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**Federal Communications Commission**

**FCC 98-85**

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

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

**REPORT TO CONGRESS**

**Adopted: May 8, 1998**

**Released: May 8, 1998**

By the Commission: Commissioner Ness issuing a separate statement; Commissioners Furchtgott-Roth and Powell dissenting and issuing statements.

1. In connection with supplemental appropriations legislation enacted on May 1, 1998, Congress requested that the Commission prepare a two-part report to Congress (the Report), addressing certain issues concerning the implementation of the federal universal service support mechanisms.<sup>1</sup> Section 2005(b)(2)<sup>2</sup> of the Senate bill directs the proposal of a

<sup>1</sup> On April 30, 1998, both the U.S. Senate and U.S. House of Representatives passed H.R. 3579, which makes emergency supplemental appropriations for fiscal year 1998. As passed by the Senate and the House, H.R. 3579 was signed into law by President Clinton on May 1, 1998. The Conference Report on H.R. 3579 eliminated from the final bill specific legislative language contained in S. 1768, the supplemental appropriations bill adopted by the Senate on March 31, 1998 (the Senate bill). Section 2005 of the Senate bill had directed the Commission to prepare and submit to Congress by May 8th a two-part report on universal service. The statement of the House-Senate conferees accompanying the final bill nevertheless expresses the expectation that, among other things, "the FCC will comply with the reporting requirement in the Senate bill, respond to inquiries regarding the universal service contribution mechanisms, access charges and cost data, and propose a new structure for the implementation of the universal service programs." Conference Report on H.R. 3579, H. Rept. 105-504.

<sup>2</sup> Section 2005(b) of the Senate bill provided in pertinent part: "(1) Report Due Date -- Pursuant to the findings of the General Accounting Office (B-278820) dated February 10, 1998, the Federal Communications Commission shall, by May 8, 1998, submit a 2-part report to the Congress under this section. (2) Revised Structure -- The report shall propose a revised structure for the administration of the programs established under

single entity to administer the support mechanisms for schools and libraries and rural health care providers, and further directs that the proposal be "pursuant to the findings of the GAO."<sup>3</sup> In response to this directive, and based on the Commission's charge to ensure the effective delivery of universal service support to targeted recipients under the Communications Act of 1934 (the Act), the Commission proposes in Part I of this Report that the Universal Service Administrative Company (USAC), the current Administrator of the high cost and low income support mechanisms, also administer the universal service support mechanisms for schools and libraries and rural health care providers. As described below, this proposal would be responsive to the Senate bill's request and preserve the goals sought by the Commission in establishing the current structure, while minimizing disruption of the on-going administration of the universal service support mechanisms.

2. Part II of the following Report supplies information concerning funding and disbursements for the schools and libraries support mechanism. This information, as provided below, demonstrates the efficient, innovative, and effective administration of this important new support mechanism.

## **I. REVISED ADMINISTRATIVE STRUCTURE**

### **A. Background**

3. In the Telecommunications Act of 1996 (1996 Act), Congress directed the Commission and the states to take the steps necessary to establish universal service support mechanisms to ensure the delivery of affordable telecommunications services to all Americans.<sup>4</sup> The 1996 Act codified long-standing federal rules and policies designed to make basic telephone service affordable throughout the nation. In addition, the 1996 Act included for the first time schools and libraries among the eligible beneficiaries of the federal universal service support mechanisms by providing that elementary schools, secondary schools, and libraries are entitled to receive, upon a bona fide request, any of the core universal services at

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section 254(h) of the Communications Act of 1934 (47 U.S.C. 254(h)). The revised structure shall consist of a single entity."

<sup>3</sup> In response to a letter from Senator Stevens to the General Accounting Office (GAO) concerning the establishment of the Schools and Libraries Corporation (SLC) and the Rural Health Care Corporation (RHCC), the GAO concluded that the Commission lacked authority to direct the National Exchange Carriers Association (NECA), as a condition of its appointment as temporary Administrator, to create SLC and RHCC. Letter from the Office of General Counsel, General Accounting Office, to the Honorable Ted Stevens, United States Senate, dated February 10, 1998.

<sup>4</sup> 47 U.S.C. § 254(b)(3).

discounted rates.<sup>5</sup> Congress further directed the Commission to "establish competitively neutral rules . . . to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms, health care providers, and libraries."<sup>6</sup>

4. On November 8, 1996, the Federal-State Joint Board on Universal Service (Joint Board) released a Recommended Decision, which included a proposal that the Commission appoint NECA as the temporary Administrator of the new universal service support mechanisms.<sup>7</sup> The Joint Board also recommended that, prior to appointing NECA as temporary Administrator, the "Commission permit NECA to add significant, meaningful representation" for non-incumbent local exchange carrier (LEC) interests to the NECA Board of Directors.<sup>8</sup> NECA was established in 1983 as an association of incumbent LECs to administer the interstate access tariff and revenue distribution processes.<sup>9</sup> NECA's responsibilities subsequently included, among other things, administering the universal service high cost fund, the Lifeline Assistance program, the long term support program and the interstate Telecommunications Relay Services fund.<sup>10</sup> Because of NECA's appearance of bias toward incumbent LECs based on the composition of its membership and Board of Directors, the Joint Board declined to recommend the appointment of NECA as the permanent Administrator of the universal support mechanisms, but did recommend that the Commission remove any regulatory barriers to NECA's rendering itself a neutral third party.<sup>11</sup>

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<sup>5</sup> 47 U.S.C. § 254(h)(1)(B). In addition to the services included in the definition of universal service under section 254(c)(1), Congress specified that the Commission "may designate additional services for such support mechanisms for schools, libraries, and health care providers." 47 U.S.C. § 254(c)(3).

<sup>6</sup> 47 U.S.C. § 254(h)(2)(A).

<sup>7</sup> Federal-State Joint Board on Universal Service, *Recommended Decision*, 12 FCC Rcd 87 (rel. Nov. 8, 1996)(*Recommended Decision*) at ¶ 833.

<sup>8</sup> *Id.*

<sup>9</sup> See generally, MTS and WATS Market Structure, *Third Report and Order*, CC Docket No. 78-72, Phase I, 93 FCC 2d 241 (1983). See also 47 C.F.R. § 69.601.

<sup>10</sup> See generally, Changes to the Board of Directors of the National Exchange Carrier Association, Inc., *Notice of Proposed Rulemaking and Notice of Inquiry*, CC Docket No. 97-21, FCC 97-2 (rel. Jan. 10, 1997), *errata*, mimeo 71784, CC Docket No. 97-21 (rel. Jan. 15, 1997) at ¶ 3.

<sup>11</sup> *Recommended Decision* at ¶ 833.

5. The Commission's Common Carrier Bureau issued a public notice generally seeking comment on the Joint Board's recommendations,<sup>12</sup> and the Commission subsequently issued a Notice of Proposed Rulemaking and Notice of Inquiry specifically seeking comment on "how the Commission should amend its rules so that NECA can reform its Board of Directors in a manner that will enable it to become eligible to serve as the temporary administrator of the universal service support mechanisms."<sup>13</sup> The Commission also sought guidance from the General Accounting Office (GAO) as to how to establish an appropriate administration for federal universal service.<sup>14</sup>

6. In the *Universal Service Order* released on May 8, 1997, the Commission appointed NECA as the temporary Administrator of the universal service support mechanisms established under section 254 of the Act, consistent with the Joint Board's recommendation, subject to NECA's agreement to make changes to its governance that would render it more representative of the interests of entities other than incumbent local exchange carriers.<sup>15</sup> The Commission recognized that NECA's membership and governance, comprised of incumbent local exchange carriers, was not sufficiently representative to ensure competitively neutral administration of the support mechanisms as required by the statute. Previously, NECA had submitted formal proposals expressing its interest in administering the universal service support mechanisms. In a January 10, 1997 letter,<sup>16</sup> NECA proposed the creation of a wholly-owned subsidiary, designated as the Universal Service Administrative Company (USAC), for this purpose. In an order released on July 18, 1997,<sup>17</sup> the Commission determined that NECA's January 10, 1997 proposal, with some modifications, would satisfy the conditions established in the Universal Service Order. Accordingly, the Commission directed NECA, as

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<sup>12</sup> FCC Common Carrier Bureau Public Notice Seeking Comment on Universal Service Recommended Decision, DA 96-1891 (Nov. 18, 1996).

<sup>13</sup> Changes to the Board of Directors of the National Exchange Carrier Association, Inc., *Notice of Proposed Rulemaking and Notice of Inquiry*, CC Docket No. 97-21, FCC 97-2 (rel. Jan. 10, 1997), *errata*, mimeo 71784, CC Docket No. 97-21 (rel. Jan. 15, 1997) at ¶ 2.

<sup>14</sup> Letter from Chairman, Reed E. Hundt, FCC, to J. Dexter Peach, Assistant Comptroller General, General Accounting Office, dated January 31, 1997.

<sup>15</sup> Federal-State Joint Board on Universal Service, *First Report and Order*, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997), *appeal pending sub nom. in Texas Office of Util. Counsel*, No. 97-60421 (5th Cir. filed June 25, 1997) (*Universal Service Order*), at ¶ 866.

<sup>16</sup> Letter from Bruce Baldwin, NECA, to Chairman Reed E. Hundt, FCC, dated January 10, 1997.

<sup>17</sup> Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service, *Report and Order and Second Order on Reconsideration*, 12 FCC Rcd 18400, FCC 97-253, CC Docket No. 97-21 (rel. July 18, 1997) (*July 18, 1997 Order*).

a condition of its appointment as the temporary Administrator, to establish an independent subsidiary, USAC, to administer temporarily the high cost and low income support mechanisms and to perform billing, collection, and disbursement functions for all of the universal service support mechanisms on a temporary basis.<sup>18</sup> The Commission further determined to establish a universal service advisory committee, pursuant to the Federal Advisory Committee Act,<sup>19</sup> that would recommend to the Commission a neutral third party to assume these functions on a permanent basis.<sup>20</sup> The Commission also directed NECA, as a condition of its appointment as the temporary Administrator, to establish two independent corporations, the Schools and Libraries Corporation (SLC) and Rural Health Care Corporation (RHCC), to administer portions of the support mechanisms for schools and libraries, and rural health care providers, respectively.<sup>21</sup> These corporations would serve as permanent administrators of those mechanisms.<sup>22</sup>

7. This administrative structure was intended to accomplish three goals. First, the Commission concluded that specialized entities, comprised of individuals with particular expertise, would foster efficient and effective administration.<sup>23</sup> Second, the Commission sought both to increase accountability to the Commission for the administration of schools, libraries, and rural health care support, and to provide adequate safeguards against waste, fraud, and abuse.<sup>24</sup> Finally, in directing the establishment of SLC and RHCC as permanent

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<sup>18</sup> July 18, 1997 Order, 12 FCC Rcd at 18418, ¶ 30.

<sup>19</sup> 5 U.S.C. App. §§ 4(a) and 3(2)(C).

<sup>20</sup> July 18, 1997 Order, 12 FCC Rcd at 18432, ¶ 60. In NECA's January 10, 1997 letter, it further proposed that, if USAC were ultimately selected as permanent Administrator, NECA would at that time spin off USAC as a separate corporate entity, unaffiliated with NECA. Letter from Bruce Baldwin, NECA, to FCC Chairman Reed E. Hundt, dated January 10, 1997.

<sup>21</sup> July 18, 1997 Order, 12 FCC Rcd at 18430, ¶ 57.

<sup>22</sup> July 18, 1997 Order, 12 FCC Rcd at 18431, ¶ 59.

<sup>23</sup> July 18, 1997 Order, 12 FCC Rcd at 18436-37, ¶ 68. The board of directors of each administering corporation includes representatives from entities that have expertise in the particular support mechanism being administered. For example, the SLC board includes representatives from school and library organizations, as well as a telecommunications industry representative. The RHCC board includes two rural health care representatives and a telecommunications industry representative. Including these members with specialized knowledge helps ensure that these support mechanisms will be responsive to the specific needs and operational practices of educational institutions and rural health care providers.

<sup>24</sup> July 18, 1997 Order, 12 FCC Rcd at 18439-41, ¶¶ 75-77. For a discussion of these safeguards, see *infra*.

entities, the Commission sought continuity in the administration of the support mechanisms for schools, libraries, and rural health care providers.<sup>25</sup>

## B. Discussion

8. *Revised Administrative Structure.* Consistent with the directive of section 2005(2)(b)(2) of the Senate bill, to which Congress has requested that we respond, we propose to merge SLC and RHCC into USAC as the single entity responsible for the administration of the universal service support mechanisms for schools, libraries, and rural health care providers.<sup>26</sup> In our view, vesting the consolidated USAC with the administrative responsibilities for all of the universal service support mechanisms, as described below, may best further the goals of efficient administration and accountability, and therefore would likely be the best option in accordance with the language of section 2005 to propose a single entity to administer the schools and libraries and rural health care support mechanisms. The USAC board includes individuals with the experience and expertise necessary to understand and implement the distinct missions of the schools and libraries and rural health care support mechanisms. The majority of the members of the boards of directors for SLC and RHCC, including representatives of schools and libraries and rural health care providers, also serve on the USAC board of directors.<sup>27</sup> In addition, USAC is already responsible for collecting and disbursing funds for the schools, libraries, and rural health care support mechanisms and has put systems in place for this purpose. Accordingly, subject to the Commission adopting a plan of reorganization that satisfies the criteria for efficient and accountable administration described below, we tentatively conclude that such a unified entity would be uniquely qualified to assume responsibility for the administration of these support mechanisms. As described more fully below, to preserve the distinct missions, expertise, and integrity of the schools and libraries and rural health care support mechanisms, board committees or divisions within USAC may be appropriate.

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<sup>25</sup> *July 18, 1997 Order*, 12 FCC Rcd at 18431-32, ¶ 59. The Commission concluded that it would be best to provide permanence and certainty with respect to the administration of universal service support, to the extent possible. If the schools and libraries and the rural health care mechanisms were administered by or affiliated with NECA or USAC, they would not serve in a permanent capacity unless USAC ultimately were selected as the permanent Administrator. Requiring a temporary Administrator to build the expertise necessary to run these support mechanisms, and then to rebuild that expertise in a permanent Administrator, would have been unduly disruptive and wasteful.

<sup>26</sup> Consistent with the requirements of section 2005(b)(2) of the Senate bill, the "single entity" responsible for administering the support mechanisms for schools, libraries, and rural health care would be USAC. USAC also would continue to administer the high cost and low income support mechanisms.

<sup>27</sup> The overlapping board structure between USAC and SLC, and USAC and RHCC, was intended to ensure close coordination of both administrative and substantive obligations of the three corporations.

9. The consolidated USAC will remain accountable to the Commission by virtue of the Commission's universal service rules,<sup>28</sup> which provide detailed guidance on administration of the universal service support mechanisms, USAC's regular coordination with Commission staff, and its quarterly filing of projected administrative expenses and estimates of support mechanism demand. The Commission also oversees the structure and content of the annual independent audit that USAC is required to undertake.<sup>29</sup> As explained to the General Accounting Office, the Commission retains ultimate authority over the operation of the support mechanisms.<sup>30</sup> Parties that object to any action taken by the corporations can bring the matter to the Commission's attention and request remedial relief. As outlined in greater detail below, we also propose in this Report a procedure for administrative review of USAC's decisions by the Commission. Moreover, we believe that naming USAC as the permanent Administrator, as proposed in this Report, would provide continuity to support mechanism contributors and beneficiaries. As a permanent Administrator, USAC's development of expertise and operational success of the support mechanisms would be encouraged fully, and not undermined by the danger that its expertise would have to be rebuilt at some near date in the future. Such a midstream change could potentially be disruptive and wasteful. Finally, USAC satisfies the statutory requirement of competitively neutral administration because it includes significant industry-wide representation of both contributors and beneficiaries.

10. *USAC's Reorganization Plan.* In response to the directive of section 2005 of the Senate bill, we propose that the functions, assets, employees, rights, and liabilities of SLC and RHCC be transferred to USAC by January 1, 1999. To implement the transfer, USAC, SLC and RHCC would be required jointly to prepare and submit a plan of reorganization for approval by the Commission. Prior to taking final action consistent with any proposals, public comment on such proposals will be sought. In addition, after reviewing the reorganization plan, and any comments received, the Commission contemplates ultimately effectuating the unified structure proposed herein through issuing a reconsideration order.<sup>31</sup> The reorganization plan must detail how USAC proposes to structure its organization and operations pursuant to established principles and requirements of corporate law, and the language of section 2005 of the Senate bill.

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<sup>28</sup> 47 C.F.R., Parts 54 and 69.

<sup>29</sup> 47 C.F.R. § 69.621.

<sup>30</sup> Letter from David H. Solomon, Deputy General Counsel, FCC, to Michael R. Volpe, Assistant General Counsel, General Accounting Office, dated January 5, 1998.

<sup>31</sup> Pursuant to section 410(c) of the Act, the Commission would consult with the state joint board members before reaching a final decision on these issues. 47 U.S.C. § 410(c).

11. We contemplate that the specialized knowledge and expertise of SLC and RHCC would be maintained in the unified structure. The joint proposal must be responsive to the direction of the Conference Report that "any proposed administrative structure should take into account the distinct mission of providing universal service to rural health care providers, and include recommendations as necessary to assure the successful implementation of this program."<sup>32</sup> To that end, the existing SLC and RHCC boards may become subsidiaries or committees of the USAC board.<sup>33</sup> In addition, the reorganization plan must delineate how the administrative systems and expertise that RHCC and SLC have developed, which differ from those required to administer the high cost and low income support mechanisms, will be preserved in USAC. The plan may also include a proposed organizational framework for staffing within USAC involving divisions or other operational units charged with discrete or specialized duties. Finally, to provide continuity to the beneficiaries and recipients of the support mechanisms during the period of reorganization, the plan must address the transfer of employees' contractual rights,<sup>34</sup> benefits, and obligations of SLC and RHCC, including the assumption of contracts for services that SLC and RHCC have entered into with subcontractors in connection with the performance of their administrative responsibilities.

12. *USAC's Permanence and Divestiture.* Given USAC's successful administration of the support mechanisms to date, we propose that the administrative structure set forth herein be made permanent, subject to the Commission's review and determination after one year that the new structure is administering the distribution of universal service support and benefits to eligible entities in an efficient, effective, and competitively neutral manner.<sup>35</sup>

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<sup>32</sup> Conference Report on H.R. 3789, H. Rept. 105-504.

<sup>33</sup> In particular, we contemplate that any such proposed operational units have the power to bind the USAC Board on certain specialized matters comparable to the power and authority vested in the current High Cost and Low Income Committee of USAC. This power should include the ability to make binding decisions on issues related to the administration of the schools and libraries and rural health care support mechanisms, but not on issues related to USAC's billing, collection and disbursement functions. See, e.g., *July 18, 1997 Order*, at ¶¶ 52 - 56.

<sup>34</sup> In particular we note that, in the Conference Report on H.R. 3579, the conferees concur with section 2005(c) of the Senate bill relating to compensation for employees administering the support mechanisms for schools and libraries and rural health care. This will be addressed in the forthcoming reconsideration order. In addition, we intend to seek comment on whether the salary limitations provided in the Senate bill should apply to the officers and employees of USAC and NECA as well.

<sup>35</sup> In the *Universal Service Order*, the Commission determined that it would establish a federal advisory committee whose function would be to recommend to the Commission an entity to serve as the permanent Administrator. *Universal Service Order*, 12 FCC Rcd at 9214, ¶ 861. Adopting the revised structure proposed herein would require that the Commission eliminate the establishment of a federal advisory committee.

Providing permanence to the proposed structure will ensure USAC's ability to continue to attract and maintain qualified personnel and to ensure the continued success of the administrative operations without unnecessary disruption to contributors and beneficiaries.

13. Because we propose in this Report that USAC be named the permanent Administrator, we further propose that, pending Commission review of USAC's performance after one year, USAC be divested from NECA. This proposal is consistent with NECA's suggestion in its January 10, 1997 letter that, if USAC were selected as the permanent Administrator, USAC should be divested from its affiliation with NECA.<sup>36</sup> As recognized by both commenters and the Federal-State Joint Board on Universal Service, NECA's membership and governance, which are composed primarily of incumbent local exchange carriers, may render NECA insufficiently representative of the diverse set of contributors to, and beneficiaries of, the support mechanisms either to serve as permanent Administrator or to warrant a continuing structural affiliation between NECA and USAC.<sup>37</sup> Insofar as USAC will have been successfully operating for nearly two years, there will be no continuing need for USAC to remain affiliated with NECA to facilitate the sharing of resources and personnel. This proposal to divest USAC from NECA would not prevent USAC from entering into contracts with NECA for the performance of particular administrative functions.

14. *USAC's Administrative Responsibilities and Accountability.* In its administration of the support mechanisms for schools and libraries and rural health care providers, we expect that USAC would apply its expertise to interpreting and applying existing decisional principles, but would not make policy or create the equivalent of new guidelines, or interpret the intent of Congress, without appropriate consultation and guidance from the Commission.<sup>38</sup> Consistent with these principles, we propose to establish a procedure under which administrative decisions made by USAC would be reviewable by the Commission. Under this procedure, an administrative decision of USAC could be appealed by affected parties to the Commission. We will seek comment on exactly how this procedure should operate. In addition, the Commission would maintain the authority to review the

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<sup>36</sup> Letter from Bruce Baldwin, NECA, to Reed E. Hundt, FCC, dated January 10, 1997.

<sup>37</sup> *Universal Service Order*, 12 FCC Rcd at 9216, ¶ 866.

<sup>38</sup> This proposal is consistent with the administrative limitations described in section 2005(b)(2)(A) of the Senate bill. Specifically, section 2005(b)(2)(A) provides: "[T]he entity proposed by the Commission to administer the programs -- (i) is limited to implementation of the FCC rules for applications for discounts and processing the applications necessary to determine eligibility for discounts under section 254(h) of the Communications Act of 1934 (47 U.S.C. 254(h)) as determined by the Commission; (ii) may not administer the programs in any manner that requires that entity to interpret the intent of the Congress in establishing the programs or interpret any rule promulgated by the Commission in carrying out the programs, without appropriate consultation and guidance from the Commission."

decisions of USAC at any time on the Commission's own motion. Moreover, to foster greater accountability of the new USAC entity to Congress as well as the Commission, we propose that, in connection with its annual audit, USAC prepare and file with Congress and the Commission an annual report describing all significant aspects of its structure and operations for the preceding year.

15. *Congressional Authorization.* We understand that the Senate bill's directive to propose a revised administrative structure was sparked in part by the GAO's letter concerning the establishment of SLC and RHCC.<sup>39</sup> We welcome action by Congress to resolve the issues raised by the GAO's letter. At the same time, we believe, contrary to the GAO's analysis, that the Commission acted lawfully in directing that NECA establish SLC and RHCC as a condition of its appointment as temporary Administrator. In response to the direction in section 2005(b)(2) of the Senate bill, that the unified structure we propose be "pursuant to the findings of the GAO," we respectfully request from Congress specific statutory authority, similar to that provided in connection with numbering administration, to create or designate, on or before January 1, 1999, one or more entities, such as the Universal Service Administrative Company, to administer the federal universal service support mechanisms.<sup>40</sup> Such authorization would eliminate any question concerning the Commission's authority generally, and under the Government Corporation Control Act,<sup>41</sup> to vest administrative responsibilities for the schools and libraries and rural health care support mechanisms in USAC and provide certainty to universal service contributors and beneficiaries. Similarly, we request that Congress enact legislation authorizing NECA to perform the administrative functions currently assigned to it under the Commission's rules. Finally, we ask that Congress specify that the body selected by the Commission, as well as NECA, would not be considered governmental agencies, government owned corporations, or

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<sup>39</sup> Letter from the Office of General Counsel, General Accounting Office, to the Honorable Ted Stevens, United States Senate, dated February 10, 1998. As noted earlier, the GAO concluded that the Commission lacked authority to direct NECA, as a condition of its appointment as temporary Administrator, to create SLC and RHCC. We note further that, before adopting the universal service order that led to the creation of SLC and RHCC (*July 18, 1997 Order*) the former Chairman of the Commission sought guidance from the GAO, but the GAO declined to respond. Letter from Chairman Reed E. Hundt, FCC, to J. Dexter Peach, Assistant Comptroller General, General Accounting Office, dated January 31, 1997.

<sup>40</sup> The requested authority is modeled after the authority granted to the Commission in section 251(e) of the Act. That section provides in relevant part: "The Commission shall create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis." 47 U.S.C. § 251(e)(1).

<sup>41</sup> 31 U.S.C. § 9102.

government controlled corporations, subject to the requirements of federal laws governing the conduct and operations of federal agencies.<sup>42</sup>

## II. FUNDING FOR SCHOOLS AND LIBRARIES SUPPORT MECHANISM

16. To ensure that the benefits of the Telecommunications Act of 1996 extend to all Americans, Congress expanded universal service under the Act to provide, among other things, support to eligible schools and libraries.<sup>43</sup> In so doing, Congress recognized that, by facilitating the deployment of advanced technologies to America's classrooms, the schools and libraries support mechanism represents a direct and vital investment in the community. As described more fully below, consistent with Congress' mandate, the Commission has taken steps to assure both that the schools and libraries support mechanism is adequately funded and that the expenditures made on behalf of eligible schools and libraries are delivered effectively and efficiently.<sup>44</sup>

### A. Funds Collected for Schools and Libraries Support Mechanism.

17. The Senate bill directs three inquiries concerning contributions to the schools and libraries support mechanism. Explanations are requested, first, for the contribution

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<sup>42</sup> Those laws would include, but not be limited to, the Federal Advisory Committee Act, the Freedom of Information Act, the Privacy Act, the Government in the Sunshine Act, Title 5: Employee Classification, Title 5: Pay Rates and Rate System, Chapter 71 of Title 5, Chapter 73 of Title 5, Chapter 75 of Title 5, Federal Property and Administrative Services Act, the Federal Tort Claims Act, the Ethics in Government Act, Title 18 prohibition against bribery and conflict of interest, the Whistleblower Protection Act of 1989, Chapter 23 of Title 5, Lobbying Disclosure Act of 1995, and the Federal Election Campaign Act of 1971. Rather, we propose that Congress authorize the designation or creation of an entity without regard to the provisions of such federal laws in a manner similar to the authorization provided under section 332(b) of the Act. 47 U.S.C. § 332(b)(1)-(4).

<sup>43</sup> 47 U.S.C. § 254(h)(2)(A).

<sup>44</sup> For example, under the Commission's rules, schools and libraries must first post their requests for proposals, or Form 470s, on a Website opened January 30. These forms contain a description of the services requested by the school or library, organized in a manner so as to enable a provider to bid on that request. Service providers and vendors search this website for potential customers and contact the schools or library directly to bid on the account. Through this process, school administrators must negotiate with service providers to obtain the best and most cost-effective package of services. To date, reports from vendors and applicants on the competitive bidding process on the whole have been very positive. This competitive bidding process has allowed service providers to identify new customers, and schools to negotiate the lowest pre-discount price possible. In some states, like Mississippi, schools and libraries are receiving on average between eight and ten bids for every Form 470 posted on the Web. Libraries also are seeing new opportunities for service. In New York, for example, one public library reported that it had received six competitive bids on its application for a T-1 line.

mechanisms for schools and libraries support and as to whether any direct end-user charges on consumers are appropriate;<sup>45</sup> and second, for the interstate and intrastate basis for such contributions consistent with section 254(d).<sup>46</sup> Third, an accounting is requested of the contributions available for use to support schools and libraries for the second quarter of 1998, in total<sup>47</sup> and as broken down by contributing entity.<sup>48</sup>

18. *Contribution Mechanism.* The Commission concluded in the *Universal Service Order* that contributions to the universal service support mechanisms should be based on end-user telecommunications revenues.<sup>49</sup> The Commission found that assessing contributions based on telecommunications revenues derived from end users is competitively neutral and relatively easy to administer.<sup>50</sup> The Commission also found that this approach satisfied the statutory requirement that support be explicit, because carriers will know exactly how much they are contributing to the support mechanisms.<sup>51</sup> The Commission did not mandate in the *Universal Service Order* that carriers recover contributions through an end-user surcharge,<sup>52</sup>

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<sup>45</sup> Section 2005(b)(3)(H) of the Senate bill requests: "[A]n explanation of the contribution mechanisms established by the Commission under the Commission's Report and Order (FCC 97-157), May 8, 1997, and whether any direct end-user charges on consumers are appropriate."

<sup>46</sup> Section 2005(b)(3)(G) of the Senate bill directs that the Commission provide: "[A]n explanation of why restricting the basis of telecommunications carriers' contributions to universal service under 254(a)(3) of the Communications Act of 1934 (47 U.S.C. 254(a)(3)) to interstate revenues, while requiring that contributions to universal service under section 254(h) of the Act (47 U.S.C. 254(h)) be based on both interstate as well as intrastate revenues, is consistent with the provisions of section 254(d) of that Act (47 U.S.C. 254(d))."

<sup>47</sup> Section 2005(b)(3)(B) of the Senate bill requests: "[A]n accounting of the total contributions to the universal service fund that are available for use to support the schools and libraries program under section 254(h) of the Communications Act of 1934 (4 U.S.C. 254(h)) for the second quarter of 1998."

<sup>48</sup> Section 2005(b)(3)(C) of the Senate bill provides that the Report contain: "[A]n accounting of the amount of the contribution described in subparagraph (b) that the Commission expects to receive from -- (i) incumbent local exchange carriers; (i) interexchange carriers; (iii) information service providers; (iv) commercial mobile radio service providers; and (v) any other provider."

<sup>49</sup> *Universal Service Order*, 12 FCC Rcd at 9206, ¶ 843.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 9211, ¶ 854. As the Commission observed, because carriers calculate their contributions by multiplying their end-user revenues by the universal service contribution factor announced by the Commission, there will be no ambiguity regarding the cost associated with the preservation and advancement of universal service. *Id.*

<sup>52</sup> *Id.* at 9210-11, ¶ 853.

but did not prohibit such surcharges, and we reaffirm that conclusion herein. The Commission further stated that, in declining to mandate an end-user surcharge, it sought to allow carriers the flexibility to decide how they should recover their contributions.<sup>53</sup>

19. The Commission emphasized in the *Universal Service Order*, however, that to the extent that carriers pass all or part of their contributions on to their customers on customer bills, carriers should include complete and truthful information regarding the contribution amount.<sup>54</sup> Such carriers, the Commission made clear, "must be careful to convey information in a manner that does not mislead by omitting important information that indicates that the contributor has chosen to pass through the contribution or part of the contribution to its customers and that accurately describes the nature of the charge."<sup>55</sup> The Commission noted that, unlike the subscriber line charge, the universal service contribution is not a federally mandated direct end-user surcharge.<sup>56</sup> The Commission observed that it would be misleading for a carrier to characterize its contribution as a surcharge, because carriers retain the flexibility to structure their recovery of the costs of universal service in many ways, including creating new pricing plans subject to monthly fees.<sup>57</sup> The Commission also pointed out that, as competition intensifies in the markets for local and interexchange services, it will likely lessen the ability of carriers and other providers of telecommunications to increase rates to customers.<sup>58</sup>

20. We recognize that, in the near term, consumers' bills will undergo some change as companies adjust to the pro-competitive mandates of the Act. The Commission anticipates that consumers should benefit from these adjustments in that rates should continue to fall, all Americans will continue to have affordable access to telephone service, and the costs of providing telephone service will be recovered in a manner that is more straightforward than that used in the monopoly era. We continue to be concerned that carriers provide clear and accurate information to subscribers. We intend to seek comment on the extent to which

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<sup>53</sup> *Id.* The Commission stated: "[A]s telecommunications carriers and providers begin merging telecommunications products into single offerings, for example package prices for local and long distance service, we anticipate that they will offer bundled services and new pricing options. Mandating recovery through an end-user surcharge would eliminate carriers' pricing flexibility to the detriment of consumers." *Id.*

<sup>54</sup> *Id.* at 9211-12, ¶ 855.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 9211-12, ¶ 855.

carriers that pass on to their customers all or part of their universal service contribution obligation are not including complete and truthful information regarding the contribution amount. We will also seek comment on actions the Commission may take to reduce any confusion that consumers may experience with regard to universal service surcharges on their bills.

21. *Revenue Base.* The Commission also explained in the *Universal Service Order* that contributions to fund the schools and libraries support mechanism would be based on both interstate as well as intrastate revenues, consistent with the provisions of section 254(d).<sup>59</sup> More recently, in the Report to Congress submitted by the Commission on April 10, 1998, we examined certain Commission decisions regarding the revenue base on which contributors' universal service contributions are assessed.<sup>60</sup> After analyzing the Commission's conclusions regarding the jurisdictional parameters placed on the Commission and on states, we concluded that we have the authority to assess universal service contributions on telecommunications providers' interstate and intrastate revenues. The *April 10th Report* concluded that the Commission's decision to base contributions to the high cost and low-income support mechanisms solely on interstate revenues and to base contributions to the schools, libraries, and rural health care support mechanisms on intrastate and interstate revenues was consistent with section 254 of the Act. For convenience, we append the relevant portions of the *April 10th Report*, as Attachment A hereto.

22. *Contributions for Schools and Libraries.* As reflected in the May 8, 1998 letter from USAC, appended hereto as Attachment B, we estimate that approximately \$619 million will be available for use to fund the schools and libraries support mechanism through the end of the second quarter of 1998.<sup>61</sup> Also reflected in Attachment B, the following represent the total estimated contributions for each category of contributors for the first and second quarters of 1998 that will be available to fund the schools and libraries support mechanism for the second quarter of 1998: (i) incumbent local exchange carriers will contribute approximately \$179 million; (ii) interexchange carriers will directly contribute

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<sup>59</sup> Section 254(d) provides in pertinent part: "[E]very 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. . . ." 47 U.S.C. § 254(d).

<sup>60</sup> Federal-State Joint Board on Universal Service, *Report to Congress*, CC Docket No. 96-45, FCC 98-67 (rel. April 10, 1998) (*April 10th Report*).

<sup>61</sup> Letter from Universal Service Administrative Company to Chairman William E. Kennard, FCC, dated May 8, 1998, appended hereto as Attachment B.

approximately \$266 million;<sup>62</sup> (iii) information service providers, which are not obligated by the statute to contribute, will make no direct contribution; information service providers, however, will contribute significant amounts indirectly, as high-volume purchasers of telecommunications, as explained in the Commission's *April 10th Report*;<sup>63</sup> (iv) commercial mobile radio service providers will contribute approximately \$87 million; and (v) other providers (e.g., competitive local exchange providers, private carriers) will contribute approximately \$92.5 million.

#### **B. Disbursements for Schools and Libraries Support.**

23. Pursuant to Congress' mandate to establish adequate funding for the schools and libraries support mechanism, the Commission in the *Universal Service Order* set an annual cap for schools and libraries funding, basing its decision on the recommendations of the Joint Board and a record consisting of more than 100,000 pages of comments, expert testimony, and other submissions.<sup>64</sup> Because of the effective administration of the support mechanism, and the public's corresponding interest, the schools and libraries support will likely reach thousands of schools and libraries, and thereby offer meaningful, vital access to these communities. Indeed, the response and interest in the schools and libraries support mechanism attests to its tremendous success. During the initial 75-day window for filing applications, more than 30,000 completed applications were received from schools and

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<sup>62</sup> This amount does not reflect the full extent of interexchange carriers' contributions to universal service support. Incumbent local exchange carriers pass through a portion of their universal service contribution obligation in the access charges they receive from interexchange carriers.

<sup>63</sup> *April 10th Report* at ¶¶ 66-72. In comments filed in connection with the April 10, 1998 Report to Congress on Universal Service, America Online reported that it expects to spend approximately \$1.2 billion for telecommunications services in fiscal 1999. The prices that it pays for those services incorporate universal service contributions. *See id.* at n. 130. America Online also estimates that Internet and online service production and consumption has generated roughly between \$10 billion and \$28 billion of incremental telecommunications services between 1990 and 1997, with incremental revenues in 1998 likely to be approximately between \$6 billion and \$17 billion. *See* Letter from George Vradenberg, III, America Online, to Chairman William E. Kennard, FCC, dated May 6, 1998 (citing MacKie-Mason, *Quantifying the Contribution: Estimates of Telecommunications Services Expenditures Attributable to Online Service Production and Consumption* (May 1998)).

<sup>64</sup> *Universal Service Order*, 12 FCC Rcd at 9054, ¶ 529. In addition to setting the annual cap, the Commission has imposed reasonable limitations on the types of discounted services that eligible schools, libraries, and rural health care providers may receive. Indeed, a significant portion of the costs of connecting schools comes from computers, software, and teacher training. These costs are not supported by universal service. Universal service support provides discounts only for telecommunications services, Internet access, and internal connections. In this way, the Commission's plan augments, not duplicates, the present efforts by states and localities to bring the information superhighway to America's classrooms and libraries.

libraries in every state in the union.<sup>65</sup> As of May 1, 1998, SLC projected that \$2.02 billion in discounts have been requested by applicants who have filed through April 28, 1998.<sup>66</sup>

24. The Senate bill directs three specific inquiries concerning disbursements for schools and libraries support. First, an estimate is requested of the costs of providing schools and libraries support, based on the applications for funding received as of April 15, disaggregated by the eligible services and facilities.<sup>67</sup> Second, a justification is sought of the amount, if any, by which the total requested disbursements from the fund may exceed the amount of available contributions for the second quarter.<sup>68</sup> Finally, an estimate is requested for the amount of contributions that will be required for the program in the third and fourth quarters of 1998.<sup>69</sup>

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<sup>65</sup> Third Quarter 1998 Fund Size Requirements for the Schools and Libraries Universal Service Program, dated May 1, 1998, at 2, appended hereto as Attachment C.

<sup>66</sup> *Id.*

<sup>67</sup> Section 2005(b)(3)(D) of the Senate bill requests: "[B]ased on the applications for funding under section 254(h) of the Communications Act of 1934 (47 U.S.C. 254(h)) received as of April 15, 1998, an estimate of the costs of providing universal service support to schools and libraries under that section disaggregated by eligible services and facilities as set forth in the eligibility list of the Schools and Libraries Corporation, including -- (i) the amounts requested for costs associated with telecommunications services; (ii) the amounts requested for costs described in clause (i) plus the costs of internal connections under the program; and (iii) the amounts requested for the costs described in clause (ii), plus the cost of internet access; (iv) the amount requested by eligible schools and libraries in each category and discount level listed in the matrix appearing at paragraph 520 of the Commission's May 8, 1997 Order, calculated as dollar figures and as percentages of the total of all requests: (I) the amount requested by eligible schools and libraries in each such category and discount level to provide telecommunications services; (II) the amount requested by eligible schools and libraries in each such category and discount level to provide internal connections; and (III) the amount requested by eligible schools and libraries in each such category and discount level to provide internet access."

<sup>68</sup> Section 2005(b)(3)(E) of the Senate bill requests: "[A] justification for the amount, if any, by which the total requested disbursements from the fund described in subparagraph (D) exceeds the amount of available contributions described in subparagraph (B)."

<sup>69</sup> Section 2005(b)(3)(F) of the Senate bill requests: "[B]ased on the amount described in subparagraph (D), an estimate of the amount of contributions that will be required for the schools and libraries program in the third and fourth quarters of 1998, and, to the extent these estimated contributions for the third and fourth quarter exceed the current second-quarter contribution, the Commission shall provide an estimate of the amount of support that will be needed for each of the eligible services and facilities as set forth in the eligibility list of the Schools and Libraries Corporation, and disaggregated as specified in subparagraph (D)."

25. In response, the costs, disaggregated by eligible services and facilities are reflected in SLC's May 7, 1998 letter appended hereto as Attachment D.<sup>70</sup> Although the total requested disbursements from the fund described above exceed the amount of available contributions described in Attachment B, the explanation for this difference is that the disbursements reflect the amount requested for a twelve month period, while the contributions reported cover only a six month period. The contributions required in the third and fourth quarter will be determined after soliciting public comment in public notices that will be released early next week. In particular, we intend to seek comment on whether the amount collected for universal service support for schools and libraries in 1998 should equal the demand reported by SLC or be limited to an amount that does not cause long distance rates to increase.

### C. Access Charge Reductions.

26. The Senate bill also seeks information relating to access charges. Specifically, it directs that an "estimate of the expected reductions in interstate access charges anticipated on July 1, 1998"<sup>71</sup> be provided, as well as "an explanation as to whether access charge reductions should be passed through on a dollar-for-dollar basis to each customer class on a proportionate basis."<sup>72</sup> Although the local exchange carriers will not file their access tariffs until June 16, 1998, based on preliminary information provided by the local exchange carriers, we estimate that the July 1, 1998 access charge reductions will be approximately \$700 million below current levels. Given this projected access charge reduction, we estimate that the quarterly collection rate for schools and libraries could rise from \$325 million (the second quarter collection rate) to approximately \$524 million<sup>73</sup> without increasing total access and universal service payments by long distance carriers. Accordingly, schools and libraries could

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<sup>70</sup> Letter from Schools and Libraries Corporation to Chairman William E. Kennard, FCC, dated May 7, 1998, appended hereto as Attachment D.

<sup>71</sup> Section 2005(b)(3)(A).

<sup>72</sup> Section 2005(b)(3)(H).

<sup>73</sup> We reach this result in the following manner. Long distance carriers pay direct contributions to universal service and, through interstate access charges, indirectly pay for most of the local exchange carrier contributions. Directly and indirectly, long distance carriers are responsible for approximately 82.5 percent of schools and libraries and rural health care contributions. Multiplying \$700 million by 1/.825 yields \$848 million. We divide \$848 million by 4 to find the incremental amount available for each quarter, which is \$212 million. We then add \$212 million to the average quarterly collection rate for the first half of 1998, \$312 million (the average of \$300 and 325 million). Accordingly, access charge reductions of \$700 million yield \$524 million as a quarterly collection rate for the third and fourth quarters of 1998.

be funded at approximately \$1.67 billion for the 1998 calendar year without increasing total access and universal service payment by long distance carriers.

27. In January 1998, the Commission began the process of removing funding for universal service from access charges. Instead of this implicit funding, we began funding universal service through explicit contributions from a broader array of telecommunications providers. In addition, in January 1998, the Commission implemented access charge reductions, and began collection of contributions for the schools and libraries and rural health care mechanisms. We have found that changes in universal service support that were implemented January 1, 1998 did not increase the overall costs of long-distance carriers or the costs that local telephone companies need to collect in local rates.<sup>74</sup> For CMRS customers, we are finding that consumers have been seeing, and are continuing to see, significant reductions in prices even though the 1996 Act required for the first time that wireless carriers contribute to the support of universal service.<sup>75</sup>

28. Access charges have been a significant portion of the total cost of providing long-distance service for all facilities-based long distance carriers. The Commission has previously found that the interstate long distance market is substantially competitive.<sup>76</sup> Because past experience indicates that long distance carriers tend to compete on the basis of per-minute rates, among other things, this competition creates strong incentives for carriers to reflect reductions in their costs through lower rates. Therefore, we would expect long

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<sup>74</sup> See Letter from Chairman William E. Kennard, FCC, to the Honorable Thomas J. Bliley, Chairman, Committee on Commerce, U.S. House of Representatives, dated May 7, 1998 at Attachment, "Changes in Interstate Interexchange Carrier Costs Occuring on January 1, 1998." (Letter and attachment appended hereto as Attachment E).

<sup>75</sup> See Letter from Chairman William E. Kennard, FCC, to the Honorable Thomas J. Bliley, Chairman, Committee on Commerce, U.S. House of Representatives dated May 7, 1998 (Attachment E).

<sup>76</sup> See, e.g., *Policy and Rules Concerning the Interstate, Interexchange Marketplace: Implementation of Section 254(g) of the Communications Act of 1934, as amended*, CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd 20730, 20733, 20742-43 (1996) (*Interexchange Second Report and Order*), stay granted, *MCI Telecommunications Corp. v. FCC*, No. 96-1459 (D.C. Cir. Feb. 13, 1997), *Order on Reconsideration*, 12 FCC Rcd 15014 (1997), further recon. pending; *Motion of AT&T to be Reclassified as a Nondominant Carrier*, Order, 11 FCC Rcd 3271, 3278-79, 3288 (1995) (*AT&T Reclassification Order*), Order on Reconsideration, Order Denying Petition for Rulemaking, Second Order on Reconsideration in CC Docket No. 96-61, 12 FCC Rcd 20787 (1997); *Competition in the Interstate, Interexchange Marketplace*, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5887 (1991), Order, 6 FCC Rcd 7255, Memorandum Opinion and Order, 7 FCC Rcd 2677 (1992), Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 2659 (1993), Second Report and Order, 8 FCC Rcd 3668 (1993), Memorandum Opinion and Order, 8 FCC Rcd 5046 (1993), Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 4562 (1995).

distance companies to pass through access charge reductions, and especially reductions in per-minute access charges, to their customers.<sup>77</sup>

## CONCLUSION

29. The interest in and success of the schools and libraries and rural health care support mechanisms to date attests to Congress' vision in extending universal service support to these important missions. This Report responds to the directives of the Senate bill. It proposes a revised structure for the administration of schools and libraries and rural health care support, and additionally provides documentation of the funding and disbursements for the schools and libraries mechanism, in particular. As described above, this Report seeks Congress' support and continuing partnership in discharging our obligations under the Act, and bringing the full benefits of a free and open telecommunications marketplace to all Americans.

FEDERAL COMMUNICATIONS COMMISSION

Magalie R. Salas  
Secretary

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<sup>77</sup> Chairman Kennard has expressed his commitment to ensuring pass-through to residential as well as business customers. Toward that end, the Chairman recently requested explanations from long distance carriers of how their reduction in access charges were passed through to customers. See Letter from Chairman William E. Kennard, FCC, to Michael C. Armstrong, AT&T, dated February 26, 1998; Letter from Chairman William E. Kennard, FCC, to Bert Roberts, MCI, dated February 26, 1998; Letter from Chairman William E. Kennard, FCC, to William T. Esrey, Sprint, dated February 26, 1998. We are continuing our analysis of interstate long-distance rates to determine whether long-distance carrier rates have fully reflected the access charge reductions this Commission ordered to take effect on that date.

## ATTACHMENT A

Excerpt from Federal-State Joint Board on Universal Service, *Report to Congress*, CC Docket No. 96-45, FCC 98-67 (rel. April 10, 1998)

toll-free Internet access; rather, it relied on section 254(h)(2)(A).<sup>456</sup> Whereas section 254(h)(1)(A) is concerned with the provision of service to "persons who reside in rural areas,"<sup>457</sup> section 254(h)(2)(A), in contrast, seeks to enhance access to advanced services for "all . . . health care providers . . ."<sup>458</sup> Section 254(h)(2)(A) is thus independent of section 254(h)(1)(A) and its limitations and, further, provides the broader authority to promulgate rules for the benefit of "all health care providers," not just rural ones. In our view, the Commission's decision to extend support for the provision of toll-free Internet access to non-rural health care providers is entirely consistent with this language.

## VII. REVENUE BASE AND PERCENTAGE OF FEDERAL FUNDING

194. In this section, we examine first certain Commission decisions regarding the revenue base on which contributors' universal service contributions are assessed. After analyzing the Commission's conclusions regarding the jurisdictional parameters placed on the Commission and on the states, we agree that the Commission has the authority to assess universal service contributions on both telecommunications providers' interstate and intrastate revenues.

195. We examine, second, the Commission's previous decisions regarding the level of interstate high cost support. At the onset, we believe it is important to make two observations to place this issue in context. First, the discussion of the issue in this Report relates only to non-rural local exchange carriers. With respect to *rural* local exchange carriers, the Commission has determined that there shall be no change in the existing high cost support mechanisms until January 1, 2001 at the earliest. We do not revisit that determination in this Report. Thus, the method of determining federal support for rural local exchange carriers will remain unchanged until at least January 1, 2001, meaning that the amount of universal service support for rural local exchange carriers will be maintained initially at existing levels and then should increase in accordance with specified factors, such as inflation, that have historically guided changes in such support. Any possible change in the support mechanism for rural local exchange carriers would require a separate rulemaking proceeding.

196. Second, we note that the pre-May 8, 1997 regulatory scheme created a *de facto* allocation of responsibility between the Commission and state commissions with respect to support for service to rural and high cost areas. That allocation of responsibility was defined by the separations rules, which placed 25 percent of booked loop costs in the interstate jurisdiction for most of the loop plant used by the non-rural LECs. In addition, the aggregate amount of LEC network investment in the interstate jurisdiction is approximately 25 percent. Through the operation of an explicit universal service support mechanism, however, greater than 25 percent of booked loop costs were placed in the interstate jurisdiction in those areas

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<sup>456</sup> See *Universal Service Order*, 12 FCC Rcd at 9157-9160, paras. 742-748; see note 434, *supra*.

<sup>457</sup> 47 U.S.C. § 254(h)(1)(A).

<sup>458</sup> 47 U.S.C. § 254(h)(2)(A) (emphasis added).

where loop costs were particularly high. As a result, some of the non-rural LECs did have slightly more than 25 percent of their booked loop costs in the interstate jurisdiction, and many rural LECs had substantially more than 25 percent in the federal jurisdiction.

197. As discussed below, we conclude that a strict, across-the-board rule that provides 25 percent of unseparated high cost support to the larger LECs might provide some states with less total interstate universal service support than is currently provided through aggregate implicit and explicit federal subsidies. The Commission will work to ensure that states do not receive less funding as we implement the high cost mechanisms under the 1996 Act. We find that no state should receive less federal high cost assistance than it currently receives. We are mindful that the Commission's work in this regard is not yet complete. We are committed to issuing a reconsideration order in response to the petitions filed asking the Commission to reconsider the decision to fund 25 percent of the required support amount. In the course of that reconsideration, we will take all appropriate steps, including continued consultation with the states, to ensure that federal funding is adequate to achieve statutory goals. We also recognize that Congress assigned to the Commission, after consultation with the Joint Board, the ultimate responsibility for establishing policies that ensure that: 1) quality services are available at just, reasonable and affordable rates; 2) all consumers have "access to telecommunications and information services" at rates that are reasonably comparable to the rates charged for similar services in urban areas; and 3) there are "specific, predictable, and sufficient" federal and state mechanisms to preserve and advance universal service. We are committed to implementing section 254 consistent with these objectives.

#### A. Revenue Base for Contributions

##### 1. Background

198. Section 623(b)(5) of the Appropriations Act requires the Commission to review its "decisions regarding the percentage of universal service support provided by federal mechanisms and the revenue base from which such support is derived." This requirement implicates several important determinations made by the Commission, including what is referred to as the "25/75" approach to sharing responsibility for universal service support between the state and federal jurisdictions. In addition, we must address Commission decisions regarding: the scope of the Commission's jurisdiction in assessing and recovering contributions; the scope of the revenue base for, and the method of recovery of, contributions to the support mechanisms for high cost areas and low income consumers and for eligible schools, libraries, and rural health care providers; and the methodology for assessing contributions to the support mechanisms. We review each of these issues below.

199. In the *Universal Service Order*, the Commission analyzed the scope of the Commission's jurisdiction with respect to the assessment and recovery of universal service support mechanisms.<sup>499</sup> The Commission concluded that it has jurisdiction to assess contributions for the universal service support mechanisms from intrastate as well as interstate revenues and to require carriers to seek state (and not federal) authority to recover a portion

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<sup>499</sup> *Universal Service Order*, 12 FCC Rcd at 9192, paras. 813-823.

of the contribution in intrastate rates.<sup>460</sup> The Commission expressly declined to exercise the entirety of its jurisdiction with respect to the assessment and recovery of contributions to the universal service mechanisms for rural, insular, and high cost areas, and low income consumers.<sup>461</sup> Instead, the Commission assessed contributions to those mechanisms based solely on interstate revenues.<sup>462</sup> With respect to the recovery of those contributions, the Commission continued its historical approach to recovery of universal service support mechanisms, thereby permitting carriers to recover contributions to these universal service support mechanisms through rates for interstate services only.<sup>463</sup>

200. With respect to the universal service support mechanisms for schools and libraries and rural health care providers, the Commission adopted the Joint Board's recommendation that these mechanisms be funded by contributions based on both the intrastate and interstate revenues of providers of interstate telecommunications services.<sup>464</sup> The Commission concluded, however, that it will permit recovery of the entirety of these contributions solely via rates for interstate services for the present time.<sup>465</sup>

201. In the *Universal Service Order*, the Commission concluded that, beginning January 1, 1999, the federal universal service mechanism for large local exchange carriers serving rural, insular, and high cost areas will support 25 percent of the difference between the forward-looking economic cost of providing the supported service and the revenue benchmark.<sup>466</sup> After considering various methodologies for calculating contributions to the universal service mechanism, the Commission determined that carriers should calculate contributions to the universal service mechanisms using end-user telecommunications revenues.<sup>467</sup>

## 2. Discussion

### a. Commission Authority With Respect to the Assessment and Recovery of Contributions to Universal Service Support Mechanisms

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<sup>460</sup> *Id.* at 9192, para. 813.

<sup>461</sup> *Id.* at 9192, para. 813.

<sup>462</sup> *Id.* at 9200, para. 831.

<sup>463</sup> *Id.* at 9198, para. 825.

<sup>464</sup> *Id.* at 9203, para. 837.

<sup>465</sup> *Id.* at 9203, paras. 837-838.

<sup>466</sup> *Id.* at 9201, para. 833.

<sup>467</sup> *Id.* at 9205-06, para. 842-843.

202. In the *Universal Service Order*, the Commission determined that Section 254 provides the Commission with the jurisdiction to assess contributions for universal service support mechanisms from both interstate and intrastate revenues, as well as to require carriers to seek authority from states to recover a portion of the contribution in intrastate rates.<sup>468</sup> Some parties argue that the Commission's decisions overstep the traditional relationship between the federal and state jurisdictions.<sup>469</sup> Other commenters argue that the Commission should exercise its full authority to assess contributions for high cost support mechanisms on both intrastate and interstate revenues.<sup>470</sup> Our review of the issue for purposes of this Report, however, leads us to the conclusion that the Commission's jurisdictional analysis in the *Universal Service Order* is sound.

203. As the Commission stated in the *Universal Service Order*, the Commission's authority over universal service support mechanisms stems from the plain language of section 254.<sup>471</sup> Specifically, although the statute contemplates the establishment of federal and state high cost support mechanisms that are consistent with the objectives of section 254, that section imposes on the Commission the ultimate responsibility to implement the universal service mandate of section 254.<sup>472</sup> Section 254(c)(1) likewise authorizes the Commission to define the parameters of universal service.<sup>473</sup> Moreover, section 254(b)(5) anticipates that the Commission will establish support mechanisms that are "specific, predictable and sufficient."<sup>474</sup> These provisions indicate that the Commission has the primary responsibility and authority to ensure that universal service mechanisms are "specific, predictable, and sufficient" to meet the statutory principle of "just, reasonable, and affordable rates." This interpretation is complementary to the states' independent obligations to ensure that support mechanisms are "specific, predictable, and sufficient" and that rates are "just, reasonable, and affordable," because the statute provides that state universal service mechanisms must be consistent with, and may not conflict with, the federal mechanisms.<sup>475</sup>

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<sup>468</sup> *Id.* at 9197, para. 823.

<sup>469</sup> See, e.g., Iowa comments at 3; Nevada PUC comments at 3-8. This issue has also been raised on appeal. See Brief of Petitioner Cincinnati Bell Tel. Co., *Texas Office of Pub. Util. Counsel v. FCC*, No. 97-60421 (5th Cir.) at 11-25.

<sup>470</sup> See, e.g., GTE comments at 29; JSI comments at 6; RTC comments at 5-6.

<sup>471</sup> *Universal Service Order*, 12 FCC Rcd at 9192, para. 814.

<sup>472</sup> Section 254(a) provides that rules "to implement" the section are to be recommended by the Joint Board and those recommendations are to be implemented by the Commission. 47 U.S.C. § 254(a).

<sup>473</sup> Section 254(c)(1) directs that the concept of universal service is an "evolving level of telecommunications that the Commission shall establish periodically." 47 U.S.C. § 254(c)(1).

<sup>474</sup> 47 U.S.C. § 254(b)(5).

<sup>475</sup> See 47 U.S.C. §§ 254(b)(5) & (f).

204. The Commission's conclusion regarding the scope of its jurisdiction is also supported by several provisions of section 254 that indicate that Congress intended universal service support mechanisms to include both intrastate and interstate services. Specifically, section 254(b)(3) establishes that the Commission's rules and policies must ensure that "consumers in all regions of the Nation . . . have access to telecommunications and information services."<sup>476</sup> This language supports a finding that universal service should include more than access to interstate services, which previously has generally been the focus of federal telecommunications law. Moreover, because the traditional core goal of universal service is ensuring affordable basic residential telephone service, which is primarily an intrastate service, it is clear that section 254(b)'s goal of affordable basic service indicates that Congress intended that both intrastate and interstate services should be affordable. It is significant that the Joint Board agreed with this conclusion by recommending that the services eligible for universal service support pursuant to section 254(c) include intrastate services.<sup>477</sup>

205. As the Commission concluded in the *Universal Service Order*, the ability of states to create separate support mechanisms covering intrastate carriers pursuant to section 254(f) does not suggest that the amount of a carrier's contributions to such a support mechanism should be based on the type of telecommunications service, intrastate or interstate, provided by the carrier.<sup>478</sup> We find no support for such an inference in the legislative history. Rather, the legislative history indicates that states continue to have jurisdiction over implementing universal service mechanisms for intrastate services supplemental to the federal mechanisms as long as "the level of universal service provided by each state meets the minimum definition of universal service established [under section 254] and a State does not take any action inconsistent with the obligation for all telecommunications carriers to contribute to the preservation and advancement of universal service" established under section 254.<sup>479</sup>

206. Similarly, section 2(b), which provides that nothing in the Act should be construed to give the Commission jurisdiction with respect to "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications services by wire or radio," does not preclude the Commission from assessing contributions based on a percentage of a carrier's intrastate revenues.<sup>480</sup> Determining such contributions for universal service support on intrastate, as well as interstate, revenues constitutes neither rate regulation of those services nor regulation of those services in violation of section 2(b). Rather, this method of assessment supports intrastate services, as expressly required by section 254 of the Act and as recommended by the Joint Board. Indeed, in assessing contributions in this way, the Commission is calculating a federal charge based on

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<sup>476</sup> 47 U.S.C. § 254(b)(3).

<sup>477</sup> *Recommended Decision*, 12 FCC Rcd at 112, para. 46.

<sup>478</sup> *Universal Service Order*, 12 FCC Rcd at 9195, para. 819.

<sup>479</sup> Joint Explanatory Statement at 128.

<sup>480</sup> 47 U.S.C. § 152(b).