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June 25, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: In the Matter of Federal-State Joint Board on Universal Service, 1998 Biennial Regulatory Review – Streamlined Contributor Federal-State Joint Board on Universal Service Contributor Reporting Requirements Associated With Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms, Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990, Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size, Number Resource Optimization, Telephone Number Portability, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, and 95-116.

Dear Ms. Salas,

Pursuant to Sections 1.415, and 1.419 of the Commission's Rules, please find enclosed the Comments of the Ad Hoc Telecommunications Users Committee in the above-captioned matter.

If you have any questions regarding this filing, please do not hesitate to contact me.

Sincerely,

Colleen Boothby

Colleen Boothby

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
1998 Biennial Regulatory Review -- Streamlined Contributor Reporting Requirements Associated With Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms	)	CC Docket No. 98-171
	)	
Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990	)	CC Docket No. 90-571
	)	
Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size	)	CC Docket No. 92-237 NSD File No. L-00-72
	)	
Number Resource Optimization	)	CC Docket No. 99-200
	)	
Telephone Number Portability	)	CC Docket No. 95-116

COMMENTS OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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June 25, 2001

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Summary

The Commission should fundamentally change the manner in which it assesses carrier contributions to the universal service fund ("USF") and prohibit carriers from recovering their contributions from their customers through marked-up USF charges. The current assessment methodology is economically inefficient, imposes a deadweight loss on the economy and thus on consumers, and is inequitable among consumers and carriers. It will also become unsustainable and a significant administrative burden on carriers and the Commission as changes in the telecommunications marketplace and information technologies shrink interstate telecommunications revenues or make them impossible to isolate from the revenues associated with other telecommunications products.

The universal service principles in section 254 of the Communications Act are not well served by a contribution mechanism that assesses carriers' contributions to the USF based on their interstate and international gross billed end-user revenues. This assessment methodology subsidizes costs which are overwhelmingly non-traffic sensitive with traffic sensitive charges. Consequently, real prices are distorted to a material degree. Carrier USF surcharges on their customers' bill are about 10%, or even higher, and the Bush Administration forecasts a near doubling of USF expenditures over the next five years. Whether or not they are displayed as a separate charge, the USF surcharges that appear on consumers' bills effectively increase the cost of the services subject to the

surcharge. As a result, telecommunications service users will have a growing incentive to seek cheaper substitutes.

Many observers are concerned that services provided via new technologies or Internet applications will, at some point, divert traffic away from services subject to the escalating USF surcharge, reducing the funds available for universal service. The solution to such migration concerns is not to impose USF contribution obligations on new information services. Not only would such an effort be legally indefensible in many instances, it would be economically unjustified and ultimately futile.

Other observers worry that the marketplace trend towards bundled offerings of telecommunications, information services, and equipment will make isolation of telecommunications services revenues impossible, further undermining the current revenue-based contribution mechanism. In the face of increased bundling, the Commission would face a staggering task if it tried to isolate revenues attributable to “basic” services or impute arbitrary revenue levels, because there is no economic basis for a rational imputation of “basic” service revenues to bundled offerings. Ultimately, even the imputation “safe harbors” that the Commission offered in its recent *Bundling Order* will fail because those rules also are economically irrational. They would increase the imputed cost of telecommunications services and undermine the utility of “bundled” service arrangements even though the Commission has concluded that “bundling” is in the public interest. Rather than saddle the marketplace with irrational and unsustainable imputation rules, the Commission should abandon its revenue-based contribution methodology for universal service.

Another fundamentally uneconomic pressure on universal service contribution methodologies is the high cost component of the USF. That component provides subsidies to rural carriers without apparent regard to the uneconomic consequences and sustainability of the fund as currently structured. The fund subsidizes carriers serving high cost areas without regard to those carriers' earnings or the affordability of their basic service rate levels. Moreover, the system ignores the distinct possibility that, as currently structured, the high cost component can make basic service less affordable for subscribers in non-high cost territories. The Commission has paid lip service to affordability in the past when it increased universal service funding rather than increasing certain residential charges. But the Commission has simply never rigorously considered affordability when it designs its subsidy mechanisms. As a result, the uneconomic decisions embedded in the current subsidy system will become increasingly vulnerable to technological and marketplace trends.

The current method of funding the USF is also inequitable among consumers because there is no necessary correlation between use of interstate interexchange services and income levels. Accordingly, some relatively low-income subscribers are undoubtedly subsidizing others in high cost areas who could afford to pay higher rates.

Moreover, subscribers are unevenly affected by the USF surcharge because of where they live. Subscribers who live in areas with communities of interest that cross state lines may pay toll charges that are effectively inflated by the USF surcharge while other consumers living in substantially similar areas that are distant from state lines escape the charge. Put differently, LEC marketing decisions and state regulatory decisions that define the size of local calling areas create significant inequities among residential consumers in the application of a revenue-based USF contribution mechanism.

The "lag" problem discussed in the *Notice* also creates significant inequities among carriers as their relative shares of interstate revenues fluctuate over time. That inequity will become more acute as RBOCs are able to enter the inter-LATA market and aggressively acquire market share.

The Commission can fix some of the forgoing problems by adopting a per line USF charge that would apply to exchange carrier and CMRS provider "lines," including the telephone numbers associated with service-enabled handsets. The administrative burdens of the current revenue-based contribution mechanism would be virtually eliminated. Moreover, because the contribution would be collected without regard to the services or applications provided over the network connection, the Commission can be confident that the USF will be sustainable in the face of technological and marketplace trends that make interstate revenues increasingly difficult to isolate and thus threaten the viability of the current mechanism.

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

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Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
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	)	
Telephone Number Portability	)	CC Docket No. 95-116

Comments of the
Ad Hoc Telecommunications Users Committee

The Ad Hoc Telecommunications Users Committee ("Ad Hoc" or "the Committee") hereby submits its Comments in response to the Commission's May 8, 2001 *Notice of Proposed Rulemaking* ("*Notice*") in the above-captioned proceedings.[1]

[1] *Federal-State Joint Board on Universal Service,* FCC 01-145, 66 Fed. Reg. 28718 (2001), ("*Notice*").

Through the *Notice*, the Commission generally seeks comment on whether it should reform the manner in which it assesses carrier contributions to the universal service fund ("USF") and the manner in which carriers may recover their contributions from their customers.[2] The *Notice* thus recognizes some painful truths about the current universal service subsidy system that some regulators and segments of the telecommunications industry have been reluctant to acknowledge, much less tackle: Fundamental reform of the existing methods for assessing and collecting USF contributions is needed. The current system is economically inefficient and inequitable to both carriers and customers. Given the technological and marketplace forces already at work, the current system will inevitably become a significant administrative burden. In the foreseeable future, the system will simply be unsustainable if it is not re-vamped soon.

I. Straight Talk About The Current System

The Commission always faces political pressure when USF issues, and residential rate changes generally, are on the table. This proceeding is likely to be no different. Most elected officials would prefer that residential rates for telephone service not increase, or not even appear to increase, on their watch regardless of the absolute level of those rates. Ad Hoc understands that reality.

Eventually, however, regulatory authorities including this Commission must acknowledge, if not publicly proclaim, that market place and technological forces will overtake the current system. Even if that were not the case, public officials should ask if the current USF system injects undesirable inefficiencies

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[2] *Id. at* para. 1

into the market that disadvantage all consumers, including those that supposedly benefit from the current system. The question in this proceeding is not whether the existing USF system should be reformed; but rather, how far the Commission will go toward fundamental reform.

A. Statutory Requirements

Section 254 (b) of the Act[3] sets forth the principles upon which the Commission must base its Universal Service policies.[4] These principles require that: (1) quality service should be available at just, reasonable and affordable rates[5]; (2) all regions of the country should have access to telecommunications and information services; (3) low income consumers and consumers in high cost areas should have access to telecommunications and information services at rates that are comparable to the rates charged in urban areas; (4) all providers of telecommunications services should make equitable and nondiscriminatory universal service support payments; (5) the mechanisms used to support universal service should be specific, predictable and sufficient; and (6) schools, libraries and rural health care providers should have access to advanced telecommunications services.

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[3] 47 U.S.C. § 254(b).

[4] Prior to enactment of the Telecommunications Act 1996, the Communications Act did not explicitly address universal service. The Telecommunications Act of 1996 added Section 254 to the Act.

[5] Just, reasonable, and affordable rates for universal service are also required by Section 254(i) of the Act, 47 U.S.C. § 254.

B. The FCC's Response

In May of 1997, the Commission issued a Report and Order adopting its core rules and policies for universal service support in the wake of the statutory changes made by the Telecommunications Act of 1996.[6] Since then the Commission has issued fourteen Reports and Orders and numerous Further Notices of Proposed Rulemaking and Reconsiderations concerning universal service. The universal service regime adopted by the Commission in those orders is a distinct improvement over the implicit cross-subsidization that historically was used support universal service. Nevertheless, as explained below, the current scheme still suffers from serious deficiencies.

The Commission created the funds known collectively as the universal service fund ("USF"), which provides support to low income subscribers for access to telecommunications services; subsidizes access to advanced telecommunications services by schools, libraries and rural health care providers; and subsidizes rural telecommunications service providers. Using a factor set by the FCC every quarter[7], providers of interstate and international telecommunications services pay a percentage of their gross billed end user interstate and international revenues to the USF. Long distance carriers then recover their contributions to the USF through charges that they levy on their

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6 *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8779 (1997), as corrected by *Federal-State Joint Board on Universal Service,* Erratum, CC Docket No. 96-45, FCC 97-157 (rel. June 4, 1997), *aff'd in part, rev'd in part, remanded in part sub nom. Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) *cert. denied* 2000 WL 684656 (U.S. Sup. Ct. May 30, 2000).

7 *See, e.g.,* Public Notice DA 01-1384, "Proposed Third Quarter 2001 Universal Service Contribution Factor," FCC, (rel. June 8, 2001).

customers, typically a percentage surcharge applied to their charges for interstate and international telecommunications services.[8]

The FCC prescribed contribution factor has increased from a low of 2.88% to 6.89% for the third quarter of calendar year 2001. Even after accounting for the effect of the court decision holding that the Commission could not include intrastate revenues in the base on which it calculated carrier contributions to the schools and libraries portion of the USF,[9] the FCC prescribed factor has risen inexorably.[10] The reason for the increase is simple: the USF has grown faster than the billed revenue base against which the contribution factor is applied. An even higher FCC contribution factor appears to be on the horizon. The *Fiscal Year 2002 Budget of the United States Government: Analytical Perspectives* projects that in FY 2006 USF receipts will be over $7.9 billion, an almost 74% increase over the FY 2000 receipts of $4.547 billion.

FCC-mandated subsidies for residential telephone service, and thus universal service, are not limited to the apparently insatiable USF, however. Multi-line business users pay not only subscriber line charges that are supposed to recover the cost of their connections to the public switched network but, in addition, they pay an FCC-approved Presubscribed Interexchange Carrier Charge ("PICC") that subsidizes residential and single line business customers'

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[8] *See Notice* at fn. 13 and Erratum (rel. June 13, 2001).

[9] *Texas Office of Public Utility Counsel v. FCC*, *supra* note 6.

[10] The USF contribution factors prescribed by the FCC have increased from 3.19% in the first quarter of 1998 to 6.89% for the third quarter of 2001. The largest jump occurred in 1999 when the United States Court of Appeals for the Fifth Circuit, in *Texas Office of Public Utility Counsel v. FCC, supra,* ruled that the Commission could not include intrastate revenues in the pool from which contributions to the schools and libraries portion of the USF are calculated.

SLC charges. The PICC recovers the costs of primary residential and single line business loops that exceed the Subscriber Line Charges (SLCs) collected from residential subscribers and single line business customers.[11] The multi-line business PICC has declined as the SLCs collected from residential and single line business subscribers has increased.[12]

The Commission acknowledges in the *Notice* that, to date, it has imposed no specific limits on the ways in which long distance carriers recover their growing USF contributions from their customers.[13] And, in fact, the major long distance carriers recover their contributions through surcharges that far exceed the FCC-prescribed contribution factor, in some cases by more than 74%.[14] The long distance carriers contend that their mark-ups are not simple profiteering or an attempt to take advantage of consumer ignorance regarding the actual, lower factors imposed by the FCC. The IXCs argue that their high mark-ups are needed to cover (1) the administrative overhead of collecting and remitting their USF contributions; (2) the USF surcharges that some customers refuse to pay; and (3) the so-called "lag" problem, *i.e.,* the dollar difference created when a carrier must contribute on the basis of past revenues that have declined by the time the charge is assessed. Ad Hoc, however, is not aware of any data provided by these carriers to support their claims that the mark-up is necessary.

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11 *Access Charge Reform,* 12 FCC Rcd 15982 (1997), *aff'd Southwestern Bell Telephone Co. v. FCC* 153 F.3d 523 (8th Cir. 1998).

12 *Access Charge Reform,* CC Docket No. 96-262, *Sixth Report and Order*, 15 FCC Rcd. 12962 (2000), *appeal pending sub nom. Texas Office of Public Utility Counsel v. FCC,* 5th Cir. Case No. 00-60434.

13 *See Notice,* para. 7.

14 MCI WorldCom Tariff F.C.C. No. 1, Section C 1.061212, issued March 22, 2001.

C. Major Defects In The Current USF System

The current USF system suffers from major deficiencies. It is economically inefficient and inequitable which hurts consumers generally, and it irrationally penalizes particular classes of consumers and carriers. Moreover, due to a variety of technological and marketplace factors, the current system will eventually implode. Stop-gap efforts to shore up this fundamentally flawed system would only impose inordinately high administrative burdens and costs on both carriers and the Commission.

1. End User Billed Revenues Are An Economically Inefficient Basis For Assessing Contributions.

The current system of assessing USF contributions based on end user billed revenues is economically inefficient because it effectively seeks to recover non-traffic sensitive costs[15] on a traffic-sensitive basis; it creates incentives for uneconomic bypass; and it creates a classic "deadweight loss" for the economy.

Economic theory dictates that traffic-sensitive charges should not be used to recover non-traffic sensitive costs. The Commission has subscribed to this point of view since the advent of its access charge plan. A brief account of the Commission's reasoning regarding the planned phase-down of Carrier Common Line Charges ("CCLC") reveals the Commission's rationale for this approach.

[15] The vast majority of the USF costs presently being recovered by the surcharge are entirely non-traffic sensitive – with most of the funding directed either to loops or the E-fund. For purposes of our discussion here, they will be described as entirely non-traffic sensitive. The single component of the existing USF funding package that is arguably traffic sensitive is related to Dial Equipment Minutes (DEM) weightings of switching costs, but this is a very small piece of the overall funding requirement. Moreover, even though these limited switching costs may be sensitive to the traffic levels transmitted over the switches being subsidized, they are not sensitive to the levels of traffic actually being surcharged.

The similarity between the workings of the CCLC (which was assessed on a per-minute of use basis) and the current USF mechanism (which is assessed as a surcharge on billed end-user revenues) is striking. In both cases, the magnitude of the charges that are assessed upon the IXCs (to eventually be paid by end-users) is entirely dependent upon the level of traffic being generated, even though the revenues are being used to fund non-traffic sensitive costs. In the case of the CCLC, the Commission found that traffic sensitive charges are not an economically efficient mechanism for recovering non-traffic sensitive costs:

> The per minute CCL charge paid by IXCs and reflected in their interstate toll rates forces high volume residential and business toll users to pay charges that exceed the local loop costs they impose on the network. This creates incentives for high volume toll customers to use competitors even when the LEC would be the most efficient access provider. Increasingly, IXCs and large business customers have alternatives to use of LEC facilities for the origination and termination of interstate traffic, particularly in major urban business centers. In such areas, they can avoid support flows inherent in the current access charge rate structure, including the CCL charge. In the long run, inefficient bypass of the LEC networks by high volume toll customers could threaten to undermine the support flows that foster universal service.[16]

The Commission concluded that "long run reliance on usage-based prices for the recovery of fixed-costs will distort economy-wide investment decisions, artificially restrict calling patterns, and may jeopardize the competitive position the U.S. now holds in the world marketplace."[17] The Commission cited two

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16 *End User Common Line Charges*, FCC CC Docket No. 95-72, *Notice of Proposed Rulemaking*, FCC 95-212, rel. May 30, 1995, at para. 20.

17 *MTS and WATS Market-Structure*, FCC CC Docket No. 78-72, Phase I, Released February 28, 1983 at para. 112. ("*Third Report and Order*")

studies that estimated the cost of inefficient pricing to consumers at between $1.5 and $1.7-billion annually.[18]

While the "bypass" concerns the Commission expressed in 1995 are not identical in this situation, the problem is conceptually identical. By targeting a particular class of service (generally, interstate and international inter-exchange service) offered by particular classes of carriers (primarily IXCs) for recovery of costs not associated with the target service, the present system distorts prices and customer choice decisions, and causes customers to seek out service configurations that minimize the impact of the surcharge (while not necessarily minimizing the true costs of providing the services).

The current USF mechanism, essentially a tax on revenues, is inefficient because carriers pass these required contributions on to subscribers, thus distorting prices. In response, subscribers demand less of the service at any given price, resulting in a "deadweight loss" to both consumers and producers.[19]

Finally, the current funding mechanism is particularly problematic because it imposes the surcharge, or tax, on more elastic telecommunications service offerings (*i.e.*, interstate and international interexchange services) and exempts the least elastic services (*i.e.*, local exchange).[20] "Optimal taxation literature" demonstrates that services should be taxed inversely to their elasticity of

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[18] *Third Report and Order* at para 112 and footnote 39. The loss estimated by these studies is solely for consumers, and does not include any additional loss to producers.

[19] James Prieger, "Universal Service and the Telecommunications Act of 1996: The Fact After the Act," *Telecommunications Policy*, Vol. 22, No. 1 (1998), pp. 57-71 ("Prieger"), at 64.

[20] *Id.* at 66.

demand.[21] Thus, the most efficient way to fund the universal service program would be to apply the surcharge (tax) on local access service, given that its elasticity of demand is so low. Because the current system relies on the application of a surcharge on the most elastic services, the USF program distorts the market (by distorting both demand and prices) even more than is necessary.[22]

2. The High Cost Fund Has Grown Without Demonstrated Need.

The high cost portion of the USF consumed the largest portion of the current USF since its inception in 1998. According to data appended to a recent report on Universal Service, eligible telecommunications carriers serving high cost areas received, and are projected to receive, USF support of about $6.1 billion for the period 1998 through 2000.[23] This amount constitutes over 58% of the total USF disbursements for that period, and will grow in absolute and relative terms as a result of the Commission's Fourteenth Report and Order in CC Docket 96-45 ("RTF Order") adopting the recommendations of the Rural Task Force.[24]

Some level of support for eligible telecommunications carriers ("ETCs") serving high cost areas may be appropriate. If a carrier's costs are above a

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21 *Id.*

22 *Id.*

23 *Universal Service: Policy Issues for the 21st Century,* at 65, Consumer Energy Council of America, March 2001.

24 *Federal-State Joint Board on Universal Service*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further *Notice* of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, FCC 01-157 (rel. May 23, 2001), ("*RTF Order*").

threshold level, if their earnings are not excessive, and if their rates are not artificially low, some level of subsidization would be in order to assure that (1) their rates are reasonably comparable to rates paid in other parts of the country; (2) their customers receive quality service; and (3) the ETCs remain financially viable.

Under the current USF system, however, subsidy flows are not dependent on, or even related to, the earnings of the ETCs serving high cost areas. Thus, companies earning excessive returns remain eligible for universal service subsidy payments. Nor is USF support related to rate levels. Companies can charge local service rates far lower than those that their customers could easily afford, snug in the knowledge that interstate rate payers in the rest of the country, including low-income subscribers whose own local service rates might be far higher, will be forced to make up the difference in the form of higher prices for long distance.

The *RTF* Order exemplifies this fractured approach to Universal Service Funding. In that Order, the Commission increased the level of high cost support for rural companies with conclusory references to the need to assure that high cost support is "sufficient."[25] More particularly, in opting to increase high cost loop support, the Commission stated that its decision is a,

> [r]easonable approach to accomplishing the sufficiency balance here because we do not want to stifle prudent investment while we continue to transition rural carriers to a support mechanism based on forward-looking economic costs.[26]

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[25] *RTF Order*, paras. 26-28.

[26] *Id.* at para 42.

The Commission went on to conclude that,

> [r]e-basing the indexed fund will ensure that eligible rural telephone companies are able to continue making prudent investments in rural facilities for the next five years, while we develop a more targeted high-cost mechanism for rural telephone companies.[27]

As most recently evidenced in the *RTF Order,* but throughout the short life of the high cost support program, the Commission once again avoided a number of difficult substantive questions. The questions include, but are not limited to, the following:

- Do all of the carriers who receive high cost subsidies need the subsidies to maintain their financial health? Or would their returns be generous even without a subsidy?

- How much subsidy really is needed to assure the availability of quality service at reasonable rates in high cost communities? Would an individual carrier's quality of service suffer without its subsidy? Would local service rate increases in lieu of a full subsidy produce rates that are still reasonable? Rates that are lower than those paid by consumers in areas that cannot qualify for a subsidy?

- Do the carriers who receive high cost subsidies use the subsidies to keep their rates for telephone service in their operating areas lower than otherwise would be the case? Or do they use the subsidies to benefit owners or to enhance their profitability?

- Is the requirement for reasonable rate comparability of such paramount importance that wealthy and middle class telephone service subscribers in high cost rural areas should receive subsidies without regard to the need for the subsidies to maintain affordable service? Is such subsidization equitable? Generally, is it equitable that lower income subscribers, not including those who qualify for low-income assistance, subsidize carriers that serve wealthy high cost areas?

- What is the economic efficiency cost of the high cost portion of the USF?

[27] *Id.* at para 43

Despite the fact that the high cost portion of the USF has grown, and will grow, faster than other parts of the USF, the Commission has never collected the data that would enable it to answer these questions nor has it ever indicated that the information would be relevant to its analysis.

3. The Current USF Contribution Mechanism Is Inequitable As Among End Users.

Searching questions are easy to pose with respect to the other forms of subsidization for residential telephone service. For example, in reforming interstate access charges, the Commission has repeatedly noted its concern about the "affordability" of higher line charges for residential customers.[28] Why is it good government policy to indiscriminately subsidize residential service without regard to the income of those who receive the subsidies and those who provide the subsidies? Does it make sense to send 40% of the low-income assistance to California where residents can self-certify that they are eligible for such assistance? Is it equitable to require telephone subscribers who may be of modest means, but who spend relatively substantial amounts for interstate and international long distance service, to pay usage-based high cost loop subsidies that benefit higher income subscribers?

Fundamentally, the purpose of universal service subsidies should be to make telephone service affordable to customers whose household income might not be sufficient to cover an undistorted price for basic local access. To achieve

[28] *Access Charge Reform*, *supra*, note 12.

this goal, a goal that Ad Hoc fully supports, the support mechanism must avoid burdening the very group of customers that are the intended beneficiaries.

Under a revenue-based funding scheme, high-volume customers effectively subsidize low-volume customers when the goal is to have high-*income* customers subsidize those at the low end of the economic spectrum. A revenue-based funding mechanism implicitly presupposes that there is some correlation between *income* and *interstate usage*, yet the Commission has cited no factual evidence that would support such a finding. And there are actually a number of reasons to expect that, all else being equal, low-income households may well generate the same, or perhaps greater, volumes of interstate long distance calling than their higher-income counterparts. For example, persons in low-income households may be less able to afford travel and more dependent on telecommunications to maintain family ties. Low-income customers may have fewer substitutes for interstate toll calling available to them, such as e-mail or web access. And higher-income consumers are more likely to own a second home, for vacation purposes, which would typically exhibit extremely low toll calling and thus make almost no USF contribution during most months of the year. And those low-income customers who are not low-volume toll users will be subsidizing higher-income households in high-cost areas via a revenue-based USF contribution mechanism.

A revenue-based funding mechanism that is tied to a customer's volume of interstate toll calling is also inherently unfair because the actual amount of interstate toll usage, and the relative proportion of interstate calling, presented by any given customer is heavily dependent upon where that customer happens to be located. All else being equal, the community of interest for customers in geographically large states with multiple metropolitan areas, such as Texas, California, Florida, and Ohio, will typically involve more in-state points than for otherwise comparable customers in geographically small states, like those in the northeast where major metropolitan areas straddle state lines and where cross-border calling is subject to toll, rather than local, rate treatment, as is the case in the New York/Northern New Jersey/Connecticut, Philadelphia/Camden/ Wilmington, and Chicago/Northwestern Indiana metropolitan areas. There is no obvious reason why some customers should be required to make larger USF contributions than others merely because they happen to live in smaller states or near a state line.[29]

Indeed, even customers with comparable proximity to out-of-state points within their normal community of interest may be treated differently under a surcharging mechanism that is driven by retail interstate toll revenue. Compare, for example, the treatment of cross-border calls within the Washington, D.C. metropolitan area and those within the New York/Northern New Jersey metropolitan area. In the Washington metro area, calls between a point in DC and suburban Maryland or Virginia, or calls between a caller in suburban Maryland and one in Northern Virginia, while physically interstate (in that they each cross a state boundary) are rated as local calls and are thus not embraced within the revenue-based USF surcharge. On the other hand, calls between

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[29] As an example, interstate revenues account for 49.94% of total revenues in Delaware, and only 31.76% of revenues in California. See, FCC Industry Analysis Division Report,

Manhattan and points in Northern New Jersey, which may involve distances as short as two miles, are rated as interstate toll and are subject to the revenue-based USF surcharge. There is no consistent pattern, policy or rationale for the particular rate treatment that applies in each multi-state situation, yet the type of rate treatment critically impacts the dollar amount of surcharge than any given customer must pay. Under the existing revenue-based surcharge, customers living close to state lines, or in multistate metropolitan areas where toll charges apply for the inter-jurisdictional calls, are unfairly being required to subsidize the rest of the country.

The revenue-based surcharge also disfavors those customers who, by virtue of relatively low volumes of interstate toll calling, pay relatively higher per-minute toll rates than those customers who subscribe to a discount toll calling plan. By-the-call long distance rates may be as high as 30 cents per minute, whereas block-of-time rates as low as 5 cents per minute. Under a fixed percentage, revenue-based surcharge, the low-volume DDD user would be required to pay up to six times as much per minute in USF surcharges as the higher-volume block-of-time customer.

4. The Current USF System Is Inequitable As Among Carriers.

In the *Notice*, the Commission acknowledges that “some carriers have argued that the existing mechanism, which is based on historical revenues, may give advantages to certain new entrants, while disadvantaging carriers with

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State-to-State Telephone Revenues and Universal Service Data, April 2001; Table 2.

declining revenues,"[30] contrary to the Act's requirement of equitable contributions. The Commission seeks comment on whether to assess carrier contributions based on current or projected interexchange revenues. As discussed in the following paragraphs, any system based on revenues, whether historic, current, or projected, would introduce the same inequities. Accordingly, Ad Hoc urges the Commission to abandon the existing mechanism of assessing carrier contributions based on revenues.

The current methodology that the Commission uses to assess carrier contributions is based on reported historical billed end-user interexchange telecommunications revenues. Originally, a carrier would report its end-user revenues semi-annually, and contributions were determined based on a carrier's historic, billed end user revenues from the prior year. Therefore, the methodology created a "USF Lag" of 12 months, in which the carrier was being assessed a contribution level based on revenues accrued 12 months ago. The 12-month lag created an inequitable and anti-competitive situation, in which carriers with declining market shares were responsible for a level of contribution that correlated with their higher end-user billed revenues of 12 months past, while new entrants in the developing market who captured new market share were not contributing to the USF fund because they were not operational, and therefore not reporting billed revenues, a year before. Earlier this year, the Commission reduced the length of the "USF Lag" by reducing the interval

[30] *Notice* at para. 20.

between the accrual of revenues by carriers and assessment of contributions based on those revenues from 12 months to an average of 6 months.[31]

But the reduction of the interval between revenue accrual and contribution assessment based on those revenues, while helpful, is not enough to correct the inequalities that the current methodology creates. As the Commission observed in the *Notice*, the mere reliance on historic revenues to assess carrier contributions may create a disadvantage for carriers with decreasing revenues (and an advantage for carriers with increasing revenues).[32] The possibility of disadvantaging carriers with decreasing revenues is inconsistent with the Commission's established principle that "universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another."[33] As such the Commission should replace the current mechanism with a mechanism that assesses universal service contributions in a competitively neutral and equitable fashion.

As an alternative to the current methodology based on historic billed revenues, the Commission seeks comment on whether to assess universal service contributions based on current or projected revenues.[34] The problem with this approach is that carrier revenues fluctuate month to month. So the lag would never be eliminated completely. Relying upon projected revenues to

31 *Notice* at para. 10. *Federal-State Joint Board on Universal Service, Petition for Reconsideration filed by AT&T, CC Docket No. 96-45*, Report and Order and Order on Reconsideration, FCC 01-85, (rel. March 14, 2001).

32 *Notice* at para. 15.

33 *First Report and Order*, 12 FCC Rcd at 8801-03 paras. 46-51.

assess carrier contributions would create many of the same inequalities associated with the use of historic revenues. A carrier cannot accurately project its future revenues, in the same way that it cannot project future market conditions, regulatory and policy changes, or the entrance (or exit) of viable competitors. To ensure that the fund is sufficient and that carriers are projecting reasonably, the Commission would have to impose significant accounting and administrative requirements that would be even more burdensome than those already in place. Any system based on "current" revenues would face the same "lag" issues involved in calculating historic revenues. Ad Hoc sees no plausible methodology that calculates carrier contributions using current or projected revenues that would eliminate the current inequalities present in the historic revenue approach (without creating new ones) and without becoming an administrative nightmare.

5. The Current USF System Is Administratively Burdensome Now And Unsustainable in the Near Future.

Administration of a USF funding mechanism that is based on relative levels of interstate toll calling requires that such usage be segregated and separately identified on a customer's bill. That requirement will become increasingly difficult to satisfy as carriers introduce new and innovative service packages and pricing plans. Technology and marketplace imperatives will blur the distinctions between, and thus the revenue streams attributable to, interstate

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[34] *Notice* at para. 20.

telecommunications, intrastate telecommunications, information services, and equipment, in a variety of ways.

First, jurisdictional lines between intrastate and interstate traffic are notoriously fluid. In fact, the local/toll distinction is entirely related to the ILECs' retail marketing considerations.

The definitions of "telephone exchange service" and "telephone toll service" are set forth at 47 U.S.C. §153, subsections (47) and (48). "Telephone exchange service" — that is, local service — is defined very broadly as "intercommunicating service" either within an "exchange" or "within a connected system" of "exchanges," or any "comparable service provided through a system of switches, transmission equipment, or other facilities." Essentially, if a service is "covered by the exchange service charge," *i.e.,* the customer pays a local rate for what the customer gets, then whatever the customer gets is exchange service. On the other side of the coin, "telephone toll service" (47 U.S.C. § 153(48)) is simply calling between exchanges for which there is a "separate charge not included in" the charge for "exchange service." In other words, toll service is any telephone service for which the customer pays a toll charge.

These definitions might appear circular, but they properly and helpfully emphasize the fundamentally artificial nature of the toll/local distinction. There is no inherent way to determine that a call across the street, across the state, or between points in two different states or even two different LATAs should be treated as "local" or "toll." In a monopoly environment, that is simply a regulatory decision, which is why some states have large local calling areas and others have small ones, and why some multi-state metropolitan areas have cross-state local rate plans (like the DC metro) while others apply interstate toll charges for the same types of calls (like in New York/New Jersey).

But in a competitive environment, that distinction will be made by competing carriers on the basis of competitive considerations. This means that the traditional incumbent LEC delineation as to what constitutes "local" versus "toll" calls is highly fluid at this point in time. Inasmuch as any distance-sensitive *costs* associated with switched telephone calls (local or toll, short- or long-haul) have long since disappeared as networks have been upgraded with modern fiber optic transport and digital switching technologies, growth of competition in local telephone service is likely to erode the local/toll distinction altogether. Indeed, precisely this has already happened in the wireless services field, a segment of the telecommunications industry that a just-released FCC study[35] has found to be intensely competitive.

While RBOCs lacking Section 271 interLATA authority would generally be precluded from defining their local calling areas to embrace portions of multiple LATAs, nothing in the statute or in Commission regulations would preclude a CLEC from, for example, defining the entire country as its "local calling area" and as such offer its customers nationwide calling without any toll, and thus without any revenue-based universal service, charges. Thus, a USF surcharge that is linked to existing ILEC local/toll rate distinctions will necessarily distort service

35 *See* FCC Wireless Telecommunications Bureau, Press Release, *FCC Adopts Annual Report on State of Competition in the Wireless Industry*, released June 20, 2001 and the accompanying presentations: *Report to Congress, Sixth Annual CMRS Competition*

packaging and pricing decisions on the part of carriers, and result in even more disparities with respect to the respective contributions to be made by individual residential and business consumers.

Beside the potential for fundamental changes in the way "toll" calls are defined by individual carriers, the marketplace-driven bundling and packaging of toll and other non-toll services will also exacerbate the administrative burden of a revenue-based USF mechanism. Sprint, for example, has recently introduced a "block-of-time" 500-minutes-per-month toll calling plan. As intrastate access charges are brought into closer alignment with interstate charges, such block-of-time packages may well include both in-state as well as interstate calling. A funding mechanism based upon interstate revenues would then need to allocate a portion of the block-of-time charge to the interstate jurisdiction, and that portion would vary based both upon the total number of minutes used by the customer in any given month, and by the relative portion of those minutes that were used to place interstate calls.

In addition to the fluidity of jurisdictional line-drawing, the current USF contribution methodology will be undermined by technological advances in, and the resulting consumer demand for, information services. Some observers fear, for example, that voice over the internet will one day become more than a service used by tech enthusiasts. They fear that voice over the internet will become a robust technological substitute for current basic telecommunications services, opening up difficult and complex issues regarding whether such services are

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Report, June 20, 2001; and *Thomas J. Sugrue Opening Remarks*, June 20, 2001. http://www.fcc.gov/wtb/.

“telecommunications” whose providers must contribute directly to the USF, or “information services” whose providers already contribute through their purchases of the underlying telecommunications used to deliver their services. Other observers worry that the internet could be used to supplant current basic data transport services and that growing numbers of consumers and businesses will substitute e-mail and instant messaging for traditional, basic telecommunications services.

These fears may be well founded. Residential and business consumers will migrate to technological substitutes that are cheaper and equally reliable, and competitive markets are supposed to produce better ways to meet the demands of consumers. The Commission cannot stop such a migration and, like King Canute, should see through the efforts of those who would have it try to hold back the tide of technological progress and marketplace evolution.

The Commission faces similar problems with the carriers’ newly granted freedom to bundle basic telecommunications services with information services and customer premises equipment (CPE).[36] The Commission proposed two safe harbors that are completely unrealistic and will not prevent the erosion of revenues against which the USF surcharge is applied.[37] The Commission has suggested that to avoid an audit or an enforcement action, carriers may treat all of the revenue from bundled offerings as basic service revenue, or alternatively, they may attribute the entire discount embedded in the bundled offering to the non-telecommunications services and products, effectively imputing a high unit

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[36] *Id.*

price to the telecommunications services provided in the bundled offering. The Commission, in effect, is encouraging distorted pricing and discouraging carriers from economically-efficient, market-driven bundled pricing, in the name of preserving the stability of the USF, despite the fact that it has found that bundling will serve the public interest. If market forces compel carriers to bundle, they will not use the Commission-designated safe harbors. Then the Commission will either accept the carriers' reported revenues or face the daunting challenge of auditing many complex transactions, with levels of bundling that the Commission acknowledges it cannot anticipate.[38]

The implications for USF funding of migration to information services and bundled offerings are obvious, albeit perhaps not currently quantifiable. Interstate and international revenues will shrink relative to demand for USF support. If it does not implement fundamental reform now, the Commission will then have only undesirable options from which to choose. It could try to produce more USF support from remaining telecommunications services by increasing the Commission-prescribed USF factor. Or it could impose a contribution obligation on a broader range of services.

The first option – increasing the Commission-prescribed USF factor – will only increase the economic incentives for consumers to find technological substitutes that are not subject to an uneconomic USF surcharge. Some residential customers already are paying a USF surcharge of 12%[39] plus, on

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37 *Id. at* paras. 49-51

38 *Id. at* para. 49

39 *See* note 15, *supra*.

certain services, a 3% federal excise tax.[40] And the economic incentives to develop technological alternatives to basic telecommunications service will, of course, increase as the USF surcharge climbs.

The other option – requiring USF contributions from services other than telecommunications -- cannot survive legal challenge. Section 254(d) of the Communications Act limits USF contribution obligations to telecommunications carriers and providers of telecommunications.

Even if the Commission were to redefine basic service so that it captured some of the technological alternatives that today would not be considered telecommunications services, it would probably accomplish little in so doing. Internet Service Providers (ISPs) can, and do, offer many functionalities, *e.g.,* access to information provided by others, e-mail, instant messaging, a variety of other information services and perhaps voice over the internet, for a single bundled price. Alternatively, some ISPs may choose to offer voice over the internet at a discrete price, but at prices well below those for basic voice telecommunications service.

The imputation rules adopted by the Commission in its recent *Bundling Order*[41] will not work to prevent erosion of the revenue base that supports the USF. Discrete pricing information for voice over the internet will not exist in many

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40 *See* 26 U.S.C. §4251.

41 *Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review --Review of Customer Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange, Exchange Access and Local Exchange Markets, CC Docket Nos. 96-61 and 98-183, Report and Order, FCC No. 01-98 (rel. March 30, 2001) ("Bundling Order").*

instances or, if such pricing does exist in some instances, the revenues subject to the Commission prescribed USF surcharge in all likelihood will be well below the traditional service revenues that would have been subject to the surcharge.[42] ISPs would be foolish to price in a way that would increase their USF contribution obligations and deny them a marketing advantage.

In sum, the current USF funding system already is economically inefficient and inequitable as among users and carriers, and will become administratively burdensome and unsustainable in the near future. Ad Hoc does not expect the Commission to address as a result of the *Notice* all of the deficiencies in the current USF system. Nevertheless, the Commission can make some important partial fixes. The suggestions that follow would result in a USF system that would be (1) more consistent with economic efficiency goals; (2) more equitable; (3) easier to implement and administer; and (4) sustainable.

II. USF Contributions Should Be Assessed on a Flat-Rated, Per Line Basis

The *Notice* seeks comment on whether to assess universal service contributions on a flat-fee basis, such as a per line or per account charge.[43] Ad Hoc supports a per line assessment for universal service contributions because that rate structure would be more economically efficient; would eliminate the end user and carrier inequities created by an end user revenue methodology, discussed above; would be administratively less burdensome; and would be

[42] *Id.*

[43] *Notice* at paras. 25-30.

sustainable despite the technological and marketplace forces identified in Section I.C.5, supra.

Accordingly, Ad Hoc urges the Commission to replace its existing contribution mechanism based on end user revenues with a non-traffic sensitive, flat-rated charge that would apply to every line connected to the public switched network. The charge would thus apply to every line connected to a local exchange carrier's switch, whether the switch belongs to an incumbent LEC or a competitive LEC. Wireless services that connect to the public switched network and thus receive the benefits of universal service should contribute on a comparable basis, *i.e.*, per telephone number associated with a service-enabled handset.

The data and public reporting requirements needed to calculate and assess a per line charge of this kind are already in place -- the relevant "nose count" should be the line count the carriers are using now to assess subscriber line charges ("SLCs") and, in the case of wireless providers, the telephone numbers associated with service-enabled handsets. Because the carriers have already established and currently maintain the necessary databases to apply a monthly charge, and the Commission has already addressed and resolved measurement issues such as PBX trunk and ISDN equivalencies, charges for Centrex lines, etc., a monthly USF charge would not be unduly burdensome to calculate and collect. [44]

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[44] *See, e.g.,* 47 C.F.R.§ 69.152 (l)(2) (PRI ISDN EUCL ratio).

A. A Per Line Assessment Is Economically Efficient

A per-line charge to fund USF is the most economically efficient mechanism. As discussed in Section I.C.1 above, the use of a revenue- based mechanism to fund universal service subsidies for non-traffic sensitive plant distorts prices and results in a deadweight loss to consumers. A per-line charge would eliminate those very inefficiencies, resulting in lower prices which benefit both end users and carriers. In addition, a per line charge would enhance competition by removing from the marketplace the distorted price signals that result from a traffic-sensitive universal service charge.

In contrast to the current revenue mechanism, which replicates the negative effects of the traffic-sensitive CCLC that the Commission has labored for so many years to eliminate, the use of a per-line charge is a much more efficient model to use for assessing USF contributions. As one economist observed with respect to the existing SLC, "[b]asic principles of economics show that it is efficient to allow prices to reflect the manner in which costs are incurred. Since subscriber line costs are not traffic-sensitive, the SLC is exactly the right place to recover those costs." [45] In addition, "[g]iven that subscribership in the United States has proven to be extremely insensitive to price change for all but the lowest income levels, a charge like the SLC is the best way to cover the costs of a universal service program."[46]

In phasing out the CCLC, the Commission explicitly rejected the notion that high-volume users should be required to contribute more towards loop costs

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[45] Prieger, at 61, footnote omitted.

than (*i.e.*, subsidize) low-volume users.[47] It likewise determined that subscribers need not necessarily make interstate calls before an interstate charge could be assessed.[48] The Commission reasoned that when an end user subscribes to a line that connects to a local dial switch, he/she gains access to both interstate and local services and that the access is non-traffic sensitive. Thus, there is a cost whether or not calls are actually made. "A subscriber who does not make local calls would normally pay a flat fee for the exchange portion of such costs. Imposing a flat [charge] for the interstate portion of those costs is equally reasonable. Any other procedure violates the general principle that costs should be recovered from the cost-causative ratepayer when it is possible to do so." [49]

The Commission's reasoning applies equally to the current revenue-sensitive universal service charge. Because the costs subsidized by universal service charges almost entirely consist of non-traffic sensitive loop plant, the more economically efficient rate structure is a per line charge.

B. A Per Line Assessment Eliminates Inequities Among Carriers and End Users

As discussed in Sections I.C.3 and I.C.4, above, the current system creates serious inequities in the contributions paid by different end user groups and different carriers. A per line charge eliminates those inequities if it is properly structured.

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46 *Id.*

47 *Third Report and Order, supra* note 17 at para. 112

48 *Id.*

49 *Id.*

First, since § 254 (d) of the Act authorizes the Commission to collect contributions only from telecommunications providers, the per line charge must be assessed only on service providers. The statute also requires any service provider contribution to be assessed on an "equitable" basis. But carrier contributions to universal service are ultimately paid by end users. Thus, any determination as to whether a contribution mechanism is "equitable" must also take into account whether the carrier contribution can be passed through to end users on an "equitable" basis. Moreover, when carriers make end users the ultimate payor of the contribution, carriers are fully reimbursed for any contribution they make. To the extent that such reimbursement occurs, so that the contribution requirement is revenue-neutral from the carrier's perspective, any contribution paid by all providers of the same telecommunications service is nevertheless "equitable," even if providers of other services are not subject to the contribution requirement.

Only a per line charge paid by local exchange carriers – whether they are incumbents or new competitive entrants – and CMRS providers can be "equitable" under this two-pronged standard. These carriers (and only these carriers) have the necessary line count data and billing systems to calculate a per line charge based on the most current demand data. Thus, a monthly per line charge paid by LECs and CMRS providers eliminates the anti-competitive and inequitable consequences for service providers of the "USF lag" problem discussed in Section I.C.4., above. For the same reason, only these carriers have the necessary data and billing systems to pass through their contribution to end users on a per line basis that is “equitable,” i.e., based on current and accurate demand data. Thus, the charge eliminates (1) the current scheme’s inequitable subsidy of customers with low interstate calling volumes by customers with high interstate calling volumes; and (2) the inequitable treatment of end users with identical traffic patterns whose geographic calling areas produce disproportionate interstate traffic levels, discussed in Section I.C.3.

Section I.C.3. also pointed out the inequities imposed by the current contribution mechanism as between residential and business users and high-income and low-income subscribers. With the exception of the Lifeline service rules,[50] the current contribution mechanism fails to rationally apply “affordability” as a universal service principle. The inequities caused by subsidization without proper consideration of affordability can not be cured by a per line approach unless the Commission establishes a single per line charge that is adjusted only to reflect the end user’s ability to pay. Thus, the same per line charge should be applied to all business lines and all residential lines, unless a rigorous affordability analysis justifies different charges in individual cases. For example, a lower per line residential charge can be established for low-income subscribers who qualify for Lifeline and Linkup programs.

C. A Per Line Assessment Would Reduce Administrative Burdens

Implementation of a USF system based upon monthly per-line charges would be administratively simple for both the carriers and the Commission, for a number of reasons. First, a per line contribution requirement applicable only to

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[50] 47 C.F.R. § 54.409

LECs and CMRS providers would apply precisely to those carriers who already have the necessary line data and billing systems to both calculate a monthly charge per line and recover it as an explicit charge from their end users. Second, the necessary data regarding the total number and type of lines as well as the lines attributable to individual end users is already being collected for purposes of the SLCs.[51] The databases and billing systems are already in place and subject to verification and crosschecking by virtue of their use for other purposes. The Commission has already adopted equivalency ratios for determining the number of per line charges that should apply to facilities such as PBX trunks and ISDN lines. And the Commission already collects much of this data as part of the ILEC price cap filings, ARMIS filings, and local competition filings. In short, the administrative infrastructure is already in place.

A per line charge would also lessen the administrative burden currently imposed as a result of the Commission's *Bundling Order.*[52] As discussed in Section I.C.5., *supra*, that order contemplates a variety of complex price imputation, cost allocation, and audit mechanisms to police the calculation of the USF contribution attributable to a bundled offering under the current revenue approach. But a per line charge would apply regardless of the services provided over a line or the equipment and/or information services bundled with any telecommunications offering that uses that line. Thus, a per line charge would

[51] CMRS providers are not subject to the Commission's Part 69 access rules and do not collect a SLC. However, the prevalence of CMRS pricing plans that include monthly minimums or service charges, the CMRS providers' need to associate traffic with the telephone number for a service-enabled handset for standard billing purposes, and the imposition of monthly E911 charges suggest that it would not be unduly burdensome for such providers to collect a monthly USF charge.

obviate the need for the inherently arbitrary price imputation and burdensome enforcement mechanisms required under the *Bundling Order*.

D. A Per Line Assessment Would Establish A Sustainable Funding Mechanism for Universal Service

Finally, a per line contribution mechanism is a powerful solution to the sustainability issues that will inevitably arise as a result of the technological and marketplace changes described in Section I.C.5, above.

A per line charge can be applied regardless of the service for which a particular line is used. Thus, new technologies that allow subscribers to use the same communications facilities for both telecommunications and information services will not affect the revenues generated by the contribution mechanism nor will they result in disparate payments by different end users. Similarly, the migration of demand from traditional telecommunications services to Internet-based and other information services will have no necessary impact on the recovery of universal service contributions because subscriber use of those services will not disturb the line count for the underlying telecommunications facilities used to provide the services.

Finally, the marketplace trend towards offerings that bundle jurisdictionally mixed telecommunications services, information services, and CPE will no longer threaten the revenues produced by the contribution mechanism and the equitable collection of contributions. Under a per line approach, carriers can collect the

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[52] *See Bundling Order, supra,* note 41.

requisite line charge regardless of the overall package price a subscriber might pay when it purchases a bundled offering.

III. The Commission Must End The Carriers' Practice Of Turning USF Assessments Into A Profit Center

It is time for the Commission to end the carriers' practice of converting their USF contributions into a profit center. As the *Notice* recognizes, carriers are marking up their contribution amounts and passing the higher amount through to their customers.[53] By marking up their contribution and characterizing the increased charge as a mere pass-through of the amount paid by the carrier as a USF assessment, carriers have grossly misrepresented the nature of their charges and unreasonably inflated the USF charges paid by end users.

And the problem is getting worse. The *Notice* observes that, while carriers were ***paying*** a contribution factor of 5.6688 percent in the fourth quarter of 2000, AT&T and Sprint were ***charging*** as much as 8.6 percent for selected services.[54] For the first quarter of 2001, however, AT&T had raised that fee to 9.9%, even though the contribution factor for the same period was only 6.68.[55]
While many observers view the carriers' mark-up of the contribution factor as opportunistic profiteering at the expense of end users (including both business end users and less sophisticated low-volume customers), carriers have claimed informally that their mark-up is justified by various factors such as the "USF lag" discussed *supra*; state universal service charges; administrative overhead; and

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53 *See Notice* at footnote 13 and text accompanying.

54 *Id.*

55 AT&T Tariff FCC No. 27, Section 3.5.12.B, 7th Revised Page 3-19.6, issued December 26, 2000.

uncollectible accounts receivable. But such anecdotal claims are simply not credible and should not influence the Commission's rulemaking in the absence of reliable data to support them. More importantly, uncollectibles and administrative overhead are simply two of the many discrete costs of doing business that every commercial entity faces to some extent and must reflect generally in its prices. By hiding behind these routine costs (which carriers presumably incurred long before the 1996 Act was passed) to justify passing through an inflated universal service contribution factor, the carriers have grossly mischaracterized the cost of the USF program and misled consumers.

Therefore, the Commission should adopt its proposal in the *Notice* to eliminate any carrier flexibility to mark-up USF charges and should require service providers who pay a USF contribution to do so through a uniform line item no higher than the assessment established by the Commission.

Conclusion

This proceeding presents the Commission with an important opportunity to put the universal service funding system on a more stable and equitable footing and protect consumers from overstated and misleading charges. By establishing a contribution mechanism that is both fair and technology-neutral in application, the Commission can advance the statutory principles served by universal service while protecting the interests of ratepayers and telecommunications service providers.

Respectfully submitted,

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