal risks, and financial uncertainty.

I am also concerned that the prior Commission's decision to limit federal support to 25% is insufficiently supported. As I have stated earlier, one of the guiding principles in any universal service reform is that all states should be held harmless -- *i.e.*, no state should receive less from the new universal service plan than it currently receives in support from the High Cost Fund and implicit subsidies in access charges. At least in some circumstances, however, there may be states that receive significantly higher than the 25% of federal support the Commission has committed to providing. Thus, by arbitrarily limiting the federal funding mechanism without relating it on a state-by-state basis to the amount of funds currently received, the Commission has failed to meet its statutory mandate that universal service funds be sufficient.

I believe the majority's opinion should have more fully addressed this issue. In addition, we should have made sure that states understand that this Commission does not -- and indeed in my opinion it cannot -- require them to rebalance or alter their local rates in any way prior to receiving additional federal universal service support.

Conclusion

The issuance of this report to Congress today is not the final chapter in the development of universal service. It is but an early chapter in a long book. It will take some time to correct many of the anomalies that I have addressed here. In addition, the Commission will need to work more closely with Congress and the States. Perhaps the Joint Universal Service Board needs to be reconvened to consider these issues in a timely fashion; I support the request by the state members of the Joint Board to refer at least certain designated issues back to that body for consideration. But, in whatever forum, I look forward to working with my colleagues to preserve and to advance universal service in the months and years ahead.