



PUBLIC NOTICE

FEDERAL COMMUNICATIONS COMMISSION
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Proposed First Quarter 1999 Universal Service Contribution Factors and Proposed Actions CC Docket No. 96-45

In this Public Notice, the Commission announces proposed universal service contribution factors for the first quarter of 1999, and makes proposals for changes to the administrative expenses of the Rural Health Care Corporation, and the use of contributions collected in previous quarters.¹

The Commission adjusted the 1998 and 1999 collection amounts for the schools and libraries support mechanism in the *Fifth Order on Reconsideration* released on June 22, 1998.² Specifically, the Commission directed the Universal Service Administrative Company (USAC) to collect only as much as required by demand, but in no event more than \$325 million per quarter for the third and fourth quarters of 1998 and the first and second quarters of 1999 to support the schools and libraries universal service support mechanism.³ The Commission also directed USAC to collect for the rural health care support mechanism only as much as required by demand, but in no event more than \$25 million per quarter for the third and fourth quarters of 1998.⁴

Pursuant to section 54.709(a)(3) of the Commission's rules, USAC, the Schools and Libraries Corporation (SLC), and the Rural Health Care Corporation (RHCC) have submitted the following projections of first quarter 1999 demand and administrative expenses:⁵

¹ See 47 C.F.R. § 54.709(a).

² *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifth Order on Reconsideration and Fourth Report and Order in CC Docket No. 96-45, 13 FCC Rcd 14915 (rel. June 22, 1998) (*Fifth Order on Reconsideration*).

³ *Id.* at 14928 para. 20; 14933 para. 29.

⁴ *Id.* at 14928 para. 21; 14933 para. 29.

⁵ Federal Universal Service Programs Fund Size Projections & Contribution Base For the First Quarter 1999 (filed Nov. 2, 1998); Schools and Libraries Fund Program Size Projections for First Quarter 1999 and Expenses for Second Quarter 1998 CC Docket Nos. 96-45, 97-21 (filed Nov. 2, 1998); First Quarter 1999 Projected Demand and Expenses for the Rural Health Care Universal Service Support Program (filed Oct. 30, 1998).

(\$ millions)

Program	Program Demand	Administrative Expenses	Interest Income ⁶	Total Program Costs
Schools and Libraries	319.9	10.2 ⁷	(5.1)	325.0
Rural Health Care	See text below	See text below	See text below	See text below
Subtotal	319.9	10.2	(5.1)	325.0
High Cost	439.1	2.2	(0.9)	440.4
Low Income	144.0	0.5	(0.7)	143.8
Subtotal	583.1	2.7	(1.6)	584.2
TOTAL	903.0	12.9	(6.7)	909.2

RHCC requests that no contributions be collected during the first quarter of 1999. RHCC explains that, to date, it has received approximately 2,500 initial applications for support. Only a small percentage of those applicants, however, have completed the application process, and RHCC does not anticipate a significant demand in the first quarter of 1999.⁸ RHCC projects that its administrative expenses for the first quarter of 1999 will total approximately \$1.4 million, and that it will also accrue interest income of approximately \$1

⁶ Because this table lists expenses, positive income flows are denoted with parentheses.

⁷ SLC reported that the increase in administrative expenses from \$4.9 million in the fourth quarter 1998 to \$10.2 million in the first quarter 1999 is the result of a significant rise in the volume of applications and post-commitment forms to be processed and the costs of implementing auditing procedures consistent with Commission rules and recommendations from the General Accounting Office and SLC's independent auditors. See Schools and Libraries Fund Program Size Projections for First Quarter 1999 and Expenses for Second Quarter 1998 CC Docket Nos. 96-45, 97-21; see also Schools and Libraries Corporation: Actions Needed to Strengthen Program Integrity Operations Before Committing Funds, T-RCED-98-243 (GAO July, 16, 1998). SLC explains that costs that would have been incurred in 1998 have been shifted to the first quarter 1999. Schools and Libraries Fund Program Size Projections for First Quarter 1999 and Expenses for Second Quarter 1998 CC Docket Nos. 96-45, 97-21. Specifically, SLC reports that it expects a significant increase in Client Service Bureau operations to support applications for the second program year, including Forms 470 and 471 filed on-line, in addition to post-commitment forms from the first program year. *Id.* SLC estimates that over 40,000 Forms 470 will be filed in the second program year, and 50,000 Forms 471 will be filed within the window period. *Id.* SLC also expects to process 270,000 post-commitment forms during 1999, with a disproportionately high share in the first quarter. *Id.* In order to implement recommendations from GAO and SLC's independent auditors, SLC has also expanded its Program Integrity Assurance operations, which will allow for the review of invoices to check for consistency between funds committed for particular services and the payment of such funds. *Id.* SLC further plans to undertake an operational audit to evaluate the internal controls established in 1998. *Id.* SLC notes that despite these added costs, it has undertaken measures to reduce costs, including provisions to accept invoices electronically, generate notifications electronically, and receive electronically filed Form 470 and 471 applications. *Id.*

⁸ RHCC has requested that the Commission extend its current calendar year by six months to June 30, 1999, and permit rural health care providers to receive support during the additional six-month period.

million during the first quarter of 1999.⁹ We have not included these amounts in arriving at the total program costs or the contribution factors because RHCC is not seeking to collect additional amounts for the first quarter of 1999.

I. Proposed Actions

Although RHCC's projected administrative expense is not included in the calculation of the contribution factors for the first quarter of 1999, we are concerned about the size of the projected administrative expense relative to the size of the support mechanism, and the amount that RHCC anticipates will be disbursed for applications filed during the first funding year. On January 1, 1999, USAC will assume an expanded role that will include responsibility for the administrative expense of the rural health care support mechanism.¹⁰ We propose that USAC, pursuant to its obligations as administrator, reduce the administrative expense associated with the rural health care support mechanism to an amount that is commensurate with the size of the support mechanism. Moreover, we propose that USAC submit, by March 1, 1999, revised first quarter administrative expenses for the rural health care support mechanism at an amount that, pursuant to 47 C.F.R. § 54.709, serves the public interest.

The rural health care support mechanism has the potential to benefit many Americans by facilitating telemedicine in rural areas of the country. We are committed to making the support mechanism work as intended by Congress. Therefore, we propose that USAC evaluate ways to improve opportunities for eligible rural health care providers to take advantage of the support mechanism and evaluate anticipated demand for 1999. We propose that USAC submit the results of such evaluation to the Commission by March 1, 1999.

It is anticipated that RHCC will have a balance of approximately \$85.5 million at the end of the fourth quarter of 1998.¹¹ RHCC estimates that, absent any changes to the rural health care support mechanism, no more than \$2 million will be committed to the support of rural health care providers for supported telecommunications services provided in 1998.¹² The Commission's rules contemplate that collections in excess of demand will be carried forward and be taken into consideration in calculating future contribution factors.¹³ Because the contributions received to date will exceed the amounts required to meet demands for the rural health care support mechanism for 1998 and the first quarter of 1999, we propose that the

⁹ First Quarter 1999 Projected Demand and Expenses for the Rural Health Care Universal Service Support Program (filed Oct. 30, 1998).

¹⁰ See *Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, Third Report and Order and Fourth Order on Reconsideration, and Eighth Order on Reconsideration, CC Docket Nos. 96-45, 97-21, FCC 98-306 (rel. Nov. 20, 1998).

¹¹ Letter from Robert Haga, USAC, to Lisa Gelb, FCC, dated Nov. 19, 1998.

¹² Letter from Lee E. Bailey, RHCC, to Kathryn Brown, FCC, dated October 28, 1998 (RHCC letter).

¹³ 47 C.F.R. § 54.709(b); *Changes to the Board of Directors of the National Exchange Carrier Association Inc., Federal-State Joint Board on Universal Service*, CC Docket Nos. 97-21, 96-45, Report and Order and Second Order on Reconsideration, 12 FCC Rcd 18400, 18427 at para. 50 (1997), as corrected by *Federal-State Joint Board on Universal Service, Errata*, CC Docket No. 96-45, DA 97-2477 (rel. Dec. 3, 1997).

excess contributions be credited back to contributors. Contributions from carriers support several universal service support mechanisms, and we propose that total contribution obligations for 1999 be reduced by the amount of the excess contributions previously received. This method of offset would allow contributors to receive their credits in a single transaction, and thus would be more efficient than, for example, issuing individual refund checks to contributors, who at the same time will be tendering payments for their 1999 contribution obligations. We propose that the excess contributions for the rural health care support mechanism be applied to the other support mechanisms with the same contribution base, i.e., the support mechanisms based upon interstate, intrastate, and international end-user telecommunications revenues.¹⁴

Specifically, we propose that half of the amount in the account for the rural health care support mechanism be used to reduce the amount of contributions collected during the first quarter of 1999.¹⁵ This action would not increase the amount of funds available for any support mechanism, but, as discussed below in section II, it would reduce carriers' first quarter 1999 universal service contributions. We further propose that once USAC has completed its evaluation of rural health care funding needs, the amount remaining in the account for the rural health care support mechanism, net of expected 1999 funding requirements, be used to reduce subsequent contribution factors.

The Commission must take steps to ensure that all of the universal service support mechanisms are administered as effectively and cost efficiently as possible. We note that the SLC's projected administrative expenses have increased for the first quarter of 1999. The SLC has filed with the Commission information explaining the bases for these increased administrative expenses.¹⁶ The SLC explained that these increases are due in part to the cost of complying with the GAO recommendations, which were intended to help ensure that discounts were provided in accordance with the statute and Commission rules. According to the SLC, the first quarter 1999 expenses also reflect the cost of complying with the Commission's *Fifth Order on Reconsideration*. In addition, the SLC has explained that the increased expenses represent the anticipated costs of processing a high volume of applications that it expects to be submitted in the next year. Thus, we have no reason to believe that this level of expenses will continue to be as high each quarter and we will continue to monitor closely these expenses. We have created efficiencies by ordering the reorganization of USAC and merging SLC and RHCC with USAC. We will continue to monitor the effects of this merger to ensure that it does create the anticipated efficiencies.

¹⁴ Pursuant to the Commission's rules, funding for the schools and libraries, and rural health care support mechanisms must be based on the interstate, intrastate, and international end user revenues derived from the provision of telecommunications services. 47 C.F.R. § 54.709(a)(1). Funding for the high cost and low-income support mechanisms must be based on the interstate and international end user revenues derived from the provision of telecommunications services. *Id.*

¹⁵ As previously noted, based upon the RHCC letter, we anticipate that the account for the rural health care support mechanism will have a balance of approximately \$85.5 million at the end of the fourth quarter of 1998.

¹⁶ See note 7, *supra*.

II. Proposed Contribution Factors Based on Proposed Actions

USAC submitted end-user telecommunications revenue for January through June 1998 based on information contained in the September 1998 Universal Service Worksheets, FCC Form 457.¹⁷ The amounts are as follows:

Total Interstate, Intrastate, and International End-User Telecommunications Revenues from January 1, 1998 - June 30, 1998: \$98.510 billion

Total Interstate and International End-User Telecommunications Revenues from January 1, 1998 - June 30, 1998: \$37.062 billion.

We estimate quarterly revenues by dividing the six-month revenue estimates by two. In addition, we decrease the revenue estimates by one percent to account for uncollectible contributions.¹⁸ Accordingly, the first quarter 1999 contribution bases are as follows:

Contribution Base for Schools and Libraries and Rural Health Care:

$(\text{Interstate, International, and Intrastate} / 2) - 1\% = \text{Contribution Base}$
 $(\$98.510 \text{ billion} / 2) - 1\% = \48.762 billion

Contribution Base for High Cost and Low Income:

$(\text{Interstate and International} / 2) - 1\% = \text{Contribution Base}$
 $(\$37.062 \text{ billion} / 2) - 1\% = \18.346 billion

Using these contribution bases, the proposed contribution factors for the first quarter of 1999 are as follows:

A. Contribution Factor for Schools and Libraries and Rural Health Care:

As indicated above, we propose reducing Total Program Costs (\$0.325 billion) by applying half of the amount in the account for the rural health care support mechanism (\$0.086 billion)/2 = \$0.043 billion), resulting in Total Program Costs of \$0.282 billion. Accordingly, the contribution factor is calculated as:

$\text{Total Program Costs} / \text{Contribution Base} = \text{Contribution Factor}$

¹⁷ Federal Universal Service Programs Fund Size Projections & Contribution Base For the First Quarter 1999 at 18 (filed Nov. 2, 1998).

¹⁸ Several carriers subject to the universal service contribution obligation have failed to meet this obligation. See Letter from Lisa Rosenblum, USAC, to Magalie Roman Salas, FCC, dated March 18, 1998 (USAC March 18 letter); Letter from Robert Haga, USAC, to Magalie Roman Salas, FCC, dated June 12, 1998 (USAC June 12 letter); see also *Conquest Operator Services Corp., Notice of Apparent Liability for Forfeiture*, 13 FCC Rcd 16075 (rel. Aug. 14, 1998); *Operator Communications, Inc., Notice of Apparent Liability for Forfeiture*, 13 FCC Rcd 16082 (rel. Aug. 14, 1998). To maintain the integrity of the universal service support mechanisms, pending enforcement of this obligation, we determine that we should account for uncollectible contributions at a rate of one percent. This is consistent with USAC's estimated rate of uncollectibles. See USAC June 12 letter.

$\$0.282 \text{ billion} / \$48.762 \text{ billion} = 0.0058^{19}$

B. Contribution Factor for High Cost and Low Income:

Total Program Costs / Contribution Base = Contribution Factor
 $\$0.584 \text{ billion} / \$18.346 \text{ billion} = 0.0318$

These factors are the proposed first quarter of 1999 universal service contribution factors. If the Commission takes no action regarding the proposed factors, the projections of demand and administrative expenses, and the other proposals set forth above, within the 14-day period following release of this Public Notice, then the proposed factors, the projections of demand and administrative expenses, and the other proposals set forth above shall be deemed approved by the Commission.²⁰ USAC shall then use the factors to calculate universal service contributions for the first quarter of 1999, and take appropriate action to implement the other proposals set forth above.

For further information, contact Jack Zinman or Linda P. Armstrong, Accounting Policy Division, Common Carrier Bureau, at (202) 418-7400.

Action by the Commission on December 1, 1998. Chairman Kennard, Commissioners Ness, Powell, Tristani, with Commissioner Furchtgott-Roth, dissenting and issuing a statement.

¹⁹ If we did not apply half of the amount in the account for the rural health care support mechanism to reduce the Total Program Costs, then the contribution factor would be calculated as follows: $\$0.325 \text{ billion} / \$48.762 \text{ billion} = 0.0067$. Thus, applying the excess contributions from the rural health care support mechanism as proposed reduces the contribution factor by .0009, or 13.4 percent.

²⁰ In the *Fifth Order on Reconsideration*, the Commission revised section 54.709(a)(3) to eliminate the requirement that the proposed contribution factors and projections of demand and administrative expenses be published in the Federal Register. The Commission concluded that, in the absence of further Commission action, the proposed contribution factors and projections of demand and administrative expenses set forth in a Public Notice would be deemed approved 14 days after release of the Public Notice in which they are announced. *Fifth Order on Reconsideration*, 13 FCC Rcd. at 14945 paras. 49, 50, and Appendix A.

DISSENTING STATEMENT OF COMMISSIONER HAROLD FURCHTGOTT-ROTH

Re: Proposed First Quarter 1999 Universal Service Contribution Factors And Proposed Actions; (CC Docket No. 96-45).

Today, the Commission releases a Public Notice announcing the proposed universal service contribution factors for the first quarter of 1999 that will automatically go into effect if the Commission takes no action within 14 days. I dissent from the proposed contribution levels for a variety of reasons, but most notably because of the Commission's refusal to evaluate with a critical eye the excessive expenses of the Schools and Libraries Corporation. While acknowledging that the other new universal service program should have its budget undergo increased scrutiny, in this Public Notice the Commission blindly accepts the establishment of a new bureaucracy to "administer" the schools and libraries program at a cost to taxpayers of more than \$40 million annually. Such an incredible budget ensures that more money will flow to another Washington bureaucracy -- the Schools and Libraries Corporation ("SLC") -- than will flow to 37 of the states, even if every application from every school in those states for the schools and libraries program were full funded.

I. Today, the Commission Approves a Bloated New Adjunct Bureaucracy -- the Schools and Libraries Corporation -- with an Annualized Budget of Over \$40 Million of Taxpayer Money with Virtually No Public Oversight.

By issuing this Public Notice today, the Commission "approves" the projected expenses for the universal service support programs.¹ I object to the exorbitant and unjustified administrative expenses of the Schools and Libraries Corporation and the *further increase* in their budget proposed by this Public Notice. At the very least, the Commission should require that a more detailed budget be filed with the Commission and reviewed for the expenditure of public funds.

Under today's scheme, the administrative expenses of the Schools and Libraries Corporation will increase again from \$4.9 million per quarter to \$10.2 million per quarter, an increase of more than 100%. And this is at a time when Congress has called for a more "streamlined" and "efficient" corporate structure. Indeed, Section 2005(b)(2)(A) of Senate Bill 1768, which prompted several universal service corporate structural revisions, provides for an extremely limited administrative entity:

[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 program in any manner that requires that entity to interpret the intent of Congress in

¹ 47 CFR Section 54.709.

establishing the programs or interpret any rule promulgated by the Commission in carrying out the programs, without appropriate consultation and guidance from the Commission.

In light of this more limited administrative function, I fail to see the need for a 100% increase in funding. Indeed, I wonder whether the overly bureaucratic structure adopted by the Commission, with its formal divisions and multiple committees overseeing them, has contributed in any way to these expenses.² Even more importantly, if the overall entity is now prohibited from setting policy and limited to the function of processing applications, then how can this bureaucracy need an increase in funding of this magnitude? Moreover, it appears from the budget that the bulk of the actual processing of the applications is contracted out to other entities. If that is so, and the Corporation is limited to only processing applications, then what is the Corporation's other functions that could require several million dollars? Is the Corporation spending several million dollars a quarter merely traveling around the country promoting the program itself?

The administrative expenses for the Schools and Libraries Corporation are considerably more than the administrative expenses of any and all of the other universal service programs. For example, the High Cost/Low Income program demand is significantly greater (\$583 million which is almost twice the schools and libraries demand), but the corresponding administrative expenses are considerably smaller (only \$2.7 million, or almost \$8 million less). In fact, the administrative expenses for the Schools and Libraries Corporation *exceeds* the administrative expenses for *all* of the other universal service programs *combined* by *seven* million dollars. Indeed, these administrative expenses on an annualized basis would equal almost 50% of the total demand of Internet Services requested by all of the 30,000 applications received for the first year of this program.³

With these questionable and excessive expenses, I find it ironic that the Commission chooses to conclude that "we are concerned about the size of the projected administrative expenses relative to the size of the support mechanism" for the Rural Health Care Program.⁴ While there expenses may need additional scrutiny as well, how can the Commission continue to ignore the burgeoning schools and libraries budget? If the appropriate standard for additional review is the "size of the administrative expenses" relative to the "size of the support mechanism," then why isn't the fact that the "size of the administrative expenses" of the High Cost/Low Income program is significantly less than the schools and libraries program while the "size of the support mechanism" for the High Cost/Low Income program is significantly greater than the schools and libraries program not evidence that this program too

² Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding Changes to the Board of Directors of the National Exchange Carrier Association, Inc; Federal-State Joint Board on Universal Service; (CC Docket Nos 97-21, 96-45), rel. November 19, 1998.

³ Federal-State Joint Board Report to Congress, rel. April 10, 1998, 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.

⁴ Public Notice at 4.

needs further review. At the very least, the Commission should have required USAC to submit a revised and more detailed first quarter budget for the schools and libraries program by March 1, 1999 as it does with the rural health care program.⁵

On an annualized basis, the schools and libraries budget for "administrative expenses" alone will exceed \$40 million. In just one year, this agency has created an adjunct bureaucracy with an "administrative" budget that is almost 25% of this entire agency's Congressional appropriation, and with virtually no oversight. Unlike the justifications and scrutiny that all agencies undergo in the appropriations process, what public official is making sure that this \$40 million of taxpayer money is well spent? What public official is making sure that salaries are reasonable, that "travel" does not include First Class, or that contingency does not include Holiday bonuses? Such cursory descriptions as "SLC Labor Costs," "Travel, Supplies and Other," "Contingency," and "Contract - Operations Component"⁶ along with lump sum allocations do not provide the type of assurances that should be in place for the expenditure of essentially public money?

I cannot endorse the disparity -- and certainly not one of this magnitude -- between the administrative expenses of the Schools and Libraries Corporation and those of the other universal service corporations. I believe there is a need for more adequate safeguards against excessive administrative spending by this program.

II. The Commission's Justifications for this Increased Budget Are Insufficient and Factually Inaccurate.

The Commission makes two points in support of the Schools and Libraries Corporation's budget. First, the Commission argues that:

[T]he SLC has explained that the increased expenses represent the anticipated *costs of processing a high volume of applications* that it expects to be submitted in the next year. Thus, we have *no reason to believe that this level of expenses will continue to be as high* each quarter and we will continue to monitor closely these expenses.⁷

In addition, the Commission argues that:

The SLC explained that these increases are due in part to the cost of complying with the GAO recommendations, which were intended to help ensure that

⁵ Public Notice at 4.

⁶ First Quarter 1999 Program Size Projections for the Schools and Libraries Universal Service Program, dated November 2, 1998, at enclosure 1.

⁷ Public Notice at 4 (emphasis added).

discounts were provided in accordance with the statute and commission rules.⁸

The Commission's final assurance is that it will "*continue* to monitor *closely* these expenses."⁹ Not only are these explanation insufficient, but they are -- in some cases -- factually inaccurate. Thus, I feel compelled to respond directly.

- A. There is a reason to believe that the Schools and Libraries Corporation's budget will be as high in each and every quarter next year -- because they have overspent their own proposed budget in every quarter that information is available.**

First, I believe that there is "a reason to believe that this level of expenses will continue." The fact that the SLC's budget has continued to increase dramatically along with the fact that it has been unable to meet its own projected budget in any quarter is an indication -- at least to me -- that this level of expenses will at least continue. In the first quarter of 1998, the estimated expenses for SLC were \$1.9 million, with a budget of \$7.8 million for the year.¹⁰ The actual first quarter administrative expenses -- with no offset for interest income earned -- was \$4.4 million.¹¹ This amount is well in excess of the what was actually budgeted, and does not even include the additional \$1.9 million which was paid to NECA during the first quarter for additional start-up expenses.¹² Thus, the actual first quarter costs for this program were \$6.3 million, or almost the entire estimated budget for the year.

Similarly, the second quarter administrative expenses of the Schools and Libraries Corporation were estimated to be \$4.16 million.¹³ The actual second quarter expenses for this program were \$6.9 million. Thus, in the first six months the Schools and Libraries Corporation spent almost twice what they had been budgeted for the entire year. At this rate, I can only conclude that the Commission's right that "there is no reason to believe that this level of expenses will continue" because it will only increase to at least \$15 million per quarter. With that kind of a track record and credibility with regard to their budget, I find "a reason to believe" that their increased expenses might continue.

Even if their past failure to meet their own budget is not convincing, I fail to understand why the Commission will not set any limit -- either in absolute dollars or in

⁸ Public Notice at 4 (emphasis added).

⁹ Public Notice at 4 (emphasis added).

¹⁰ Second Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated January 30, 1998, at 4.

¹¹ Fourth Quarter 1998 Fund Size Requirements for the Schools and Libraries Universal Service Program, dated July 31, 1998, at page 3.

¹² ID. at note 5.

¹³ Second Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated January 30, 1998, at 4.

percentage of their projected budget -- on *overspending*. Surely at some point the program's spending in excess of their own budget indicates a need to reexamine the program. Why won't the Commission indicate such a level?.

Finally, even if there spending does drop back to \$5 million per quarter, that would be an annual budget of \$25 million, which is still excessive. Moreover, why won't the Commission now commit to concluding that if the second quarter budget estimates do not drop to \$5 million, then that would justify a reexamination of this bureaucracy and its "administrative" budgetary needs?

B. This is the third time the Schools and Libraries Corporation has asked for -- and been given by the FCC -- additional money to "process" a high volume of 1999 applications, but the filing of those applications was delayed in the previous quarters and the money was still spent.

I object to allowing this Corporation to continue to ask for an increasing amount of money to "process" the 1999 applications. In the estimates for the Schools and Libraries Corporation's third quarter expenses of \$4.2 million, SLC indicated that it would "begin review of applications for 1999 funding in the fall of 1998."¹⁴ They indicated that there were "significant assumptions underlying our expense estimates" including "a total of about 50,000 FCC Forms 470 for 1999 funding filed in the Third Quarter."¹⁵ With that in mind, the SLC estimated that "35 percent of the \$4.2 million we project to need for expenses in the Third Quarter will be for 1998 Funding Year-related activities and 65 percent [\$2.73 million] for 1999 Funding Year. That proportion will be even more heavily weighted to Funding Year 1999 in the Fourth Quarter, . . ."¹⁶ Again in their fourth quarter estimates, the Schools and Libraries Corporation repeated that they "will begin processing applications for the second program year"¹⁷ as part of their justification for their expenses. But now the Schools and Libraries Corporation estimates that it will need a "significant increase in expenses compared to the Fourth Quarter of 1998."¹⁸ And what is the main reason? "One major factor in this expected increase is Client Service Bureau operations to support applications for the second

¹⁴ Third Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated May 1, 1998, at 4.

¹⁵ Third Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated May 1, 1998, at 4.

¹⁶ Third Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated May 1, 1998, at 4.

¹⁷ Fourth Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated July 31, 1998, at 2.

¹⁸ First Quarter 1999 Program Size Projections for the Schools and Libraries Universal Service Program, dated November 2, 1998, at 2.

program year."¹⁹ I fail to understand why the Schools and Libraries Corporation can continue to ask for more and more money to process the same applications.

Indeed, in their latest filing, the Schools and Libraries Corporation justifies its expenses by saying that it estimates "that in the second program year, over 40,000 Forms 470 will be filed" But I thought that 65% of the third quarter's expenses or \$2.73 million had already been allocated to that function? Moreover, why does this processing cost only \$2.7 million in the fall of 1998, but now cost \$5 million in the Winter of 1999? Why has the cost of processing fewer applications increased? I realize that the 1999 application window has been delayed several times, but then what has happened to the vast sums of money that we have already allocated to that processing function for the third and fourth quarters? Why is that money not available for processing the applications now? I can only conclude that the Commission is being derelict in its oversight duties to continue to fund the exact same request, and at an increasing cost to taxpayers each time, without asking even these basic questions. I cannot support spending taxpayer money twice -- none-the-less three times -- for the same thing.

C. In almost every quarter, the Schools and Libraries Corporation has either asked for money or overspent its budget because of developing additional program integrity assurances for these cash grants.

In their latest filing, the Schools and Libraries Corporation indicates that its budget increases in part because of the "expansion of SLC's Program Integrity Assurance (PIA) operations,"²⁰ In its second quarter filing, under the heading "Program Integrity Assurance," the Schools and Libraries Corporation indicated that its estimate now "includes \$4.9 million needed for a comprehensive process review function"²¹ At that time, SLC indicated that the "growth in the budget estimate" was for work "to protect the program from waste, fraud, and abuse."²² But when explaining why the actual costs for the second quarter exceeded the estimates by \$1.2 million, SLC states that its costs have risen "for our program integrity assurance unit to help protect against waste, fraud and abuse."²³ Again in the fourth quarter estimates, SLC "further supplemented its program integrity operations to protect against waste fraud and abuse. These costs are reflected in the Fourth Quarter

¹⁹ First Quarter 1999 Program Size Projections for the Schools and Libraries Universal Service Program, dated November 2, 1998, at 2.

²⁰ First Quarter 1999 Program Size Projections for the Schools and Libraries Universal Service Program, dated November 2, 1998, at 2.

²¹ Second Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated January 30, 1998, at 8.

²² Second Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated January 30, 1998, at 8.

²³ First Quarter 1999 Program Size Projections for the Schools and Libraries Universal Service Program, dated November 2, 1998, at 5.

estimate."²⁴ I fully support the efforts to ensure that this program is being administered in an efficient and consistent manner and believe that the audits that occurred have been essential. I believe, however, that after the program has been running for more than a year, additional overexpenditures for "program integrity assurances" should require more of an explanation than a word processing macro that says "to protect against waste fraud and abuse."

D. The Commission inaccurately states that these increased expenses for program integrity were necessary for "discounts" when this level of scrutiny has only been necessary because the Commission required a system of "cash grants" directly to schools and libraries.

Most importantly, all of these program integrity assurances have only been necessary because the FCC required that schools apply for cash grants not merely "discounts" on telecommunications services. If the Commission had merely required that telecommunications carriers provide a certain level of discount for their telecommunications services when provided to schools and libraries, these excessive administrative expenses would have been unnecessary. A complex cash grant system with thousands of applications from schools all over the country was not what Congress envisioned nor what the statute required, and has necessitated a federal bureaucracy to "process" these applications. Auditing and oversight is only needed because of the use of cash grants instead of a more limited discount program. Moreover, if there has to be an application process, at least a state-by-state block grant program would have provided for only 50 applications and a much smaller application review process.

E. I do not believe that the Commission can "continue" to monitor closely when it has not been doing so thus far.

In objecting to the second quarter contribution factors, I noted that SLC was allocated almost four times as much money for administrative expenses as the high-cost/low income funds and that the administrative budget increased from \$2.7 million to \$4.4 million or by 65% in just that one quarter. In objecting to the next quarter's contribution factors, I noted that these increased administrative expenses continued in the third quarter, despite the fact that, at that time, the Schools and Libraries Corporation could not even provide an accurate estimate of all its administrative costs for the first quarter.²⁵ Despite raising these concerns for almost nine months, the Commission continues ahead with the Schools and Libraries Corporation's budget, while raising issues about the budget of other programs. Indeed, the

²⁴ Fourth Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated July 31, 1998, at 2.

²⁵ Third Quarter 1998 Fund Size Requirements for the Schools and Libraries Universal Service Program, dated May 1, 1998. In their subsequent filings, the Schools and Libraries Corporation now calculates their actual First Quarter administrative expenses -- with no offset for interest income earned -- as \$4.4 million. This amount is well in excess of the \$2.7 million that was actually budgeted, and does not even include the additional 1.9 million which was paid to NECA during the first quarter for additional start-up expenses. Fourth Quarter 1998 Fund Size Requirements for the Schools and Libraries Universal Service Program, dated July 31, 1998, at page 3.

Commission has not addressed many of the questions I have raised above, such as what happened to the third and fourth quarter money already allocated to processing the 1999 application forms? And, why shouldn't the FCC review the SLC's budget in a similar manner as Congress reviews this agency's request? With that background, I cannot support the word "continue" in the phrase "continue to monitor closely."

As an example of the Commission's arbitrary scrutiny, I look to the Commission's reference in reviewing the RHCC's budget to making sure that it "serves the public interest."²⁶ First, I note my continuing frustration with such an arbitrary standard. As I have explained above why is the RHCC's excessive budget not in the public interest but the SLC's greater budget in the public interest, despite the fact that both are excessive when compared to the High Cost/Low Income Program's budget? I can only conclude that the Commission has an arbitrary bias in favor of some universal service programs over others.

A better standard to evaluate or monitor the cost of the program is one advocated by the Schools and Libraries Corporation itself -- 1% of the total program ceiling. In its second quarter filing, SLC indicated that

Even with the growth, SLC's current estimate of its program delivery budget is significantly less than 1.0 percent of the program ceiling for 1998 -- and this for a year when the SLC will incur substantial non-recurring start-up costs and will go through two complete cycles of processing applications.²⁷

Using this standard, the SLC's first quarter 1999 budget should only be \$3.25 million. The Schools and Libraries budget now exceeds that by almost \$7 million.

If that standard is too rigorous, however, then why not use the Commission's own statement's from a year ago. In the Public Notice setting the contribution factors for the first quarter of 1998, the Commission stated that:

Administrative expenses appear to be high relative to projected quarterly demand, because start-up costs have been allocated to the first quarter. We anticipate that administrative expenses will total less than two percent of annual program costs.²⁸

Even using this more generous standard, the Schools and Libraries Corporation's budget would exceed a "reasonable" amount (2%) by almost \$4 million. I can only conclude that the Commission does not really intend to "continue to monitor" the expenses of this program with any standard that might be meaningful.

²⁶ Public Notice at 3.

²⁷ Second Quarter 1998 Program Size Projections for the Schools and Libraries Universal Service Program, dated January 30, 1998, at 9.

²⁸ Public Notice released December 16, 1997, at note 20 (referring to RHCC's budget).

III. The Costs of the Schools and Libraries Program Outweigh the Benefits, At Least for Many States

In any event one thing that is clear is that, with such high administrative expenses, the costs of this program outweigh the benefits of it, at least to many particularly rural states. If the total amount requested by every applicant to the schools and libraries program were fully funded, the following rural or high-cost states would not receive as much money -- or just barely as much money -- as the Schools and Libraries Corporation estimates that it will spend on administrative expenses in the *First Quarter of 1999 alone*: Alaska (\$10 million), Arkansas (\$11 million), Idaho (\$5 million), Kansas (\$12 million), Maine (\$3 million), Montana (\$3 million), North Dakota (\$4 million), Nebraska (\$5 million) Nevada (\$8 million), South Dakota (\$4 million), Utah (\$5 million), Vermont (\$3 million), West Virginia (8 million) and Wyoming (\$2 million). In contrast, large states like California (\$277 million), Georgia (\$104 million), Illinois (\$109 million), New York (\$138 million), and Texas (\$169 million) are the big winners as they would all receive in excess of \$100 million. Similarly, even if this distribution is examined on a per capita basis, many rural states would receive 60% or less than the national average: Arkansas, Idaho, Indiana, Kansas, Maine, Missouri, Montana, Nebraska, Oregon, Utah, Vermont, West Virginia, and Wyoming. I do not believe that such a distribution is what Congress intended by the "preservation" and "advancement" of universal service.²⁹ Rather, I believe Congress intended that rural areas should receive the *lion's share* of any increase in the federal universal service fund; support for rural and high-cost areas should not be viewed as the residual after enormous amounts for other federal universal service obligations have been promised.³⁰

Finally, I note that these figures do not even represent all of the costs of the program. Ten million dollars in the first quarter is only the tip of the iceberg. What about the costs of the schools across America that must take the time and expense to fill out these applications? How many teacher, administrative and parent hours have been spent filling out these applications and how much state administrative time has been wasted reviewing them? Moreover, what about the cost of the tens of millions of parents and teachers who have had their expectations raised only to have been crushed by a program that was ill-conceived from the start?

IV. The Size and Scope of the Schools and Libraries Program is in Excess of Congressional Intentions.

In addition, as I have described on several occasions, the size and scope of the current schools and libraries program is far in excess of what was envisioned by Congress and thus

²⁹ 47 USC Section 254 (b).

³⁰ See Press Statement of Commissioner Harold Furchtgott-Roth Regarding the Schools and Libraries Program's First Wave of Commitment Letters; Attachment A.

beyond the Commission's authority to establish.³¹ I believe that the universal service contributions, at least to the extent they are providing support for non-telecommunications services to non-telecommunications carriers, may not be fairly characterized as mere "fees." Some have argued that there is only one section of the act that provides funding for universal service and that any challenge to universal service necessarily sweeps in all of the programs.³² I point out, however, that the contributions for the schools, libraries, and rural health care support mechanisms are based not only on *interstate* but *intrastate* revenues, while the contributions for the high cost program are based solely on interstate revenues. Thus, there are separate rates to fund separate programs.

I have also described on several occasions my conclusion that the legality of the Commission's approach to calculating contributions is highly questionable.³³ As I read the Communications Act, it does not permit the Commission to assess contributions for universal service support mechanisms based on intrastate revenues. Rather, the Act makes clear that the power to collect charges based on such revenues rests within the exclusive province of the States.

Finally, I question whether the Commission's current plan to differentiate among bona fide applications -- as will be necessary with these contribution levels -- is legal. The Commission's rules already consider a schools' economic status in determining the level of support to which they may qualify. The Commission also takes economic status into account to determine whether the schools are even eligible for participation in the inside wiring aspect of the school and libraries program. I do not see how the Commission has the discretion to prioritize among bona fide applications. The universal service provisions of section 254(h)(1) mandate that "upon a bona fide request" the "telecommunications carriers ...shall"

³¹ See Testimony of Commissioner Harold Furchtgott-Roth Regarding Universal Service before the Ways and Means Committee of the House of Representatives. See also, Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding Federal State Joint Board on Universal Service, CC Docket 96-45, *Third Order on Reconsideration*, 12 FCC Rcd 22801 (1997); Statement of Commissioner Harold Furchtgott-Roth Regarding the Second Quarter 1998 Universal Service Contribution Factors, rel. March 20, 1998; Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding the Federal-State Joint Board Report to Congress, rel. April 10, 1998; Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding the Report to Congress in Response to Senate Bill 1768 and Conference Report on H.R. 3579, rel. May 8, 1998; Statement of Commissioner Harold Furchtgott-Roth Regarding the Common Carrier Bureau's Proposed Revisions of 1998 Collection Amounts For Schools and Libraries and Rural Health Care Universal Service Support Mechanisms, rel. May 13, 1998; Statement of Commissioner Harold Furchtgott-Roth Regarding the Common Carrier Bureau's Clarification of "Services" Eligible for Discounts to Schools and Libraries, rel. June 11, 1998; Statement of Commissioner Harold Furchtgott-Roth Regarding the Common Carrier Bureau's Third Quarter 1998 Universal Service Contribution Factors, rel. June 12, 1998.

³² See Testimony of General Counsel Chris Wright Regarding Universal Service before the Ways and Means Committee of the House of Representatives.

³³ Separate Statement of Commissioner Harold Furchtgott-Roth Regarding the Second Quarter 1998 Universal Service Contribution Factors, rel. March 20, 1998; Dissenting Statement of Commissioner Harold Furchtgott-Roth Regarding the Federal-State Joint Board Report to Congress, rel. April 10, 1998.

provide a discount.³⁴ All of the applications that met our previous rules are bona fide requests, and I question the propriety and legality of differentiating among them. In addition, I note that there is no such mandatory language under section 254(h)(2). Thus, I believe that the Commission must ensure that applications that have sought funding under 254(h)(1) are separated from those seeking funding 254(h)(2), and that the Commission ensure that the 254(h)(1) applications for legal services are fully funded. To the extent that an application seeks funding under section 254(h)(2), the Commission must set those applications aside until it can ensure adequate funding for all of the 254(h)(1) applications.

Conclusion

I reiterate my desire that the Commission delay further implementations of this new universal service program until we have addressed *all aspects* of universal service -- including rural and high cost issues. Such a delay would provide us the opportunity to reconsider some of our legal conclusions related to the implementation of this new program, as I believe we must do. At the very least, however, we must become more involved in the oversight of this program and the growing burden its administrative expenses are placing on the telecommunications ratepayers.

³⁴ 47 U.S.C.A. section 254(h)(1)(B).

Attachment A

November 23, 1998

**PRESS STATEMENT REGARDING THE SCHOOLS AND LIBRARIES
CORPORATION'S FIRST WAVE OF COMMITMENT LETTERS
BY FEDERAL COMMUNICATIONS COMMISSIONER
HAROLD FURCHTGOTT-ROTH**

Today, the Schools and Libraries Corporation announced that it has begun issuing commitment letters to schools and libraries across the country. As this program begins, it is an appropriate time to reflect upon what Congress intended for universal service to mean and compare that to how these programs are living up to those goals as envisioned by Congress.

Under the 1996 Act, the Commission's primary universal service responsibility was to establish explicit and sufficient universal service funding for rural America. The clear emphasis of Section 254 is to preserve and enhance universal service in rural, high-cost areas of the country. Rural, high-cost universal service is not just one of many objectives of Section 254; it should be the *highest* priority. There are other goals of Section 254, but it is difficult to read Section 254 in its entirety and understand how a federal universal service fund program could have as its primary emphasis anything other than rural support. It is hard to dispute that the universal service section of the Telecommunications Act of 1996 was primarily intended to aid rural America.

With that goal in mind, let us examine what has taken place. Federal universal service support has nearly doubled in size since passage of the Act. But amazingly, most of that growth has not benefited rural states. Instead, growth of universal service has been for other programs that largely flow to other areas of the country. Indeed, in this first wave of commitment letters from the Schools and Libraries Corporation, states like Alaska (only \$206 thousand), Maine (only \$230 thousand), Montana (only \$335 thousand), North Dakota (only \$241 thousand), Nevada (only \$145 thousand), Vermont (only \$103 thousand) and Wyoming (only \$138 thousand) are all rural states that should be the primary beneficiaries of universal service, but instead they each receive less than 1/2 of one percent (.5%) of this initial distribution. Similarly, South Dakota (only \$394 thousand), West Virginia (only \$470 thousand), New Mexico (only \$578 thousand), Nebraska (only \$692 thousand), Arkansas (only \$621 thousand), Colorado (only \$641 thousand) and Idaho (only \$462 thousand) receive less than 1%. Such a distribution cannot be what Congress envisioned.

Moreover, a close inspection of the total amounts requested by these states reveals a similar bias for urban states in this program. In their latest filing, the Schools and Libraries Corporation estimates that its first quarter 1999 administrative costs will exceed \$10 million.³⁵ If the total amount requested by every applicant were accepted and fully funded, the following rural or high-cost states would not receive as much money -- or just barely as much money -- as the Schools and Libraries Corporation estimates that it will spend in administrative expenses in the First Quarter of 1999 alone: Alaska (\$10 million), Arkansas (\$11 million), Idaho (\$5 million), Kansas (\$12 million), Maine (\$3 million), Montana (\$3

³⁵ First Quarter 1999 Program Size Projections for the Schools and Libraries Universal Service Program, dated November 2, 1998.

million), North Dakota (\$4 million), Nebraska (\$5 million) Nevada (\$8 million), South Dakota (\$4 million), Utah (\$5 million), Vermont (\$3 million), West Virginia (8 million) and Wyoming (\$2 million). In contrast, large states like California (\$277 million), Georgia (\$104 million), Illinois (\$109 million), New York (\$138 million), and Texas (\$169 million) are the big winners as they would all receive in excess of 100 million. Similarly, even if this distribution is examined on a per capita basis, many rural states would receive 60% or less than the national average: Arkansas, Idaho, Indiana, Kansas, Maine, Missouri, Montana, Nebraska, Oregon, Utah, Vermont, West Virginia, and Wyoming. Again, I do not believe that such a distribution is what Congress intended.

As of today, if one includes the Joint Board's recommended decision, the Commission will have provided universal service support for the schools and libraries program, and the rural health care program (although none of that money has been disbursed yet), provided additional support for the lifeline and link-up programs, and provided for additional universal service support for non-rural carriers. In effect, these potential universal service beneficiaries have been "promised" enormous and unending benefits, long before other potential universal service beneficiaries (specifically the rural, high-cost program) have been addressed. I fear that for the small rural carriers, there may not be any money left to help increase their support.

Congress intended -- and the 1996 Act required -- that the Commission focus its efforts on rural, high cost areas *first*, as opposed to finding support for these new programs that primarily benefit other areas of the country. 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 areas should have received the *lion's share* of any increase in the federal universal service fund.