

Changes in Interstate Interexchange Carrier Costs
Occuring on January 1, 1998 (in Millions of Dollars)

<u>Exogenous Cost Changes</u>	<u>1/1/98</u>
Long Term Support	(493)
Universal Service Flowback	783
Reversal of Bell Atl. OB&C Overcharge Adjustment	(11)
Equal Access Expense	(33)
Revision to Facilities-Based TIC	(10)
Marketing Expense	10
Part 69 GSF Rule Change, CC Dk 96-262	(190)
Central Office Maintenance Cost	(4)
Other, including DEM Weighting Changes	(30)
Total Exogenous	22
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<u>Other Adjustments</u>	
Decline Due to Understated BFP, CC DK 97-149	(101)
Decline in IXC Charges Due to SLC Increases	(815)
PICCs	1,859
Reduction in per-minute charges due to PICCs	(1,859)
PICC Charges not paid by IXCs (Non-Pre subscribed Lines)	(90)
Use of headroom to offset PCI changes	41
Miscellaneous Effects, including Mid-Year Filings	(15)
DEM & USF Flowthrough Changes, Rate of Return LECs	(268)
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Access Charge Reduction at Base Period Demand	(1,225)
Effect of Growth in Demand to 1998 Levels*	(185)
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Additional Reductions in IXC Costs	
CC Dk 97-149 Refund (Jan. 1998)	(50)
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Total Reduction In IXC Access Costs	(1,461)
Elimination of Old High Cost Fund Payments	(980)
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Total Reduction In IXC Costs	(2,441)
New Explicit Universal Service Payments by IXCs	2,406
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Net Change in IXC Costs	(35)

*Assuming 6% annual growth in minutes of use and 4.5% growth in PICCs;
PICCs are assumed to grow somewhat faster than lines because
line growth is largely in multi-line business and non-primary lines.

May 8, 1998

**Separate Statement
of
Commissioner Susan Ness**

Re: Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579

I welcome today's opportunity for the Commission to respond to concerns that have been expressed by Congress. We have no greater responsibility, or challenge, than to implement successfully the Telecommunications Act of 1996. An active and continuing dialogue between the FCC and Congress is important to keeping implementation on track. We do our best to follow the statute as Congress wrote it, but, to the extent that we receive additional congressional guidance on ways in which our implementation decisions can be improved, I am happy to be responsive.

In particular, there have been significant congressional concerns about the administrative structures that were established to administer various universal service support mechanisms. Although I firmly believe that the structures previously established were suited to the goals of efficiency and accountability, and consistent with our statutory authority, it is clear that Congress believes the job can be done better if, at a minimum, the Schools and Library Corporation and the Rural Health Care Corporation are combined in a single entity. I believe we should follow this guidance and that the best way to do so probably is to fold both SLC and RHCC into the Universal Service Administrative Corporation.

A final decision, of course, should await the development of a specific proposal, the opportunity for deliberations by the Commission and the state members of the Federal-State Joint Board on universal service, and confirmation from Congress that the revised structure will meet with approval. It is my sincere hope that this approach will not only receive congressional support but also meet the needs of the intended beneficiaries of the universal service provisions of the Telecommunications Act.

Similarly, if Congress has concerns about the salaries paid to the senior employees of SLC, RHCC, USAC, or NECA, then it is our responsibility to take responsive action. Funds used for administration of the high-cost, low-income, or school, library, and rural health support mechanisms necessarily diminish, to some degree, the funds that will be available for the beneficiaries of the programs. Although these corporations require capable administrators, and the boards of directors of each of these associations have made independent decisions about the salaries they pay their executives, the unambiguous wishes of Congress must be respected -- and followed.

This report also provides valuable information about the manner in which universal service support is being collected. The key point this report demonstrates is that *universal service funding for schools, libraries, and rural health care is being collected without necessitating increases in the costs of services to telecommunications consumers.* Access charge reductions, in particular, coupled with growth in the industry, declining costs, increased competition, and the elimination of deadweight losses, enable the new universal service support mechanisms to be initiated -- and the low-income and high-cost programs to be maintained -- while aggregate prices to consumers continue to *decline*. There is, to be sure, a growing amount of confusion about various line-items that are appearing on consumers' bills, and I believe we should be forceful in acting to ensure that these charges are not misleading or inappropriate. But the line on the bill that matters most is the bottom line, and that's the line we are working hardest to reduce.

I want to work with Congress to ensure that the Telecommunications Act is a resounding success. I strongly believe that Congress acted wisely in deciding to expand the traditional notion of universal service by supporting the connection of classrooms and libraries to the information superhighway. I will continue to work to ensure that this vision -- which is so crucial to our success as a nation in the 21st century -- is successfully implemented, with congressional guidance and support.

May 8, 1998

**DISSENTING STATEMENT OF COMMISSIONER
HAROLD FURCHTGOTT-ROTH**

Re: Universal Service Report to Congress in Response to Senate bill 1768 and Conference Report on HR 3579.

Introduction

I regretfully dissent from the majority's Report to Congress on universal service. I remain concerned that the Commission fails to address the underlying frustration that many members of Congress, and the general public feel, as a result of the Commission's misguided Universal Service Order last May.

As I stated only a month ago in this Commission's last report to Congress: priorities matter. I remain convinced that rural, high-cost universal service is not just one of many objectives of Section 254; it should be the *highest* priority. The federal government has had universal service programs for rural, high-cost areas and for low-income Americans for many years. Section 254 embodied these ideals and set forth goals that emphasize rural, high-cost support as well as low-income support and other objectives. Instead of such an emphasis, we have made costly promises for some services without making promises for increases in rural, high-cost programs. 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.

This Report provides another missed opportunity, and the accompanying structural changes to the Schools and Libraries Corporation that are required by it provide another reason, for the Commission to put on hold its plans to implement a far-reaching schools and libraries program until after it has finished implementing the rural, high-cost fund issues. I also object to the majority's continued refusal to allow any of the benefits of reduced access charges to actually flow to consumers. For these and other reasons explained below, I must reluctantly and respectfully dissent from the majority opinion today.

I. Public Funds Should Not Be Allocated for Schools and Libraries Until the Proposed Restructuring Has Been Completed.

The proposal for consolidating the three corporations is a good first step in reaching a more rational, efficient, and legal structure to administer universal service. I have several reservations, however, with the specifics of the proposal. First, I am concerned that the proposal merely perpetuates too much of the current bureaucracy. For example, it appears that the majority would simply fold the current Schools and Libraries and Rural Health Care Corporations into USAC in their entirety, with the new "operational units" maintaining virtual autonomy as they would have the power to bind the USAC Board regarding matters within their expertise.¹ I am concerned that the ultimate reorganization/streamlining plan obtain the benefits of economies of scale and consolidate the ultimate responsibility for universal service into one decision-maker.

The consolidation of the ultimate decision-making authority is also important for accountability. I am concerned that adequate safeguards may not have been implemented to prevent fraud and abuse. Recently, there have been complaints that some schools and libraries are basing their award of contracts on the amount of ineligible items that the bidder is willing to provide at "no cost." Such actions could encourage bidders to inflate the cost of eligible services, to provide ineligible services for free. This is the type of behavior that the Commission must ensure is not taking place prior to the disbursement of any public funds.

I also remain concerned that the majority fails to address fully the issues raised by the GAO report regarding the legality of the Commission creating these corporations without specific statutory authority. I commend the majority for seeking Congressional guidance regarding this issue. I remain convinced, however, that the Commission should explicitly acknowledge the legitimacy of GAO's conclusions regarding the legality of these corporations, and wait for Congressional approval of the revised structure prior to further expenditure of any funds. I fail to see how the Commission can direct that these corporations continue to act without first receiving the requisite authorization from Congress.

In addition, I would take this opportunity to clarify that the full Commission must take a more active role in the direct oversight of these quasi-public companies. Congress clearly favors a more efficient organization of only limited administrative functions, without the ability to "interpret the intent of Congress" or "any rule promulgated by the Commission."² Yet, the majority indicates that the revised entity might be able to apply its expertise to interpreting and applying existing "decisional principles."³ I am concerned that, while a good start, the majority does not go far enough in delineating specific means of

¹ Report at footnote 33, para. 11.

² Section 2005(b) of Senate bill 1768.

³ Report at para. 14.

ensuring full Commission involvement in all budgetary decisions and the policy-making process.⁴ As it will take some time to restructure the universal service corporations, it would be prudent and in the taxpayers interest to suspend further expenditures on schools and libraries.

II. The Excessive Funding Proposed for Schools and Libraries Will Harm Consumers and Increase Telecommunication Rates

I also object to the majority's conclusions regarding the funding that has been provided to the schools and libraries program. For the following reasons, I disagree with the majority's conclusion that the steps the Commission has taken thus far were necessary to assure that the schools and libraries funding mechanism was adequately funded and the program delivered efficiently.⁵

First, as I have stated previously, the size and scope of the current schools and libraries program is in excess of what was envisioned by Congress, and thus beyond the Commission's authority to establish. Nothing in the statute or the legislative history indicates that Congress contemplated 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.⁶

The Schools and Libraries Corporation projected that, as of May 1, 1998, \$2.02 billion in discounts has been requested by applicants. Although current Commission rules cap the program at \$2.25 billion or demand, the report indicates that the Commission will seek comment on whether the amount collected this year should equal demand or "be limited

⁴ For example, I am concerned that about the degree of oversight that is being exercised regarding administrative and start-up costs. In their latest filing, the Schools and Libraries Corporation indicates that it paid NECA \$1.86 million in start-up costs, more than three times the original estimate, and it is still not able to provide an accurate estimate of all its administrative costs for the first quarter. Third Quarter 1998 Fund Size Requirements for the Schools and Libraries universal Service Program, dated May 1, 1998.

⁵ Report 'at para. 16.

⁶ 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.

to an amount that does not cause long distance rates to increase."⁷ While I certainly agree that the Commission should not collect any revenues that would cause long distance rates to "increase," I remain frustrated that the majority assumes that any reduction in access charges should be "used" for *new* universal service programs, instead of turning any of the reductions back to consumers. Unfortunately, the majority indicates its intention to use the entire \$700 million in access charge reductions estimated for July to increase the quarterly contributions to the schools and libraries program from \$325 million to approximately \$524 million for a fund of \$1.67 billion for 1998. This amount is not only excessive but prevents consumers from receiving any of the benefits of deregulation.

Chairman Kennard's letter to Chairman Bliley, Attachment E to this Report, entirely misses this point. The issue is not whether, despite massive tax increases that just offset decreases in federal access fee and charges, IXCs have no net differences in costs. The issue is whether, absent massive new taxes, consumers would be better off. By the Bureau's own analysis, consumers are bearing \$2.4 billion in new costs in 1998 alone. How much lower might prices have been? How much more might the promise of the 1996 Act of lower prices for consumers been fulfilled? How many more businesses might have been spawned? Professor J. Hausman has estimated that consumers lose more than \$2 for every \$1 paid in taxes on long-distance services.⁸ Thus, the FCC had an opportunity to put more than \$5 billion back in the pockets of ordinary Americans. But the FCC has chosen not to.

There is implicit in the Bureau's calculations a set of new taxes that just balances a reduction in federal charges and fees. Is this balance coincidental or the artifact of a private deal between industry and the Commission? The promise of the 1996 Act was that rates would come down, not that they would remain the same as the result of secret deals in which one set of federal taxes goes down and another goes up, while citizens are none the worse for the regulatory sleight of hand. Are we left to believe that if access charges and other fees had been reduced by only \$200 million, that new universal service taxes would have been only \$200 million? Or that if fee reductions had been \$5 billion that new taxes would have been \$5 billion? Moreover, there is no assurance that the consumers who benefit from access reductions will be the same consumers who will bear the new universal service burden. For example, business consumers could disproportionately benefit from the access charge reduction while residential consumers pay for new universal service fees.

Second, I am concerned that the majority continues to use all access reductions for new universal service fees while the high-cost program has not been fully implemented. As I argued in our previous report to Congress, "the potential pot of revenue that the FCC can collect for universal service from fees on interstate services is limited." Some potential

⁷ Report at para. 23.

⁸ Jerry Hausman, "Taxation by Telecommunications Regulation," National Bureau for Economic Research, Working Paper Series 6260, November 1997.

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 (rural, high-cost programs) have voiced all of their concerns.

Third, the plan outlined in the Report not only uses every cent of access charge reduction for new universal service programs, it will actually cause an *increase* in fees for some telecommunication services. Buried in the Report is the proposition that a \$700 million reduction in access charges will yield \$848 million in additional funds for schools and libraries.⁹ How is this possible? Because the majority anticipates increasing all contribution rates equally, even though almost 20% of the schools and libraries contributors will not benefit from reduced access charges. Thus, for example, wireless carriers will be required to pay proportionately higher costs, despite the fact that they have received no access charge reduction.

Fourth, I also note that this entire dilemma has been caused, at least in part, by the Commission's misguided and unlawful decision to fund inside wiring and other non-telecommunications services. As I explained in the April 10th report to Congress, the Commission has no statutory basis to provide direct financial support for non-telecommunications services and to non-telecommunications carriers. According to the Schools and Libraries Corporations own estimates, the vast majority of the program's demand is for non-telecommunications services and facilities.¹⁰ The vast majority of demand is for funds to provide inside wiring -- what should be an ineligible facility. Indeed, the amount *already* collected this year would almost fully fund the demand for telecom services.

At a minimum, I believe the Commission should reduce the current quarterly contribution rate for schools and libraries from \$325 million to a mere \$25 million. Such a reduction would allow previous access charge reductions and those contemplated for this July to flow to consumers directly, while still providing more than sufficient funds -- \$675 million for 1998 -- to pay for *all* of the telecommunications services that have been requested by any school this year. The Commission would then have until January 1, 1999 to reevaluate the scope and scale of the schools and libraries program, while also finishing what should have been its first priority, namely, the rural and high-cost program.

In addition, I am concerned with the report's suggestion that carriers should conceal their universal service contributions from consumers. As I have stated previously, no carrier should have its billing information restricted or limited by the Commission. The Commission has explicitly provided carriers with the flexibility to decide how to recover

⁹ Footnote 73 accompanying para. 24.

¹⁰ Attachment D; total demand for telecom services is only \$655,688,020, while total demand for internet services is \$88,208,299 and total demand for internal connections is \$1,275,399,870.

their payments, including as charges on consumers bills, and I am concerned by implications that such charges are fraudulent or misrepresentations. Indeed, section 254(e) requires that funding mechanisms for universal service be explicit. Consumers have a right to know what federal charges they are paying; the Commission should not discourage companies from placing universal service charges on their bills.

Finally, I continue to believe that the Commission erred in assessing contributions to the schools and libraries and rural health care programs based on intrastate revenues. Any federal assessment on intrastate revenues is beyond the Commission's authority. 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 fundamental federal-state dichotomy.

Conclusion

Section 254 is an integral part of the Telecommunications Act of 1996. The Commission has yet to implement it properly, despite repeated opportunities. The proper implementation of section 254 should be of the highest priority.

May 8, 1998

**SEPARATE STATEMENT OF
COMMISSIONER MICHAEL K. POWELL, DISSENTING**

Re: Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579.

I write separately to explain why I am dissenting from this Report to Congress. The Common Carrier Bureau has done an admirable job of drafting the text of this Report over the last several weeks despite uncertainties regarding whether Congress would ultimately request the Report and what that request would entail. As a result of poor internal Commission processing, however, I have not been given a full opportunity to consider and influence the content of this Report. Because I do have some concerns with the content of the Report, I feel I have no choice but to dissent.

In the interest of being responsive to Congress, however, I briefly describe below some of my concerns regarding the Report and our universal service programs generally:

- I am increasingly troubled by the suggestion, evidenced in the Report, that carriers should conceal their universal service contributions or not allow carriers to recover such contributions from consumers. Section 254(e) of the Act expressly mandates that universal service support be "explicit." 47 U.S.C. § 254(e). Further, as the Report recognizes, carriers have the flexibility to decide how they will recover their universal service contributions, and I doubt the Commission has authority to prevent carriers from recovering from their customers. My fear is that, rather than accept our apparent lack of authority to prevent carriers from passing their contributions on to their customers, the Commission will continue down the road, as evidenced in the Report, of suggesting that politically-unpopular methods of recovering such contributions (*i.e.*, line items on consumer telephone bills) somehow amount to fraud or misrepresentation. Clearly, carriers should not be allowed to commit fraud or misrepresentation. Yet I am hesitant to suggest that carriers are guilty of these offenses simply because they inform their customers that a component of their bills will be used to recover contributions mandated by the government. To the extent we are, as a practical matter, scrutinizing statements and line items on bills to pressure carriers into hiding from the customer support mechanisms that the Act requires be made explicit, I must respectfully object. I also must object to the notion, implicit in some calls for scrutiny of carriers' bills, that carriers commit misrepresentation if they do not indicate that they have benefited from access reductions at the same time they make their recovery of universal service contributions explicit on customer bills.
- I seriously question the Report's suggestion that the starting point for

determining the appropriate level of funding for the Schools and Libraries program should be an assumption that all reductions in access charges be used to fund that program. The Commission should acknowledge that the Act's addition of various universal service programs to the traditional high cost, low income and other programs will require the overall amount of universal service subsidies to rise relative to the sum of implicit and other subsidies that existed prior to the Act's passage. At the very least, we should expect that carriers will seek to recover their contributions to these additional, new programs from their customers. Indeed, I believe it would be inconsistent with the statutory mandate that universal service support be made explicit if the Commission were to -- formally or informally -- attempt to force carriers to conceal from customers the recovery of costs attributable to government-mandated programs. The Act mandates that we compensate for reductions in implicit access charges by adding explicit universal service subsidies. Consequently, "access charge reductions" cannot be viewed as a *quid pro quo* for lowering or eliminating the amounts carriers recover as explicit line items on customers bills. Moreover, I seriously question the validity of tying the funding level of *any* of our universal service programs to reductions in access charges.

- I also am concerned that a sizeable portion of demand for the Schools and Libraries program is attributable to discounts for internal connections and Internet access, which the Commission is not *required* to fund as advanced services pursuant to section 254(h); rather, the Commission could decide to postpone funding internal connection and Internet access discounts temporarily or indefinitely. (It is noteworthy that, had the Commission decided not to fund internal connections and Internet access at this time, funds collected for the first 6 months of 1998 would likely cover the demand by schools and libraries for discounted telecommunications services.)
- I would support limiting the revenue base of the Schools and Libraries program to interstate revenues. I remain unconvinced that there is a principled basis for assessing contributions based on both intrastate and interstate revenues for that program, while limiting assessment of contributions for other universal service programs to interstate revenues.
- I am not yet persuaded that, contrary to the analysis of the General Accounting Office, the Commission acted lawfully in directing that NECA establish the Schools and Libraries Corporation and the Rural Health Care Corporation as a condition of its appointment as temporary administrator. Under the Government Corporation Control Act, "[a]n agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action." 31 U.S.C. § 9102. To my knowledge, no law specifically authorizes the Commission to establish corporations, and I find arguments that the Commission merely directed the establishment of the

corporations as a condition of appointment unavailing. If there is a distinction between directing the establishment of the corporations *as a condition of appointment* and establishing the corporations outright, it appears to be a distinction without a meaningful difference.

I also note that Commissioner Furchtgott-Roth raises additional, serious concerns in his statement dissenting from this Report. Had the Commission's internal processes afforded me more of an opportunity to engage with my colleagues regarding the contents of this Report, I might have been persuaded that there are equally valid arguments in opposition to the criticisms I highlight above. Regrettably, that opportunity was never presented.

As I stated in my statement for the April 10, 1998 Report to Congress, I fear that support for these beneficial programs will erode among both legislators and the general public 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. With the issuance of this Report, I regret that we pass up yet another opportunity to foster such belief, in part, because we failed to allow for full consideration of this matter by the entire Commission.