W. Scott Randolph
Director – Regulatory Affairs

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OFFICE OF THE SECRETARY

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October 17, 2001

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

EX PARTE OR LATE FILED

Ex Parte: **Federal-State Joint Board on Universal Service, CC Docket No. 96-45; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements, 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; Numbering Resource Optimization, CC Docket No. 99-200; and Telephone Number Portability, CC Docket No. 95-116**

Dear Ms. Salas:

On October 16, 2001, Tom Lucke and Jennifer St. Hill of Cambridge Strategic Management Group (CSMG), and Vin Callahan and the undersigned, representing Verizon, met with Carol Mattey, Katherine Schroeder, Anita Cheng, Paul Garnett, and Greg Guice of the Common Carrier Bureau to discuss the Universal Service Fund contribution mechanism. Representatives from CSGM reviewed the results of their study, which demonstrates how a per-line recovery mechanism would dramatically increase the telephone service bills for households with lower long distance usage.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, and original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceedings indicated above. If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,

W. Scott Randolph
Director - Regulatory Matters

cc: Carol Mattey
Katherine Schroeder
Anita Cheng
Paul Garnett
Greg Guice

In Support of the Current USF Contribution Mechanism

October 2001

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Discussion Items: Changing the Current Universal Service Fund Contribution Mechanism is Unnecessary, Bad for Low Usage Long Distance Consumers, and is Therefore Bad Public Policy

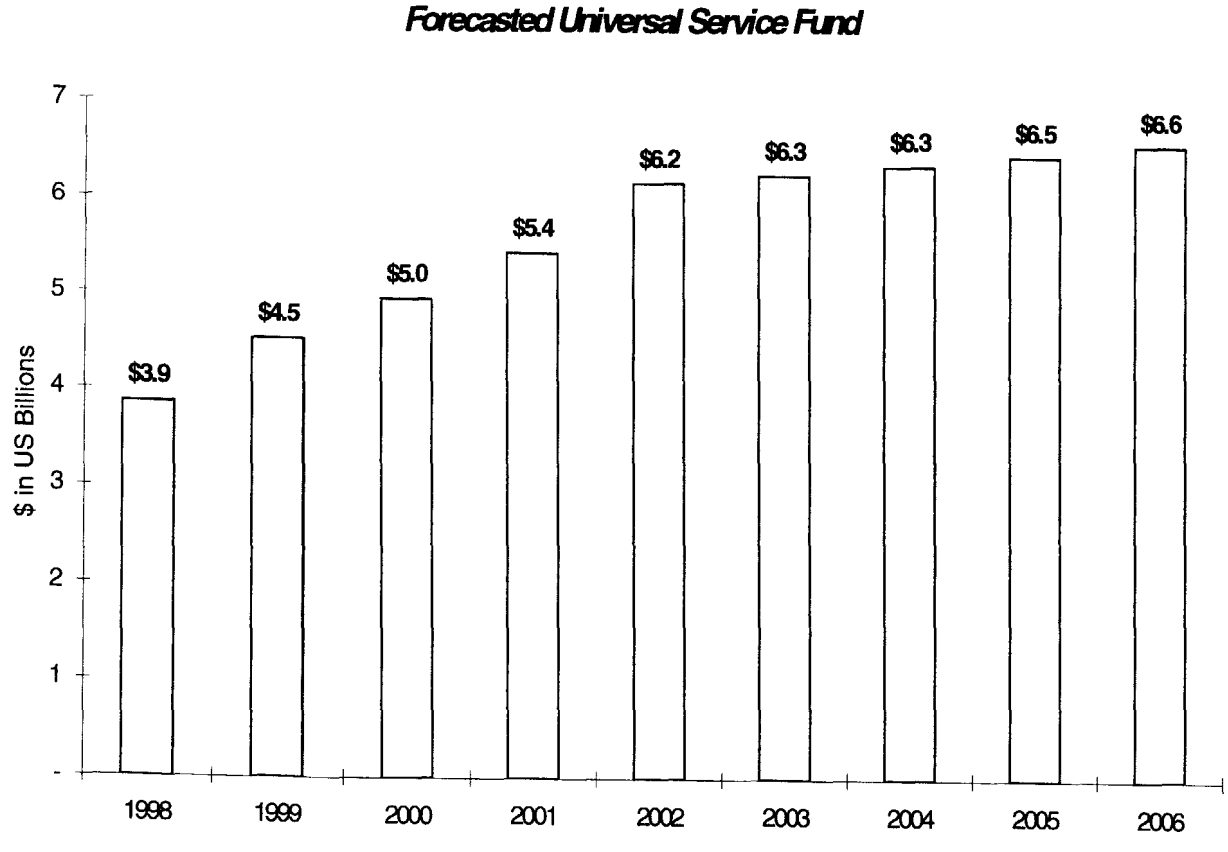
- Forecasted Consumer Contributions Remain Roughly the Same Unless the Fund Size is Increased with Additional Programs
- A Per-Line Recovery Mechanism Shifts a Disproportionate Share to Lower LD Spend Households Which May Result in Consumer Backlash

Methodology

- Verizon Engaged the Cambridge Strategic Management Group (CSMG)
- CSMG Utilized Third Party Information to Develop the Bulk of the Data and Perform all the Analysis for This Study

In order to address the impact of changes in USF contribution mechanisms, we start with a forecast of the fund size, including all current programs and the anticipated MAG plan

- The fund stays relatively constant after 2002 when the MAG plan is implemented



Source: FCC Documents

USF fund includes:

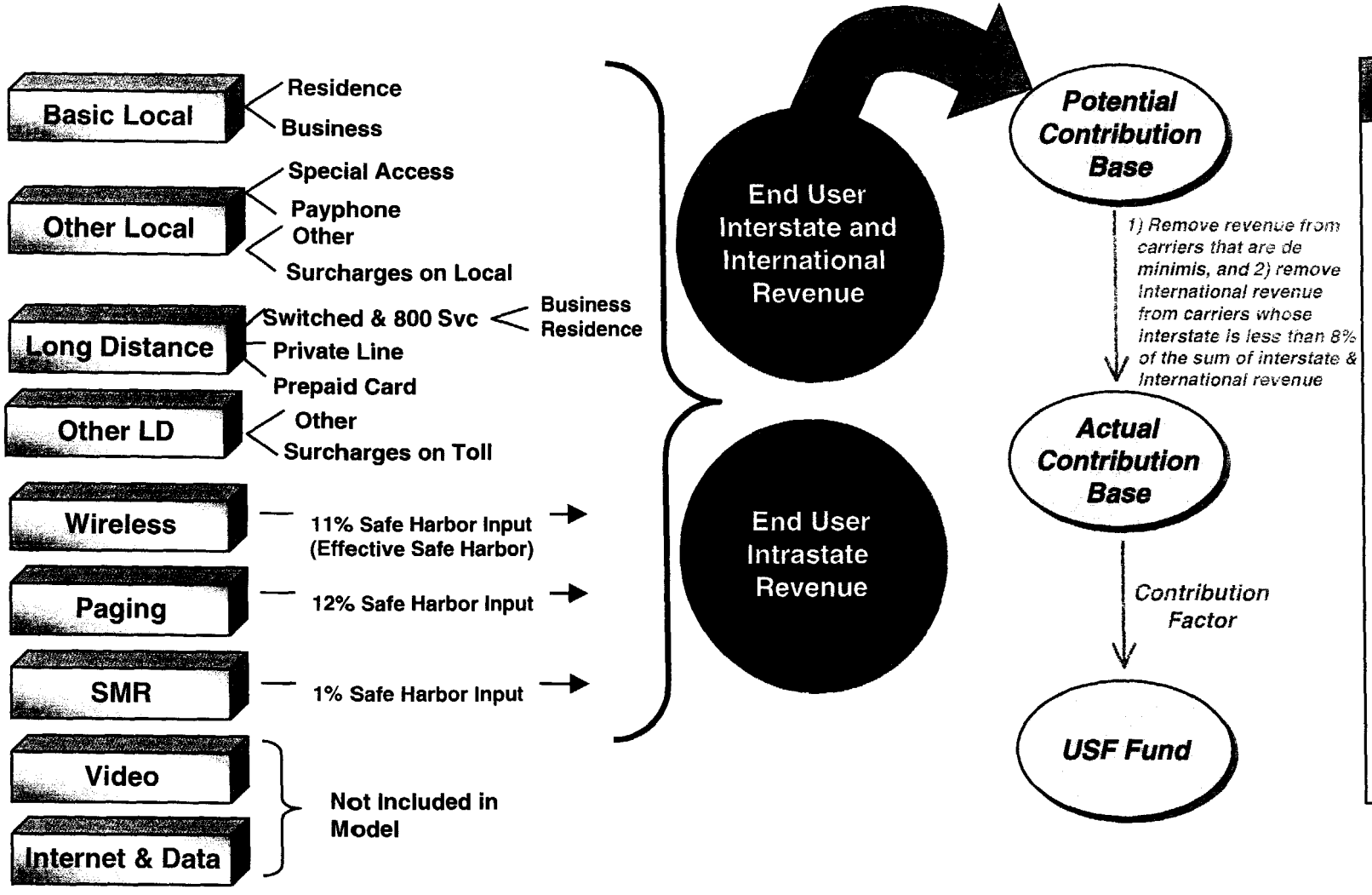
Existing programs:

- High Cost Fund (HCF)
  - High Cost Loop Support (HCL)
  - Long Term Support (LTS)
  - Local Switching Support (LTS)
  - Forward-Looking High Cost Support (Proxy Model)
  - Interstate Access Service Support (CALLS program started 7/1/00)
- Low Income Support
- Schools/Libraries and Rural Health Care (started 1/1/98)

Future programs:

- New High Cost Program-Multi-Association Group (MAG) plan - estimated start 1/1/02

We then develop an end-user based model that generates total industry revenues. We use interstate and international revenues to estimate the contribution base from which the universal service fund is derived



Guiding Principles:

- Model uses actual data for 1999 and 2000 where available and forecasts each service through 2006
- Revenues are forecasted using historical growth rates and/or 3rd party forecasts
- All displacement and replacement estimates described on the following page are derived from 3rd party sources

For a base case analysis, we include the effects of current and future industry trends (access line replacement and long distance MOU displacement) which we forecast with the aid of 3rd party reports

Access Line Replacement*

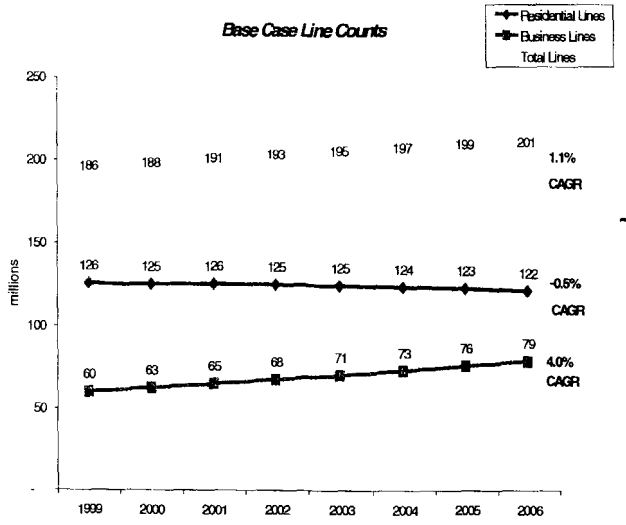
	Wireless Substitution	Broadband Substitution
Description	• Decline in access line growth due to increased substitution of wireless for wireline (both primary and non-primary lines) • Residential only – business not included due to lack of adequate 3rd party forecasts	• Decline in access line growth due to increased broadband penetration (cable modem & DSL) vs. dial-up Internet access • Residential and business
Sources	• IDC Replacing Landline with Wireless: How Far Can it Go? 2000	• Yankee Group VoDSL: All Talk, No Action ... Yet, 2000 • JPMorgan/McKinsey Broadband 2001 • PCIA Global Wireless Portfolio 2000 • MSDW The Broadband Report 2000

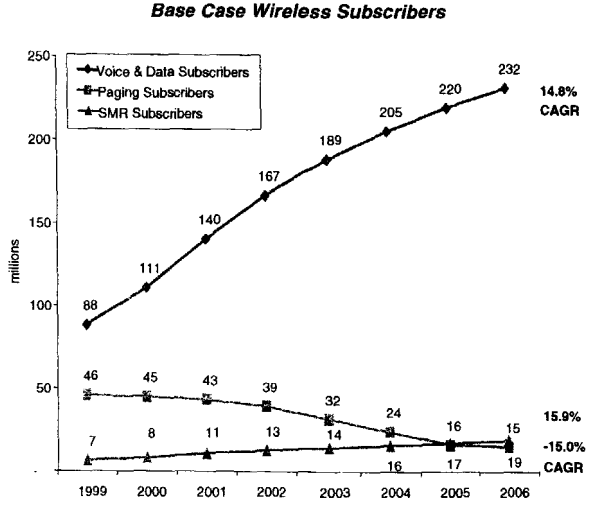
LD MOU Displacement

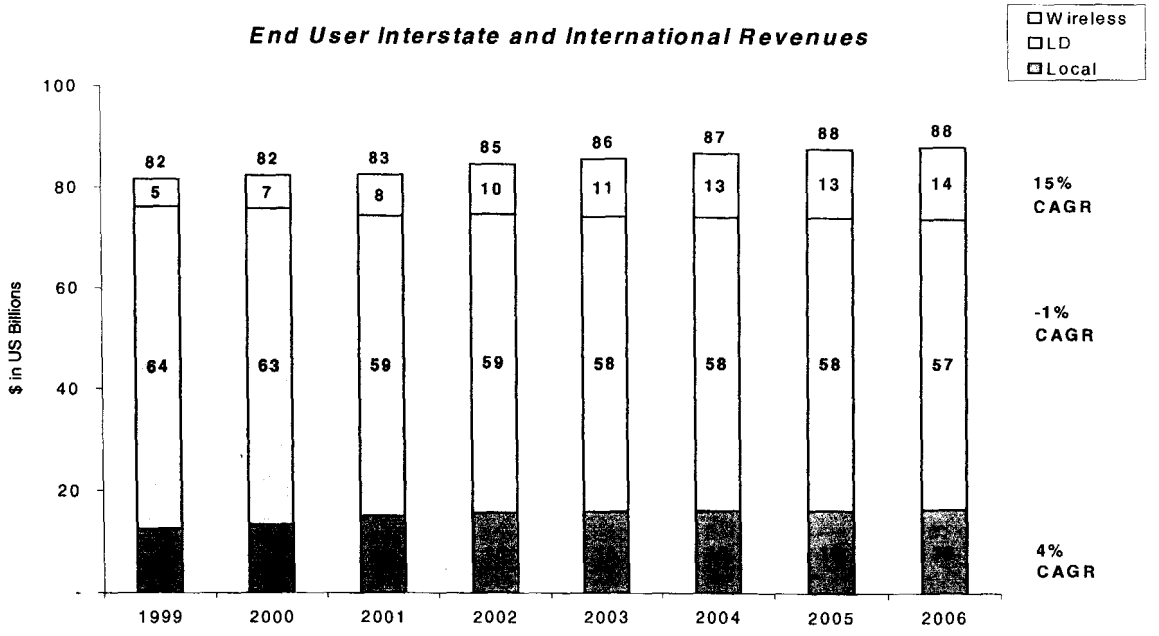
	Wireless Migration	VoIP Migration
Description	• Shift of wireline MOU to wireless as packages including LD become more common and rates decline • Residential only – business not included due to lack of adequate 3rd party forecasts	• Shift of circuit-originated MOU to VoIP as VoIP technology becomes widespread and consumers take advantage of lower rates • Residential and business
Sources	• Yankee 2000 • Yankee TAF Survey 2000 • IDC Replacing Landline with Wireless: How Far Can it Go? 2000	• Yankee Group VoDSL: All Talk, No Action ... Yet, 2000

*NOTE: For the purposes of the USF model, we are not including the effect of competitive technology substitution from cable telephony and VoDSL. These technologies drive a shift from traditional land lines to non-traditional carriers but will not affect the total revenue from voice services. The USF national model derives aggregate end user industry revenues and thus should not exclude lines served by competitive technologies.

The resulting access line and subscriber forecasts generate interstate/ international end user revenue forecasts; this revenue grows slowly but steadily at about 1% per year overall





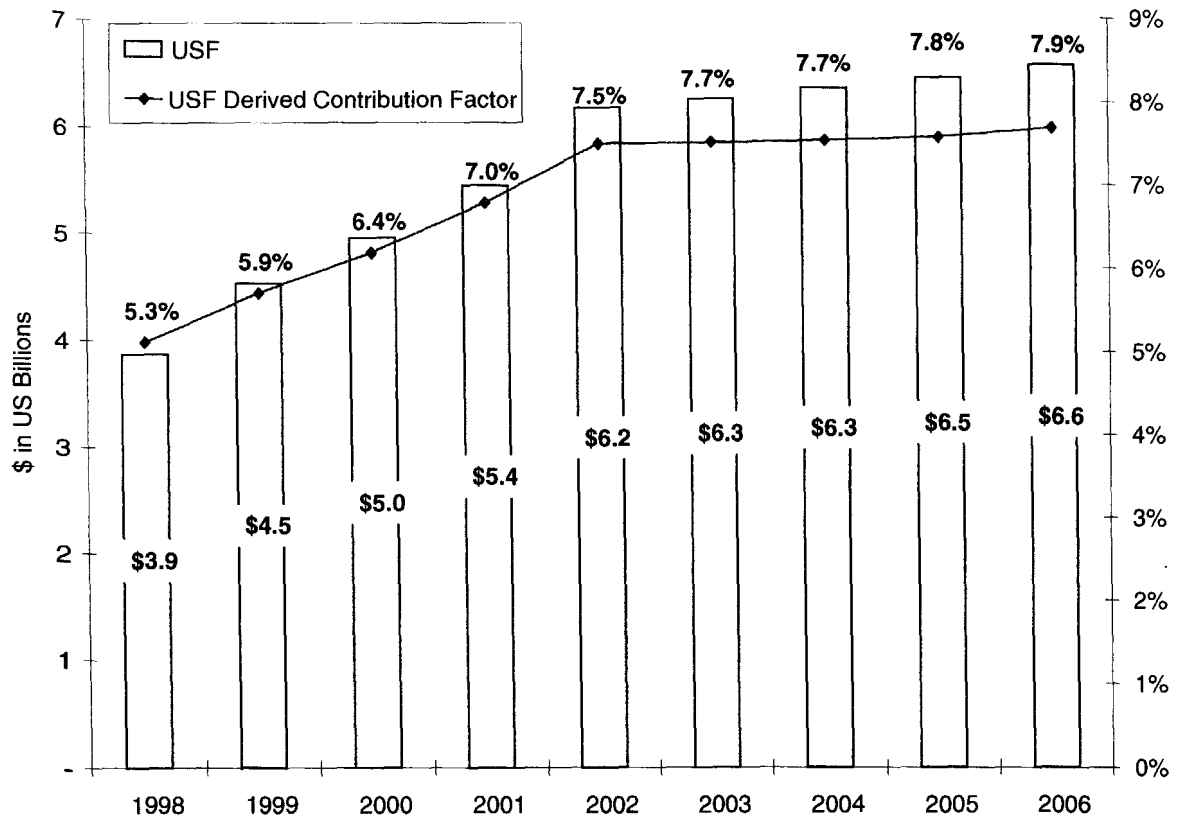


Overall Compound Annual Growth Rate (CAGR) = 1%

Note: We assume that the current effective 11% wireless safe harbor is constant over the entire forecast period

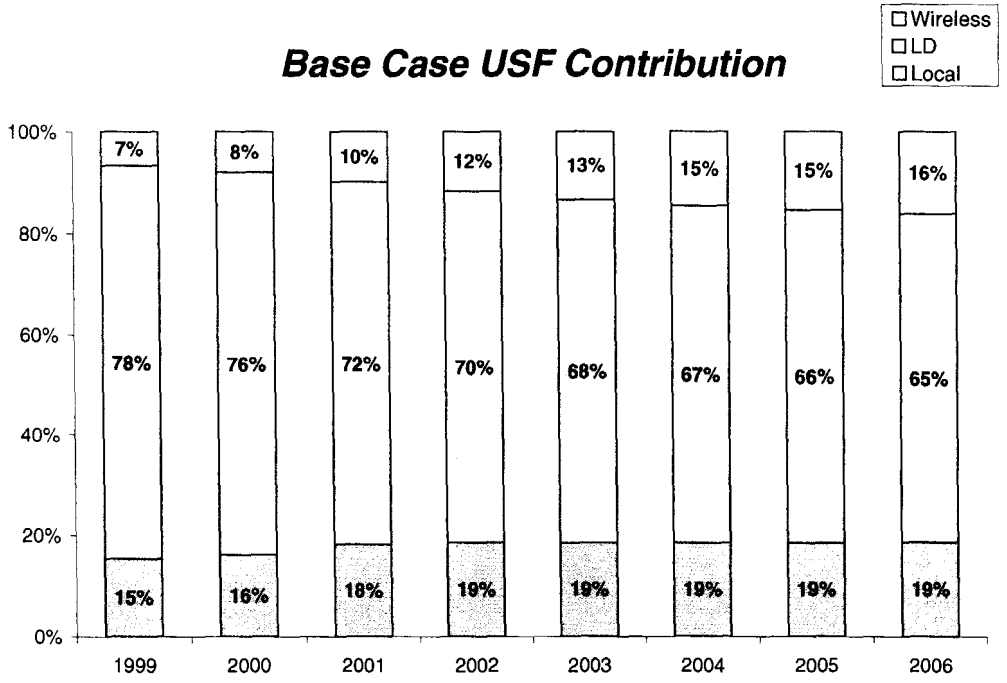
Using the model-generated interstate/international revenue and the independent fund forecast, we derive a contribution factor that grows to 7.5% in 2002 and remains relatively steady thereafter

USF Derived Contribution Factor



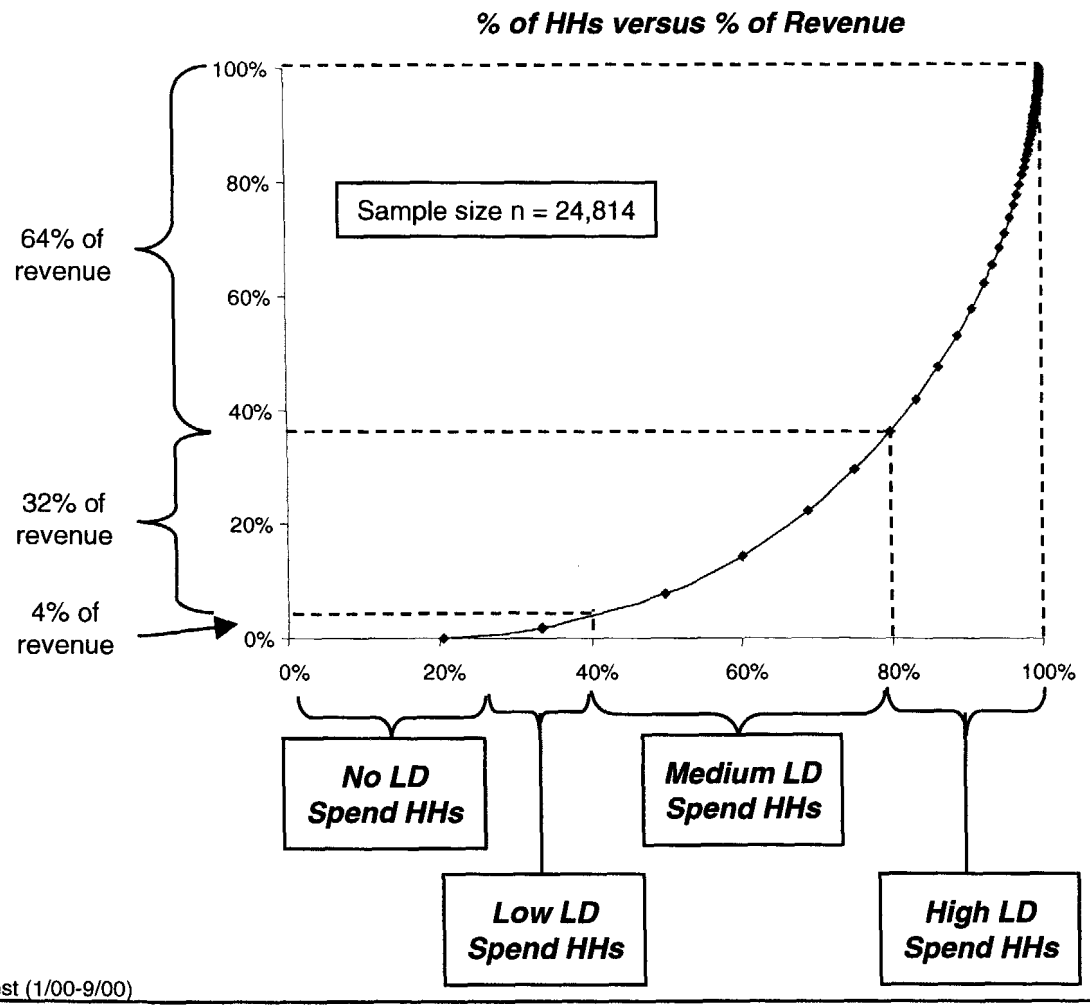
This forecast thus demonstrates that consumer contributions will remain roughly constant unless the fund size is increased with additional programs

Using the derived contribution factor and interstate retail revenue forecasted by the national model, we find that local and wireless revenues increase over time (as opposed to long distance revenue)



	2000	2002	2004	2006	CAGR (1999-2006)
Local Contribution	$0.8B	$1.1B	$1.1B	$1.2B	8.3%
Long Distance Contribution (Intra LATA & Inter LATA)	$3.8B	$4.4B	$4.3B	$4.3B	2.7%
Wireless Contribution	$0.4B	$0.7B	$0.9B	$1.1B	20.2%
TOTAL FUND	$5.0B	$6.2B	$6.3B	$6.6B	5.5%

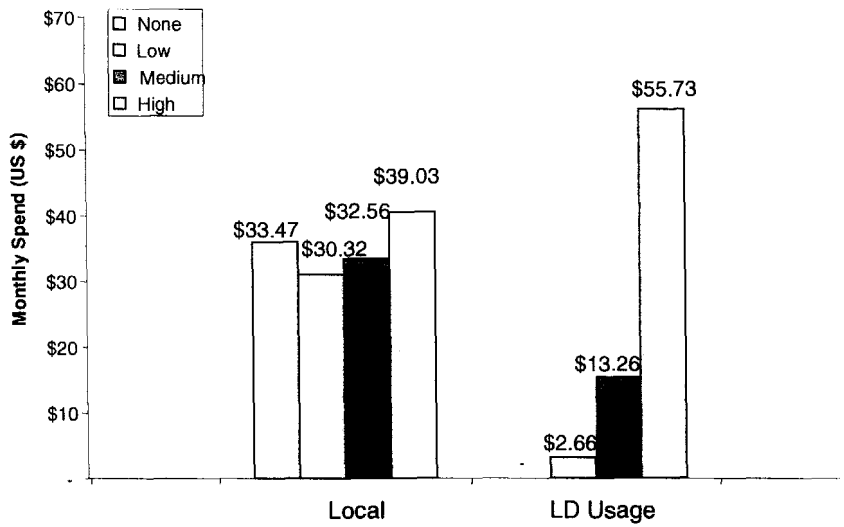
In order to address the FCC's concerns about whether the proposed flat per-line assessment methodology shifts a disproportionate share of contributions on specific classes of customers, we use the TNS bill harvest database to yield four consumer segments based on LD spending level



Source: TNS Bill Harvest (1/00-9/00)

Below are details on the four household profiles, showing that local monthly bills are similar for all segments while LD spend is significantly different by segment

Consumer Spend Levels by Service



Service	No LD Spend HH 25% of HHs $33,457 average income			Low LD Spend HH 15% of HHs $32,180 average income			Medium LD Spend HH 40% of HHs $38,256 average income			High LD Spend HH 20% of HHs $46,082 average income		
	Monthly Bill for HHs with Service	% With Service	Lines per HH	Monthly Bill for HHs with Service	% With Service	Lines per HH	Monthly Bill for HHs with Service	% With Service	Lines per HH	Monthly Bill for HHs with Service	% With Service	Lines per HH
Local	$33.47	100%	1.07	$30.32	100%	1.06	$32.56	100%	1.08	$39.03	100%	1.16
LD Usage	$0	0%		$2.66	100%		$13.26	100%		$55.73	100%	
LD USF	$0			$0.28			$0.97			$2.12		
No LD Calls on Bill	30%			14%			5%			3%		

Indeed, the per-line recovery mechanism dramatically increases the household recovery for lower LD usage households which may ultimately result in consumer backlash

- The contribution from 80% of all US households (no, low, and medium LD usage households) will significantly increase with a per-line recovery mechanism
- While the contribution from the remaining 20% of all US households (high LD usage households) will decrease with a per-line recovery mechanism

	Current Recovery Mechanism ($/month)	*Per Line Recovery Mechanism ($/month)*	*Change in Monthly USF Recovery Payment from Current Mechanism to Per Line Mechanism*
No LD Usage 25% of Households	$0.44	$1.52	↑ Increases by 245%
Low LD Usage 15% of Households	$0.72	$1.64	↑ Increases by 128%
Medium LD Usage 40% of Households	$1.41	$1.76	↑ Increases by 25%
High LD Usage 20% of Households	$2.59	$1.90	↓ Decreases by 27%

In summary, the proposed per line assessment mechanism does not benefit consumers, the FCC, USAC, or industry players; therefore, the current USF interstate and international retail revenue assessment method should remain in place

CONSUMERS

- In a uniform per-line assessment method, the consumer segments representing low to moderate LD spending (80% of total US households) would unfairly bear an increased USF burden while the 20% of households with high LD spend would be responsible for a lower contribution

FCC & USAC

- With a different USF collection mechanism, the USAC would need to overhaul its assessment system, requiring significant administrative expense (e.g. billing & collection, audit system, cost of transitioning etc.)
- Fund sufficiency issues may result with a per-line recovery mechanism which would violate the requirement that USF mechanisms be sufficient and predictable
- In a per-line or per-account system, the FCC would need to spend time defining "lines" and "customers" and how to assess these units when necessary

INDUSTRY PLAYERS

- With a different USF contribution mechanism, telecommunications carriers would incur significant capital and operating investments to comply with a different assessment mechanism (e.g. customer service, updated billing systems, employee training, etc.)
- A per-line or per-account method would reduce the collection burden on providers with higher interstate/international revenues by increasing the collection burden on providers with lower interstate/international revenues