

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service)	
)	
1998 Biennial Regulatory Review –	)	CC Docket No. 98-171
Streamlined 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	)	CC Docket No. 90-571
Individuals with Hearing and Speech)	
Disabilities, and the Americans with)	
Disabilities Act of 1990)	
)	
Administration of the North American)	
Numbering Plan and North American	)	CC Docket No. 92-237
Numbering Plan Cost Recovery	)	NSD File No. L-00-72
Contribution Factor and Fund Size)	
)	
Number Resource Optimization	)	CC Docket No. 99-200
)	
Telephone Number Portability	)	CC Docket No. 95-116
)	
Truth-in-Billing and Billing Format)	CC Docket No. 98-170

COMMENTS OF THE COALITION FOR SUSTAINABLE UNIVERSAL SERVICE

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SUMMARY

The existing federal universal service fund is facing a crisis: its mechanism for collecting universal service support funds is both economically unsustainable and unlawful. As wireline interstate telecommunications revenues have begun to shrink dramatically over the past couple of years, universal service funding has increased and the USF contribution factor has swelled to its highest level ever. This will only continue. The revenue assessment base will continue to decline, driven by the substitution of wireless for wireline long distance, the growth of non-telecommunications long distance substitutes such as e-mail and instant messaging, and the “leakage” created as higher and higher contribution factors induce customers and their providers to structure contracts that bundle interstate telecommunications services with intrastate services, information services, and customer premises equipment to minimize the revenue attributed to interstate telecommunications services. Universal service funding demands will increase. The result is a USF “death spiral” that pushes revenues out of the assessment base, and results in ever increasing USF recovery line items for consumers. The current USF assessment mechanism is unsustainable, and thus cannot meet the statutory requirement in Section 254(d) of the Communications Act that the mechanism be “sufficient.”

Moreover, experience over the nearly five years since the Commission adopted its current USF contribution mechanism shows that that mechanism is patently discriminatory, and therefore fails the statutory requirement that it be “equitable and nondiscriminatory.” Reporting lags mean that carriers that are losing market share pay a greater share of universal service contributions at any given moment in time than their competitors that are gaining market share. Moreover, the “interim” revenue reporting

“safe harbor” that the Commission adopted in 1998 for commercial mobile radio services (“CMRS”) providers has never been updated and finalized, and it systematically discriminates in favor of wireless providers of interstate long distance services. The limited international exemption that the Commission adopted after the Fifth Circuit’s decision in *Texas Office of Public Utility Counsel v. FCC* discriminates in favor of “pure play” international carriers and against carriers that provide both interstate and international telecommunications services. The bundling “safe harbors” that the Commission adopted systematically discriminate against bundled service providers, to the extent those “safe harbors” are actually used. When examined as a whole, the current system has become irrational, and it can no longer meet the statutory requirement in Section 254(d) that the USF assessment mechanism be “equitable and nondiscriminatory.”

There is a solution. The Coalition for Sustainable Universal Service’s (“CoSUS” or “Coalition”) proposal for a connection- and capacity-based approach is sustainable, predictable, sufficient, equitable, and nondiscriminatory—in short, it meets the requirements of Section 254(d) of the Act. It will avoid the USF “death spiral,” because overall connections will continue to grow and provide a stable, fair basis for assessments. The Coalition proposal to use connections as a basis for universal service assessments is also competitively and technologically neutral, is adaptable to new technologies, will eliminate reporting-lag inequities, will reduce consumer confusion, and will facilitate price comparisons.

Moreover, under the Coalition proposal, residential consumers as a whole, as well as low income consumers will actually be better off, on average. Their average total

monthly universal service recovery fees fall. Even when an individual consumer does see a universal service recovery fee increase, that increase will be very small, especially when compared with the increases that will occur in any event for all but a small group of very-low-volume users under today's existing, revenue-based assessment mechanism. Business users likewise will be better off, on the whole. Residential customers and business customers both win because a shrinking interstate telecommunications revenue base will be replaced by a growing connections base, thereby spreading the universal service burden across all users of the interstate public network. And the Congress and the Commission can be assured that universal service will be funded on a stable, predictable, and sufficient basis.

The Coalition proposal should be implemented in two stages, but it is essential that there be no delay in its full implementation. Under the first stage, residential, wireless and switched multiline business users would move to a connection-based charge, effective July 1, 2002. During a twelve-month period, special access and private line connections would be transitioned to a connection and capacity-based charge. This year-long transition period will give carriers and other contributors time to implement necessary billing and tracking systems.

No alternative is superior to the Coalition plan. Sprint's alternative would perpetuate the inequities in the current system, and tinkering with the current system to eliminate the lag does nothing to address the core problem of a shrinking USF contribution base—a quickly and steadily worsening problem that demands prompt resolution. Moving to a connection-based assessment mechanism but splitting the assessment between the connection provider and an interconnecting carrier (such as a

long distance company) is both backwards-looking in terms of industry structure and incurs significant transactions and consumer confusion costs without any public policy benefit. The Commission should remember its ill-fated experience with the Presubscribed Interexchange Carrier Charge (“PICC”), which it has largely abandoned because the PICC resulted in unnecessary transaction costs and consumer confusion.

Neither Section 254(d) nor Section 2(b) of the Act precludes the Commission from implementing a connection-based universal service contribution formula. Because the Coalition’s connection- and capacity-based mechanism creates a funding formula that is equitable, nondiscriminatory, specific, predictable, and sufficient, and applies to all interstate telecommunications carriers, it does not risk running afoul of the language in Section 254(d) that states that “every telecommunications carrier . . . shall contribute” to “sufficient” universal service mechanisms on “an equitable and nondiscriminatory basis.” When construed as a whole, the first sentence of Section 254(d) permits the Commission to adopt a connection- and capacity-based mechanism, as does the *de minimis* exemption created by the second sentence of Section 254(d). Moreover, consistent with well-established judicial precedent, an interstate universal service assessment on a connection that is or can be used to provide interstate services in no way is precluded by Section 2(b)’s preservation of state authority over rates for intrastate service.

Finally, Joint Board referral is neither statutorily required nor warranted. The Commission has authority to adopt the Coalition proposal on its own.

The universal service funding mechanism faces a crisis, but it is a crisis that can be solved with a pro-consumer, pro-competitive, pro-universal service solution. The Commission should adopt the Coalition’s proposal without delay.

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**COMMENTS OF THE COALITION FOR
SUSTAINABLE UNIVERSAL SERVICE**

The Coalition for Sustainable Universal Service (“CoSUS” or the “Coalition”), comprised of the Ad Hoc Telecommunications Users Committee, AT&T, e-commerce & Telecommunications Users Group (“eTUG”), Level 3 Communications, and WorldCom, hereby files comments in response to the Commission’s *Further Notice of Proposed*

Rulemaking regarding reform of the current unsustainable and unlawful, insufficient, inequitable and discriminatory universal service contribution mechanism.¹ Reform of the universal service contribution mechanism cannot and should not be delayed. The current assessment base of interstate and international end user revenues is shrinking and a “death spiral” of ever-escalating contribution factors and a declining assessment base has begun. The Commission should immediately, by July 1, 2002, adopt and implement a proposal by the Coalition to begin to collect universal service contributions from carriers and other contributors² based on the number of connections to a public network provided by that contributor and, over twelve months, should fully phase in a connection- and capacity-based contribution system. The Coalition’s proposal meets all statutory requirements, and will provide the best means of ensuring the continued preservation and advancement of universal service.

¹ *In re Federal-State Joint Board on Universal Service; 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; 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; Truth-in-Billing and Billing Format*, Further Notice of Proposed Rulemaking & Report & Order, 2002 FCC LEXIS 975, CC Dockets No. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, FCC 02-43 (rel. Feb. 26, 2002) (“FNPRM”).

² References in these comments to “carrier” contributions are meant to include contributions from all universal service contributors.

I. BACKGROUND

A. Coalition Participants

The Ad Hoc Telecommunications Users Committee is an unincorporated entity that represents the interests of large consumers of telecommunications services before the FCC and the courts. The Ad Hoc membership includes some of the country's largest companies.

AT&T is among the world's communications leaders, providing voice, data and video communications services to large and small businesses, consumers and government entities. AT&T and its subsidiaries furnish domestic and international long distance, regional, and local communications services, cable (broadband) television and Internet access services. AT&T also provides directory and calling card services to support its communications business. AT&T provides local service to millions of customers in the United States.³

e-Commerce & Telecommunications Users Group (eTUG) represents the electronic commerce, information technology, Internet, and telecommunications public policy interests of commercial, educational, and governmental end users. eTUG's goal is to facilitate, protect, and promote end user interests with respect to public policy deliberations in order to achieve quality, cost-effective information and telecommunications systems.

Level 3 is a communications and information services company with the first international communications network completely optimized, end-to-end, for advanced

³ See Letter from James W. Cicconi, AT&T, to Chairman Michael K. Powell, FCC, dated Apr. 4, 2002, in CC Docket Nos. 01-338, 96-98 and 98-147.

IP technology. Level 3 offers IP-based services, including broadband transport, submarine transmission services, and softswitch-based services. It also provides collocation services. Level 3 offers transport and bandwidth services primarily to other carriers, Internet service providers (ISPs), application service providers (ASPs), and voice-over-IP service providers who utilize substantial amounts of bandwidth to deliver their services. Level 3 also provides private line service to a number of end user customers, including ISPs. Level 3's network is designed with softswitch architecture, which is a distributed set of hardware and software platforms that are used to seamlessly interconnect IP networks to the circuit-switched network.

WorldCom, Inc., a global telecommunications company, does business through its WorldCom group and its MCI group. WorldCom group, a leading provider of service to the enterprise segment, operates the company's network assets, and offers a wide range of local, long distance and international telecommunications services, broadband access, Internet services, web hosting, and related products and services to business customers. WorldCom group operates local networks in approximately 100 MSAs, and has one of the largest nationwide long distance networks. WorldCom group also operates extensive international networks, including operations in more than 65 countries encompassing the Americas, Europe, Africa and the Asia-Pacific regions. MCI group offers a broad portfolio of products to residential and small business customers, as well as to wholesale customers. The services offered by MCI group include local voice services in 32 states, nationwide long distance and international voice services, wireless, and advanced messaging. In addition, MCI group offers wholesale voice, dial-up Internet and data services. WorldCom provides local service to millions of customers in the United States.

B. Statutory Requirements and the Commission’s Existing Assessment Mechanism.

Section 254(d) of the Communications Act of 1934, as amended, (“Communications Act” or “Act”) sets forth the statutory mechanism for funding federal universal service support created pursuant to the other subsections of Section 254. Section 254(d) was part of Congress’ effort to create “explicit” mechanisms to ensure that universal service could continue to be preserved and enhanced even as the Act “open[ed] all telecommunications markets to competition.”⁴ Section 254(d) requires the Commission to create a mechanism to collect universal service assessments from interstate telecommunications carriers: “Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service.”⁵ However, it also grants the Commission the authority to “exempt a carrier or class of carriers from this requirement [to contribute to universal service pursuant to the first sentence of Section 254(d)] if the carrier’s telecommunications activities are limited to such an extent that the level of such carrier’s contribution to the preservation and advancement of universal service would be *de minimis*.”⁶ The third sentence of Section 254(d) gives the Commission the authority to require non-carrier “providers of interstate

⁴ H.R. Rpt. No. 104-458, at 1, 104th Cong., 2d Sess. (1996) (“1996 Act Conf. Report”); *see also* S. Rpt. 104-23, at 1, 104th Cong, 2d Sess. (1996) (“1996 Act Senate Report”).

⁴⁷ 47 U.S.C. § 254(d).

⁶ *Id.*

telecommunications” to “contribute to the preservation and advancement of universal service if the public interest so requires.”⁷

In addition to Section 254(d), Section 254(b) sets forth six principles on which the Commission must base its universal service policies, and it also authorizes the Commission to adopt additional principles. One principle is that “[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.”⁸ A second principle calls for “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.”⁹ Exercising its authority to add other principles,¹⁰ in the *Universal Service First Report and Order*, the Commission promulgated a principle of competitive neutrality, stating:

COMPETITIVE NEUTRALITY -- Universal service support mechanisms and rules should be competitively neutral. In this context, competitive neutrality means that universal service support mechanisms and rules neither unfairly favor nor disfavor one technology over another.¹¹

Also in the *First Report and Order*, the Commission decided to assess common and private carriers a percentage of end user interstate and international telecommunications revenues to support its high cost and low income universal service

⁷ *Id.*

⁸ *Id.* § 254(b)(4).

⁹ *Id.* § 254(b)(5).

¹⁰ 47 U.S.C. § 254(b)(7) (granting the Joint Board and the Commission authority to “base policies for the preservation and advancement of universal service” on “[s]uch other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act”).

¹¹ *In re Federal-State Joint Board on Universal Service*, Report & Order, 12 FCC Rcd 8776, 8801 (¶ 47) (1997) (“*Universal Service First Report & Order*”).

programs, and it assessed those same providers a percentage of all end user telecommunications revenues, including intrastate revenues, to support its program for connections to schools, libraries and rural health care providers.¹² It also established a *de minimis* contribution threshold, which it later raised to \$10,000.¹³ In a subsequent order, it provided a limited exclusion for non-carrier systems integrators.¹⁴

In October 1998, in response to concerns raised by mobile wireless providers about the difficulties in classifying commercial mobile radio services (“CMRS”) end user revenues as interstate or intrastate, the Commission created a series of interim “safe harbor” percentages for CMRS services.¹⁵ CMRS providers could use these interim “safe harbor” percentages to distinguish interstate from intrastate end user telecommunications revenues for the purposes of the Commission’s universal service assessment mechanism, or they could report a percentage that was less than the “safe harbor” but would be

¹² *Id.* at 9201, 9204 (¶¶ 831, 837). Although private providers of standalone telecommunications to third parties for a fee were required to contribute to universal service, the Commission did not require carriers’ carriers, or entities that provided telecommunications to themselves for their own needs, to contribute to universal service. *Id.* at 9185 (¶ 799). Subsequently, the Commission made clear that Internet Service Providers (ISPs) that provide their own telecommunications are not required to contribute to universal service on the basis of those self-provided telecommunications. *In re Federal-State Joint Board on Universal Service*, Report to Congress, 13 FCC Rcd 11501, 11534 (¶ 69) (1998) (“1998 Report to Congress”).

¹³ *Universal Service First Report and Order*, 12 FCC Rcd at 9187-88 (¶ 803); 47 C.F.R. § 54.708.

¹⁴ *In re Federal-State Joint Board on Universal Service; Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure & Pricing, End User Common Line Charge*, Fourth Order on Reconsideration in CC Docket No. 96-45, Report & Order in CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, 13 FCC Rcd 5318, 5472 (¶ 278) (1997).

¹⁵ *In re Federal-State Joint Board on Universal Service*, Memorandum Opinion & Order & Further Notice of Proposed Rulemaking, CC Docket No. 96-45, 13 FCC Rcd 21252 (1998) (“*Interim CMRS Safe Harbor Order*”).

required to provide back-up documentation at the Commission's request.¹⁶ The Commission emphasized, however, that this "safe harbor" was interim, "pending final Commission resolution of these issues."¹⁷ The Commission at the same time issued a *Notice of Proposed Rulemaking* seeking comment on various proposed mechanisms for separating interstate from intrastate CMRS revenues on a more permanent basis.¹⁸ No action has ever been taken in response to this *NPRM*.

When the Commission's *Universal Service First Report and Order* was appealed, the United States Court of Appeals for the Fifth Circuit reversed in part, holding, *inter alia*, that the Section 2(b) precludes the Commission from assessing federal universal service contributions based on intrastate revenues.¹⁹ The Fifth Circuit also struck down the contribution mechanism as applied to carriers that provided international telecommunications service, but no or very little interstate service.²⁰ On remand, the Commission adopted a limited exemption for the international carriers whose annual end user interstate telecommunications revenues were less than 8 percent of its total end user interstate and international telecommunications revenues.²¹ In the Order accompanying

¹⁶ *Id.* at 21258 (¶ 11).

¹⁷ *Id.* (¶ 12).

¹⁸ *Id.* at 21261-21274 (¶¶ 17-36).

¹⁹ *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) ("*TOPUC I*").

²⁰ *Id.* at 434-35.

²¹ *In re Federal-State Joint Board on Universal Service; Access Charge Reform*, Sixteenth Order on Reconsideration in CC Docket No. 96-45, Eighth Report & Order in CC Docket No. 96-45, & Sixth Report & Order in CC Docket No. 96-262, 15 FCC Rcd 1679, 1687-8 (¶ 19) (1999).

the *FNPRM* in this proceeding, the Commission increased that exemption threshold to 12 percent of total end user interstate and international telecommunications revenues.²²

In May 2001, the Commission, reacting to concerns that “the telecommunications marketplace has changed rapidly and technologies have evolved, with major developments including increased competition, migration to new products and services and bundling of traditionally distinct services,” issued an *NPRM* to review the federal universal service assessment mechanism.²³ Coalition members Ad Hoc, AT&T, Level 3 and WorldCom filed comments in response to that *NPRM*.

C. Coalition Proposal

In November 2001, as a further response to the Commission’s *Notice of Proposed Rulemaking*, the Coalition put forward a specific proposal for a connections- and capacity-based universal service contribution methodology.²⁴ By proposing to migrate from an historical end user interstate and international telecommunications revenue-based contribution formula to one based on network connections and the capacity of those connections, the Coalition proposal would stabilize the universal service contribution mechanism in light of declining interstate and international end user telecommunications

²² *FNPRM* at ¶ 125.

²³ *FNPRM* at ¶ 1; *In re Federal-State Joint Board on Universal Service; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, & Universal Service Support Mechanisms; Telecommunications Services for Individuals with Hearing & Speech Disabilities, & the Americans with Disabilities Act of 1990; Administration of the North American Numbering Plan & North American Numbering Plan Cost Recovery Contribution Factor & Fund Size; Number Resources Optimization; Telephone Number Portability*, Notice of Proposed Rulemaking, 16 FCC Rcd 9892 (2001) (“*2001 Contribution NPRM*”).

²⁴ Ad Hoc Telecommunications Users Committee/AT&T/e-Commerce Telecommunications Users Group/WorldCom *Ex Parte*, dated Nov. 14, 2001, at 1.

revenues, and eliminate the most discriminatory and inequitable (and therefore unlawful) effects of the current historical revenue-based methodology.

Under the Coalition proposal, universal service contributions would be paid according to a formula based on the number, type and capacity of connections the contributing entity provides to retail customers to connect those customers to a public network. Every interstate telecommunications carrier would be subject to the formula, and would contribute for all connections provided by that carrier between a retail customer's premises and a public network that are used to provide standalone interstate telecommunications or telecommunications services. Under this proposed formula, when a carrier does not provide the direct connection to the customer, but is connected to customers through an intervening common or private carrier, only the carrier providing the direct retail customer connection and not the transiting carrier would pay the contribution. Mobile wireless carriers would be assessed based on the number of activated handsets in service.

In addition to interstate and international telecommunications carriers, private carriage providers of standalone interstate and international telecommunications for a fee to third parties would also be required to contribute to federal universal service mechanisms under the connection- and capacity-based formula, subject to the exemptions set forth in Sections 54.706(d) and 54.708 of the Commission's rules, just as such providers must contribute under the current mechanism.²⁵ The Coalition proposal neither

²⁵ In its initial proposal, the Coalition did not specifically address the issue of whether information service providers that self-provision telecommunications connections and that provide those connections to retail customers as part of their information service should be assessed for universal service contributions on the basis of those connections. In the interim, the Commission has issued its *Wireline Internet Access*

precludes nor requires inclusion of other connections providing interstate telecommunications pursuant to the Commission's authority under Section 254(d).²⁶

Where multiple carriers may be involved in providing the direct connection between the end user and the public network, such as when an ILEC provides UNE facilities for a competitive local exchange carrier ("CLEC") or under a Section 251(c)(4) resale arrangement, the Coalition's proposed formula would assign the contribution responsibility to the interstate telecommunications provider that "owns" the retail customer relationship; *i.e.*, has the end user customer billing relationship. Thus, the CLEC that purchases a UNE loop in order to provide local-exchange and exchange-access service to an end user would pay a USF connection assessment, and the ILEC

Broadband Framework NPRM, which directly raises these issues. *In re Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers; Computer III Further Remand Proceedings; Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review - Review of Computer III and ONA Safeguards and Requirements*, Notice of Proposed Rulemaking, 2002 FCC LEXIS 824, CC Docket Nos. 02-33, 95-20, 98-10, FCC 02-42, at ¶ 1 (rel Feb. 15, 2002) ("*Wireline Broadband Internet Access Framework NPRM*"). As discussed further in Section III.A.2.b, *infra*, as an interim matter pending the Commission's final resolution of the *Wireline Broadband Internet Access Framework NPRM*, these ISPs should not be required to contribute to universal service on the basis of these connections. To ensure competitive neutrality during this interim period, providers of DSL-based services should also not be required to contribute to universal service on the basis of the independent connection channel over which DSL service is provided.

²⁶ The Commission, for example, recently held that cable modem services, as offered to consumer end users, were properly classified as "information services" under the Act, and included an interstate "telecommunication" component. *In re Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet over Cable Facilities*, Declaratory Ruling & Notice of Proposed Rulemaking, GN Docket No. 00-185, CS Docket No. 02-52 (rel. Mar. 15, 2002). The Commission has likewise sought comment on whether wireline Internet access services offered over broadband facilities should be similarly classified. *Wireline Broadband Internet Access Framework NPRM* at ¶ 1. In that same *NPRM*, the Commission sought

providing the UNE loop to the CLEC would not.²⁷ Similarly, a CLEC that purchases ILEC services for resale pursuant to Section 251(c)(4) would pay the USF connection contribution, rather than the ILEC providing the wholesale service. The same would be true with respect to an interstate special access line purchased by an interexchange carrier (“IXC”) from an ILEC and then resold to an end user as part of a private line service: the IXC would pay the contribution assessment. On the other hand, when the end user purchases the special access line directly from the LEC itself, the LEC would pay the contribution assessment for that customer’s public network connection.

The Coalition also proposed that the contribution amounts would be scaled according to the type of customer connection and the capacity of the connection. Carriers would not be assessed a universal service contribution for providing a Lifeline connection, and carriers would be prohibited from recovering universal service contributions from Lifeline subscribers. For residential, single-line business and non-paging CMRS subscribers, the initial connection-based assessment rate would be \$1.00 per connection per month. For paging connections, the initial connection-based assessment rate would be \$0.25 per month.

For multiline business and special access/private line services, connection-based assessments would be phased-in in two steps, so that implementation of a reformed contribution system can begin immediately and would not be delayed by systems

comment on whether providers of broadband Internet access services should be required to contribute to federal universal service mechanisms. *Id.* at ¶ 16.

²⁷ There would be no difference between a CLEC that purchases only an unbundled loop, and a CLEC that purchases a UNE loop in combination with other elements (*e.g.*, UNE-P).

changes.²⁸ Initially, for the first twelve months, interstate special access and private line providers would continue to pay universal service contributions based on the last previously established revenue-based contribution factor.²⁹ The connection-based assessment for switched multiline business lines, including payphone lines, would be set at a dollars and cents-per-month amount sufficient to close the difference between total universal service funding and the amount to be collected in assessments for pagers, residential/single-line business/non-paging CMRS, and special access/private line.³⁰ During this first twelve months, carriers would have the time to develop systems to track and bill connection- and capacity-based charges for special-access and private-line services. At the end of that transition year, the assessments for switched multiline business, special access and private line would be recomputed into a set of capacity charges according to the following tiers:

²⁸ This two-step transition is detailed more specifically in Attachment 1, Description of the Process and Mechanism for Setting Initial Assessment Rates, Calculation and Remittance of USF Assessments under “Collect-and-Remit” Changes to the Assessment Rate During the Transition, and Establishing and Adjusting Assessment Rates After Capacity Tiers are Implemented (*“Process & Mechanism Description”*).

²⁹ During the transition year, of course, this factor could rise or fall along with all other assessments. *See Process & Mechanism Description* at 3. Also, in its November 14, 2001 *ex parte* submission, the Coalition referred to this transition mechanism as an alternative option. *See Ad Hoc Telecommunications Users Committee/AT&T/e-Commerce Telecommunications Users Group/WorldCom Ex Parte*, dated Nov. 14, 2001, at 2 n.1. Upon further consideration, the Coalition is proposing only this transition mechanism, because it should be able to be implemented rapidly.

³⁰ *See Process & Mechanism Description* at 2-3. The Coalition currently estimates that the switched multiline business assessment rate will initially be approximately \$2.75. This amount would vary depending on the estimated line counts used by the Commission and USAC to compute the initial assessment rate. Payphone lines would be assessed to the provider of the line to the payphone service provider (“PSP”), rather than to the PSP. There would be no universal service contribution assessment for “public interest payphone” lines.

- **Tier 1:** Connections with a capacity of less than 1.5 Mbps,³¹ including payphones: \$X per connection per month;
- **Tier 2:** Connections with a capacity of 1.5 Mbps or greater, but less than 45 Mbps:³² 5 times \$X per connection per month; and
- **Tier 3:** Connections with a capacity of at least 45 Mbps:³³ 40 times \$X per connection per month.

These three tiers conform to the DS-0, DS-1, and DS-3 industry conventions.

The “capacity” of a connection should be defined as the maximum capacity that the end user has ordered onto its premises per month, regardless of the connection methodology or technology, or the services that are delivered over that connection. This definition will ensure that an end user will not be penalized for carrier decisions. For example, a carrier that is planning for future increases in demand and/or hoping to serve other customers in the vicinity might provide a DS-3 connection where the end user only requested a DS-1 connection; that customer should only be charged at the Tier 2 rate. On the other hand, an end user that contracts for a baseline T-1 connection, but also wants DS-3 capacity for heavy traffic periods, would be assessed at the DS-3 rate. Customer capacity requests are easily tracked under existing record-keeping, and the proposed definition works for any sort of special access or private line service: *e.g.*, each end point of a point-to-point or point-to-multipoint interstate private line will be assessed based on whatever capacity the end user has specified for that channel termination to the customer premises. The conversion of switched multiline business and special access/private line initial assessments into capacity-based assessments at the end of the transition would not

³¹ In other words, connections that are less than a T-1/DS-1.

³² In other words, connections that are less than a DS-3, but at least a T-1/DS-1 or greater.

change the proportion of the total universal service fund collected from switched multiline business and special access users at the time of the conversion,³⁴ nor would it, in and of itself, change the assessment rates for pagers or for residential/single-line business/non-paging CMRS.³⁵

Once the initial assessment rates are established, all connection rates would change in equal proportion when changes were necessary to account for either changes in the size of the total USF or changes in the aggregate level of USF revenues that would be generated under the existing assessment rates (due to changes in the number of connections, or, for special access/private line in the initial step of the transition, due to changes in retail customer revenues).³⁶ In other words, if the Commission implemented the per-connection contribution mechanism and then six months later increased total USF such that anticipated collections would not be sufficient to cover anticipated expenditures, all assessment rates for all connection classes would be adjusted in equal proportion. If the anticipated shortfall, for example, would be two percent, then all

³³ In other words, connections that are a DS-3 or greater.

³⁴ The amount of the per-connection assessment rate for switched multiline business lines could increase or decrease.

³⁵ The proportion of USF borne by different customer segments could change over time with relative changes in demand. As discussed further below, the assessment rates for these connection classes could change based on changes in the fund, or overall connection counts. However, the relative assessment rates between customer classes will remain constant.

³⁶ This adjustment mechanism is detailed more specifically in the *Process & Mechanism Description*. The Coalition has not taken a position on how many times during the course of a year the above-referenced calculations would have to be performed, *e.g.*, quarterly. Especially in the first year, when the contribution mechanism continues to rely, in part, on volatile interstate revenues, the Coalition does not object to quarterly adjustments. However, after the transition, the Commission should consider reducing the number of times during the course of a year to update the assessment rates

assessment rates (including the transitional special access/private line percentage of end user telecommunications revenues) would be increased by two percent. Lifeline connections are never assessed, and the adjustment mechanism changes nothing for Lifeline connections. By increasing or decreasing all contribution rates proportionately, the Coalition proposal would assure that all classes of end users share the burdens of an increasing fund, and the benefits of a smaller fund, thus maintaining maximum public accountability.

Finally, in order to simplify consumer bills and to eliminate discrimination and inequity resulting from the use of historically reported data, the Coalition proposed that providers pay universal service contributions on a “collect and remit” basis.³⁷ Under “collect and remit,” providers would bill their retail customers for USF contributions, and would be required to remit USF contributions for each connection for which the provider received payment of the USF element.³⁸ “Collect and remit” simplifies USF fees for carriers by eliminating both the carrier-specific risk of uncollectibles³⁹ and the differential impact of reporting lags on providers, eliminating the largest sources of variation in carrier USF recovery fees. “Collect and remit” does not discriminate against providers with a shrinking base of connections, as compared with providers with a growing base of connections, because both the retrenching and the growing carrier remit

for all connection charges. These updates are costly for contributors to administer, regardless of whether they are permitted to mark up their recovery rates.

³⁷ See *FNPRM* at ¶ 101.

³⁸ The members of the Coalition have different views as to whether the provider’s fee to the customer should include a “mark-up” for costs such as administrative or transactions costs. The individual coalition members will provide those views separately.

³⁹ The initial USF assessment rates might have to be computed including a reserve to cover projected uncollected USF charges.

the contributions actually collected. Therefore, “collect and remit” will ensure that the universal service contribution mechanism meets the statutory requirements that contributions be “equitable and nondiscriminatory.”⁴⁰

II. THE CURRENT CONTRIBUTION MECHANISM IS INEQUITABLE, DISCRIMINATORY, UNSUSTAINABLE, INSUFFICIENT AND UNPREDICTABLE.

The FCC’s current mechanism for calculating and collecting contributions to federal universal service based on interstate and international end user telecommunications revenues is unlawful and cannot remain in effect because it no longer complies with Section 254’s statutory requirements. The Commission has no discretion in this matter in light of the evidence and the law. Section 254(d) requires that the formula for calculating each carrier’s universal service contributions be “equitable and nondiscriminatory” and that it be “specific, predictable and sufficient.” In light of five years of experience and dramatic changes in the telecommunications industry, it is apparent that the current system is both inequitable and discriminatory. In addition, changes in the industry have shown the current system to be unsustainable. Because collecting universal service funds is an integral part of any universal service mechanism, as the funding mechanism becomes unsustainable and breaks down, the FCC’s universal service mechanisms are no longer “specific, predictable and sufficient.”⁴¹ Reform is not just a policy option; it is now a statutory mandate.

⁴⁰ 47 U.S.C. § 254(d).

⁴¹ *Id.*

A. Interstate End User Telecommunications Revenues Are Shrinking and Fund Size Is Growing, Leading to Increased Contribution Factors.

There is now little doubt that the universal service contribution factor, currently set at 7.2805 percent, will continue to increase.⁴² Not only is the total size of the federal universal fund continuing to increase, but the base of total end user interstate and international telecommunications revenues is also declining because of changes in the structure of the telecommunications sector.⁴³ Neither of these fundamental changes is likely to be reversed, and it is now possible that the contribution factor could climb to 13 percent by 2006.⁴⁴

Under existing Commission orders alone, it is certain that total universal service funding will continue to increase. First, when the Commission implements the Interstate Common Line Support in July 2002, as called for by the *MAG Order*,⁴⁵ total universal service support will increase. Second, the caps on the rural high-cost fund adopted as a result of the Rural Task Force recommendations will continue to increase both with

⁴² See Declaration of Daniel Kelley & David Nugent (“Kelley/Nugent Declaration”), appended hereto as Attachment 4, at ¶ 38 (performing sensitivity analysis that shows that reasonable changes to Verizon’s own model would yield a contribution factor of 10 to 13 percent in 2006).

⁴³ *Id.* at ¶ 12.

⁴⁴ *Id.* at ¶ 38.

⁴⁵ *In re Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service; Access charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation; Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, Second Report & Order & Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, & Report & Order in CC Docket Nos. 98-77 & 98-166, 16 FCC Rcd 19613, 19642-44 (2001) (“*MAG Order*”).

inflation and as the number of working loops continues to increase.⁴⁶ Third, as CLECs are certified as eligible telecommunications carriers, universal service support can increase to the extent that service to the customers of those carriers was not previously supported.⁴⁷ Fourth, under both the *MAG Order* and the *RTF Order*, as CLECs enter markets and win customers from the ILECs, the amount of universal service support paid per line to the ILECs (and therefore also to the CLECs) will rise.⁴⁸ The President's Fiscal Year 2003 Budget projects that the federal universal service fund will exceed \$7.2 billion annually by FY2006.⁴⁹

Moreover, both the Commission and Congress are considering additional changes that could increase the federal universal service fund. Currently pending in Congress are

⁴⁶ *In re Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report & Order, Twenty-Second Order on Reconsideration, & Further Notice of Proposed Rulemaking in CC Docket No. 96-45, & Report & Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11262, 11265 (2001) ("*RTF Order*"); *see also* 47 C.F.R. Pt. 36, Subpart F; *id.* Pt. 54, Subpart D.

⁴⁷ *See, e.g., In re Federal-State Joint Board on Universal Service*, Recommended Decision, 16 FCC Rcd 6153, at App. A (2000) (Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service).

⁴⁸ ILEC Interstate Common Line Support, for example, is calculated as a residual of common line revenue requirement and the revenues derived from common line charges. Thus, if an ILEC loses a customer, the line charges that the ILEC receives falls, so the universal service support residual will increase. *See* 47 C.F.R. § 54.307; *see generally RTF Order*, 16 FCC Rcd 11244. In the *RTF Order*, the Commission declined to adopt the RTF's recommendation that common line support be frozen when a CLEC entered the market, so that the ILEC's common line support will also increase as CLECs win customers. *See RTF Order*, 16 FCC Rcd at 11291 (¶ 115).

⁴⁹ Office of Management & Budget, Executive Office of the President, Budget for Fiscal Year 2003, Analytical Perspectives at 676 (2002) ("FY2003 Budget, Analytical Perspectives"). The budget predicts that universal service outlays will exceed \$7.27 billion in FY2006, and \$7.11 billion in FY2007.

bills to repeal the caps on the high-cost fund.⁵⁰ The Commission has issued public notices to seek comment on whether the definition of supported services should be expanded to include broadband services or other services such as extended area service, and whether further changes are necessary to the Lifeline and Link-up programs for low-income individuals.⁵¹ Furthermore, the Commission is currently reviewing its justification for establishing the Interstate Access Universal Service Support Fund at \$650 million,⁵² and the structure of its non-rural high cost fund.⁵³ The Commission has sought comment on ways to modify its rural health care program, in part to increase participation.⁵⁴ These bills and rulemakings could all result in further increases in the amount of annual universal service funding.

At the same time, the universal service assessment base—that is, end user interstate and international telecommunications revenues—is shrinking. The USF contribution base reported by USAC and used by the Commission to calculate the

⁵⁰ Universal Service Support Act, S. 500, 107th Cong., 1st Sess. (2001); Universal Service Support Act, H.R. 1171, 107th Cong., 1st Sess. (2001).

⁵¹ *In re Federal-State Joint Board on Universal Service Seeks Comment on Review of the Definition of Universal Service*, Public Notice, 16 FCC Rcd 16155 (2001); *In re Federal-State Joint Board on Universal Service Seeks Comment on Review of Lifeline & Link-Up Service for All Low-Income Consumers*, Public Notice, 16 FCC Rcd 18407 (2001).

⁵² *In re Common Carrier Bureau Seeks Comment on Remand of \$650 Million Support Amount Under Interstate Access Support Mechanism for Price Cap Carriers*, Public Notice, 16 FCC Rcd 21307 (2001).

⁵³ *In re Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking & Order, 17 FCC Rcd 2999 (2002) (“*Qwest Remand NPRM*”).

⁵⁴ *In re Rural Health Care Support Mechanism*, Notice of Proposed Rulemaking, WC Docket No. 02-60, FCC 02-122, at ¶ 10 (rel. Apr. 19, 2002).

contribution factor has declined.⁵⁵ This shrinkage in the universal service assessment base does not appear to be a one-time phenomenon, and is primarily due to a sharp decline in assessable end user interstate and international telecommunications revenues reported by interexchange carriers. In 1999, interexchange carriers reported an average of \$13.871 billion in end user interstate and international telecommunications revenues per quarter.⁵⁶ For the third quarter of 2001, the end user interstate and international telecommunications revenues reported by interexchange carriers were only \$11.450 billion, a drop of over 17 percent from 1999 levels.⁵⁷

Financial analysts confirm that wireline long-distance voice revenues fell 11.6 percent in 2001 after falling 7.7 percent in 2000.⁵⁸ Some of this revenue decline is attributable to downward pressure on rates, and some to leakage from the system as interstate telecommunications services increasingly are available as part of bundled service offerings. However, the significant drop in wireline switched-access minutes

⁵⁵ Because of a transition from semiannual revenue reporting to quarterly reporting, data are not available for the last six months of 2000. However, the contribution base for the first quarter of 2001 was almost \$400 million below the quarterly average during the first six months of 2000. *Compare* FCC Contribution Factor PN 2Q 2001 *with* FCC Contribution Factor PN 3Q 2001. The only increase in the contribution base was in the 3Q 2001, in which the contribution base increased 2.5 percent. J. Lande & K. Lynch, *Telecommunications Industry Revenues 2000*, Table 14, Industry Analysis Division, Common Carrier Bureau (Jan. 2002) (“*Telecommunications Industry Revenues 2000*”). In 4Q 2001, however, the contribution base declined 3.9 percent from the previous quarter – to its lowest level since 1Q 1999. *See* 2Q 2002 Contribution PN, available at <<http://www.fcc.gov/wcb/iatd/lec.html>>.

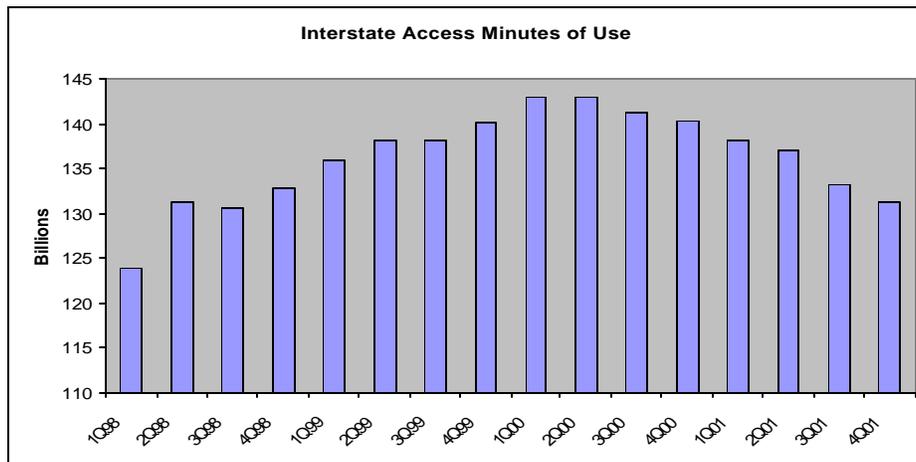
⁵⁶ J. Lande, *Telecommunications Industry Revenues 1999*, Table 8, Industry Analysis Division, Common Carrier Bureau (Sept. 2000) (“*Telecommunications Industry Revenues 1999*”). A reported potential universal service contribution base from interexchange carriers of \$55.486 billion over four quarters averages \$13.871 billion per quarter.

⁵⁷ *Telecommunications Industry Revenues 2000* at Table 14.

most likely reflects continued consumer substitution of e-mail, instant messaging, Internet transactions in lieu of toll-free calling, and most of all wireless long-distance service, for wireline long-distance service.⁵⁹ As discussed in more detail below, substitution of a wireless provider’s long distance service for a wireline provider’s long distance service by itself reduces the universal service contribution base because of the discriminatory manner in which the wireless “safe harbors” operate.⁶⁰

The decline in wireline interstate and international usage has been dramatic. Since the second quarter of 2000, ILEC interstate switched-access minutes of use, the most significant measure of actual toll usage, has fallen continuously.⁶¹ Chart 1 illustrates this decline over the past two years:

Chart 1



⁵⁸ J.P. Morgan Securities, Inc., “Telecom Revenue and Capex Trends, Fourth Quarter 2001,” at 7 (Mar. 25, 2002).

⁵⁹ See Kelley/Nugent Declaration at ¶¶ 16-18.

⁶⁰ See Section II.C.3, *infra*; Kelley/Nugent Declaration at ¶ 18.

⁶¹ Kelley/Nugent Declaration at ¶ 29. FCC data show that, for as long as the FCC has been tracking interstate switched-access MOUs, usage had never before declined for longer than a single quarter. Industry Analysis Division, Common Carrier Bureau, *Trends in Telephone Service*, Table 11.3 (Aug. 2001) (“*Trends 2001*”).

It is unlikely that CLEC-provided switched access minutes-of-use offsets this marked decline in wireline switched access minutes.⁶²

The inevitable result of a shrinking contribution base and an increasing universal service fund is a substantial increase in the universal service contribution factor. As discussed in the attached Kelley/Nugent Declaration, increases in the universal service fund, combined with decreases in end user interstate and international telecommunications revenue, will likely result in universal service contribution factors exceeding 10 percent by 2006, and could result in contribution factors as high as 13 percent.⁶³

B. Increasing Universal Service Contribution Rates Are Creating a USF “Death Spiral” by Causing Consumers and Providers to Structure Bundled Purchases and Offerings to Avoid USF Contribution.

As universal service contribution factors continue to increase, revenue from bundles of interstate and international telecommunications services and other telecommunications services, information services and CPE will be allocated so as to avoid, to the maximum extent possible, federal universal service contribution. This will be especially true with respect to contract offerings negotiated between carriers and large customers, but may even be true in the mass market. As carriers characterize smaller portions of their bundled services as “interstate and international telecommunications,” the decline in the universal service assessment base will accelerate. This acceleration in the shrinkage of the assessment base will drive the contribution factor still higher, creating additional incentives to reduce the percentage of bundled offerings attributable

⁶² Kelley/Nugent Declaration at ¶ 29.

⁶³ *Id.* at ¶ 38.

to interstate and international telecommunications. The result is a “death spiral” for universal service funding, which will render the entire universal service support mechanism unsustainable, and therefore insufficient and unpredictable.

The Commission has recognized that bundling can encourage consumers to subscribe to new, advanced or specialized services, give them a choice of relying on one provider to integrate a package of services, and eliminate transactions costs.⁶⁴ Moreover, CMRS has long been sold as a combination of CPE, intrastate, and interstate service. In wireline telecommunications, bundles of interstate and intrastate service are becoming increasingly common and offer value for consumers.⁶⁵ The reality, however, is that the Commission has no effective and nondiscriminatory way to police the manner in which the parties to a contract allocate revenues within a bundled contract (or set of contracts) for interstate and intrastate telecommunications services, information services, CPE, and other services. Users understandably seek the best possible total price. If getting that price means that more revenue is allocated to intrastate telecommunications services, information services and CPE, so that federal universal service charges can be minimized, that will be the outcome.

Any proposed method of identifying interstate telecommunications revenues within a bundled package is arbitrary and administratively unworkable. For example, under the Commission’s bundling “safe harbors,” a carrier is permitted to allocate

⁶⁴ *In re 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 & Enhanced Services Unbundling Rules in the Interexchange, Exchange Access & Local Exchange Markets*, Report & Order, 16 FCC Rcd 7418, at ¶ 10 (2001) (“*Bundling Order*”).

revenue to the interstate or international telecommunications component of a bundle using the “standard business” or “tariffed” stand-alone rate for the interstate telecommunications service.⁶⁶ Other commenters have proposed revenue allocation according to the lowest stand-alone rate.⁶⁷ But under either system, it can be difficult to identify the appropriate stand-alone rate at all. Often, there are multiple stand-alone rates that could serve as potentially appropriate points of reference for the bundled service, and determining which of these offerings is the most appropriate analogue has no easy answer. That is true even when services are tariffed; in a detariffed environment, determining the appropriate cross-reference is almost impossible. Perhaps even more significantly, customers themselves will not be content passively to accept allocation of revenues within the bundle according to the FCC’s “safe harbors.” Providers will be forced by competition to use other allocation mechanisms that recognize that contract rates are usually below “standard” or “tariffed” rates.⁶⁸ Maintaining the revenue-based approach will increasingly place the Commission in the role of “rate police,” passing judgment on the inherently arbitrary process of choosing the proper analogue for services within a bundle.⁶⁹

⁶⁵ See, e.g., <http://www.mci.com/res_local_service/jsps/default.jsp> (discussing MCI’s Neighborhood plan, which offers unlimited long distance and unlimited local calling for a single monthly rate).

⁶⁶ See *Bundling Order*, 16 FCC Rcd at 7447 & n.152 (¶ 50).

⁶⁷ See, e.g., Home Telephone Comments at 9. All references to party comments in this document are to comments filed in response to the 2001 *NPRM* in this proceeding. See 16 FCC Rcd 9892 (2001).

⁶⁸ Ad Hoc Comments at 24. The *Bundling Order* expressly permits carriers to use other methods to allocate revenues, provided they are “reasonable.” *Id.* at 7448 (¶ 53).

⁶⁹ See AT&T Comments at 12; WorldCom Comments at 18-20. A per-connection assessment would also obviate the need for the complex factors proposed by Sprint, which would not be stable over time. See Sprint Comments at 10-16.

The problem of allocating revenues does not apply only to mixed bundles that include information services and CPE, but also to sales of local exchange and exchange access service. The comments of SBC illustrate this point.⁷⁰ SBC first argues that, because CLECs are not required to perform jurisdictional separations, there is no way to identify the portion of their revenues that are interstate. SBC therefore alleges that CLECs do (or could) game the system and understate their interstate revenues. SBC therefore proposes that “[t]he Commission could establish a safe harbor interstate allocation percentage for the exchange access component of each access line and give CLECs the option of performing a separations calculation to justify a different interstate allocation percentage.”⁷¹ Of course, once incumbent ILECs obtain Phase I pricing flexibility, they also execute contract tariffs and no longer provide services according to rates that have some historical tie to separations. Competition-based deregulation and forced allocation of revenues into interstate and intrastate categories to sustain universal service are fundamentally inconsistent.

Moreover, experience over the last five years strongly suggests that the Commission cannot escape the bundling quagmire simply by prescribing a set of allocators. The one instance in which the Commission has prescribed specific allocators to address a “bundled” offering has been for CMRS, and that example illustrates the difficulties in separating bundled revenues for the purposes of the current universal service contribution mechanism. Under existing Commission “interim” safe harbors, cellular, broadband PCS and digital SMR providers can report 15 percent of their total telecommunications revenue as interstate, paging providers can report 12 percent of their

⁷⁰ SBC Comments at 11-12.

paging revenues as interstate, and SMR providers can report 1 percent of their total revenues from analog SMR as interstate.⁷² These “safe harbors,” however, have not kept pace with marketplace developments. They were set at a time when digital “one-rate” plans were just being announced, before the CMRS industry had widely adopted “bucket pricing” plans, and before companies like Blackberry introduced two-way RIM pagers. These allocators are now out of date and highly discriminatory, as marketplace innovations have led consumers to “shift[] their long distance calling from traditional wireline service to wireless service.”⁷³ The Commission has never updated these allocators. Although the CMRS “safe harbors” were promulgated as “interim” guidance in 1998, and were accompanied by a *Notice of Proposed Rulemaking*, the Commission never completed that proceeding.⁷⁴

Without an effective and marketplace-consistent means to address the allocation of revenues within a bundled contract, the current end user interstate and international telecommunications revenue-based contribution mechanism leaves the Commission with the unpalatable alternatives of either eliminating bundling or accepting the universal service “death spiral” as customers seek to minimize their universal service charges. But the Commission has recognized that bundling benefits consumers and eliminated the rules that formerly precluded bundling.

In light of the inevitability of the USF “death spiral” in the face of bundling, the end user interstate and international telecommunications revenue-based contribution

⁷¹ *Id.* at 12.

⁷² *Interim CMRS Safe Harbor Order*, 13 FCC Rcd at 21258-60.

⁷³ *2001 Contribution NPRM*, 16 FCC Rcd at 9904 (¶ 24).

⁷⁴ *See Interim CMRS Safe Harbor Order*, 13 FCC Rcd at 21260-81.

mechanism can no longer meet the statutory requirement that the universal service mechanism be “specific, predictable and sufficient.”⁷⁵ Although the Commission is currently reconsidering the definition of the term “sufficient,” it certainly cannot encompass a contribution mechanism that is unsustainable. If there is no sustainable way to collect universal service contributions, there is simply no way for that mechanism to be “sufficient [to] preserve and enhance universal service.”⁷⁶ The Commission cannot continue to maintain a contribution system that fails to meet this fundamental statutory requirement.

C. The Current End User Interstate Telecommunications Revenue-Based Contribution Mechanism Is Discriminatory and Inequitable.

The current end user interstate and international telecommunications revenue-based contribution mechanism, with its hodgepodge of exemptions and special rules, is both discriminatory and inequitable, in contravention of Section 254(d)’s command that contributions be made “on an equitable and nondiscriminatory basis.” Experience has revealed the current system to be unlawful, and it therefore cannot be continued.

1. Interstate Revenue-Based Contribution Either Discriminates in Favor of or Against Providers that Bundle Interstate Telecommunications with Other Products.

As discussed above, if the Commission does not force carriers to use one of its two unrealistic and marketplace-incompatible bundling “safe harbors,” the interstate end user telecommunications revenue-based contribution mechanism will favor providers that can bundle interstate telecommunications with other services and allocate revenues to

⁷⁵ 47 U.S.C. § 254(d).

⁷⁶ *Id.*

portions of the bundle other than interstate telecommunications. On the other hand, if the Commission actually forces carriers to use only its two bundling “safe harbors,” the Commission will discriminate against providers that bundle telecommunications services with other services, because the two “safe harbors” deliberately and systematically overallocate revenues to interstate telecommunications.⁷⁷ In either case, the interstate end user telecommunications revenue based contribution mechanism cannot be described as “nondiscriminatory” -- it will favor one set of providers or the other arbitrarily and without any reference to underlying costs or cost-differentials.

2. *Reporting Lags Create Inequity and Discrimination in a Dynamic Telecommunications Market.*

In the initial comments in this proceeding, numerous commenters, including SBC, recognized that assessing USF contributions based on an historically-reported level of end user interstate and international telecommunications revenues (sometimes called the “USF lag”) is *not* competitively neutral.⁷⁸ In particular, the USF lag creates an artificial competitive advantage for telecommunications carriers with increasing interstate or international revenues because those carriers are not obligated to contribute to the universal service fund for six months, after which time they are able to spread the recovery of those contributions over a by-then larger revenue base.⁷⁹ By contrast,

⁷⁷ See AT&T Comments at 12; Ad Hoc Comments at 23-24. Under the Commission’s two bundling “safe harbors,” a contributor must either allocate revenues to interstate services using “tariffed” rates, which are often well above negotiated contract rates, or it must allocate all revenue for the *entire bundle* to interstate telecommunications. *Bundling Order*, 16 FCC Rcd at 7447 (¶¶ 49-50).

⁷⁸ See, e.g., Excel Comments at 6 (“Changes in the industry . . . make a historical revenue mechanism inaccurate and anti-competitive.”); see also Ad Hoc Comments at 16-19; ASCENT Comments at 4; AT&T Comments at 9-11; SBC Comments at 5-6.

⁷⁹ See, e.g., Excel Comments at 6.

carriers with declining interstate and intrastate revenue accrue large assessments, which then must be spread over a smaller revenue base.⁸⁰ For instance, SBC notes that because it is losing access lines to competitors, “SBC has been put in the position of under-recovering its universal service contributions because such contributions are tied to historical revenue data.”⁸¹

The same effect occurs in long-distance markets. By basing USF contributions on a carrier’s interstate revenues during the previous six-month period, the current system places existing long-distance carriers at a competitive disadvantage compared to new entrants to the long-distance marketplace, including the Regional Bell Operating Companies (“RBOCs”) that have received authority to provide in-region long-distance service under section 271 of the Act. When they launch service, those new entrants are not required to contribute to the Universal Service Fund for six months because they have no historical revenues upon which to base contributions. As the *Notice* points out, this enables those new entrants to undercut the prices offered by established providers who are contributing to the Universal Service Fund.⁸² Moreover, this competitive advantage continues in subsequent years given that, “to the extent that new entrants increase their long distance market share and recover contributions against current end user revenues, the revenue base against which they recover contributions would remain greater than the revenue base against which their contributions are assessed.”⁸³ In contrast, established long-distance carriers confronted with declining market share and revenues face the

⁸⁰ *See id.*

⁸¹ SBC Comments at 5; *see also* Ad Hoc Comments at 16-19; ASCENT Comments at 4; AT&T Comments at 9-11; Excel Comments at 6-8; SBC Comments at 5-6.

⁸² *2001 Contribution NPRM*, 16 FCC Rcd at 9901 (¶ 14).

opposite effect: under the current system, they will have to recover from a declining current revenue base their universal service contributions assessed against a larger revenue base from a prior period.⁸⁴

This real-world discrimination is a fundamental defect of the current end user interstate and international telecommunications revenue-based contribution methodology. Although it is appealing in theory to think of the telecommunications industry and its participants as operating in a steady state, the reality is that marketplace conditions and contributors' relative market shares and revenues are constantly changing. The dramatic erosion of interstate end user toll usage and revenues over the past two years illustrates the magnitude of shifting industry conditions. In this environment, it is not reasonable -- and there is no record support -- for the Commission to assume that contributors operate in a steady state. As such, the current contribution system based on historically reported revenues cannot meet the statutory command that contribution be "nondiscriminatory," and thus, the current system must be discarded.

3. *The CMRS Safe Harbor Creates a Systematic Discrimination in Favor of Wireless-Based Service.*

In the initial comments in this proceeding, several commenters recognized that the existing wireless safe harbor significantly understates the amount of interstate revenues earned by wireless telecommunications providers, thereby unfairly shifting the burden of funding the universal service system to wireline carriers.⁸⁵ Moreover, even the wireless

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *See* AT&T Comments at 13; WorldCom Comments at 12-15. *But see* CTIA at 6 (arguing for expansion of the safe harbor).

carriers agreed that there was no mathematically accurate way in which to divide or characterize wireless revenues as interstate or intrastate. AT&T Wireless stated, “wireless carriers are unable to determine with any certainty the amount of revenue attributable to interstate traffic.”⁸⁶ Verizon Wireless refers to widespread wireless offerings where customers are given a monthly allowance of airtime usage minutes that can be used for interstate or intrastate calls and concludes, “carriers do not have the ability to determine the precise jurisdictional category of each revenue item, further complicating the task of breaking down their revenues into separate intrastate and interstate totals.”⁸⁷

When the Commission set the wireless safe harbor percentages in 1998, it based those percentages on the then-reported percentage of interstate wireline minutes of use reported for the dial equipment minutes weighting program (the predecessor of local switching support).⁸⁸ Those percentages do not reflect the extent to which wireless consumers disproportionately use their wireless phone for interstate calls, especially with the increased substitution of wireless-based for wireline-based long distance that has occurred since the introduction of wireless one-rate plans.⁸⁹ Moreover, unlike wireline consumers (and carriers) who pay universal service contributions based on the Subscriber

⁸⁶ AT&T Wireless Comments at 3.

⁸⁷ Verizon Wireless Comments at 4-5.

⁸⁸ See *Interim CMRS Safe Harbor Order*, 13 FCC Rcd at 21263.

⁸⁹ Even Verizon admits that “wireless migration” is a real trend, reflecting the “shift of wireline MOU to wireless as packages including LD become more common and rates decline.” Verizon Oct. 26, 2001 *Ex Parte* at 6 (further describing the shift of circuit-originated MOU to VoIP); *id.* at 36 (forecasting that 14 percent of landline long distance MOU will be replaced by wireless MOU by 2004, up from 1 percent in 2000).

Line Charge (“SLC”) even absent actual interstate usage, the safe-harbor percentage was set solely on interstate usage. These deficiencies make the wireless safe harbors inequitable and discriminatory.

A simple example best illustrates both the discriminatory impact of the existing CMRS “safe harbors” and the extent to which the “safe harbors” undermine the sufficiency of the federal universal service mechanisms. Daniel Kelley and David Nugent compared the universal service contribution that would be paid by Verizon for a wireline long distance subscriber with the amount of universal service contribution Verizon Wireless would pay if that same 100 minutes of wireline long distance usage were provided over the customer’s cellular or PCS telephone.⁹⁰ The wireless “safe harbor” results in an 80 percent decline in the amount contributed to support federal universal service mechanism for those 100 minutes of interstate usage.⁹¹

The FCC’s reported revenue statistics further confirm this discriminatory effect. As reflected in the decline in switched access MOUs, significant wireline long distance usage has shifted to wireless, with a commensurate decline in long distance end user interstate telecommunications revenues.⁹² While reported wireless interstate end user telecommunications revenues appear to have grown by approximately \$4 billion since 1999, toll carriers reported interstate end user telecommunications revenues dropped by

⁹⁰ Kelley/Nugent Declaration at ¶ 18.

⁹¹ *Id.*

⁹² *Id.*

over \$8 billion during the same period.⁹³ The interstate revenues allocated to wireless services, however, have not increased to nearly the same extent.

In light of this record evidence, the Commission cannot continue the current contribution methodology with its wireless safe harbors. This system is patently discriminatory, and cannot meet the statutory requirement that the contribution mechanism be “equitable and nondiscriminatory.” Accordingly, the Commission must discard the current system and find an equitable and nondiscriminatory basis for universal service contributions.

4. *The Partial “International” Exemption Is Discriminatory and Inequitable.*

Similarly, the arbitrary partial “international exemption” is also inequitable and discriminatory.⁹⁴ That exemption is not competitively neutral, as it exempts from universal service contribution all international revenues for carriers whose interstate end user telecommunications revenues are less than twelve percent of their combined end

⁹³ Based on the annualized average of FCC reports of reported revenues for the first three quarters of 2001, we estimate that wireless carriers will report approximately \$9.3 billion in assessable end user interstate and international telecommunications revenues for 2001. For toll carriers, we estimate they will report approximately \$52 billion in assessable end user interstate and international telecommunications revenues for 2001. *See Telecommunications Industry Revenues 2000; Telecommunications Industry Revenues 1999.*

⁹⁴ *See, e.g.,* AT&T Comments at 13; Telstar Comments at 2-5. Although the Fifth Circuit reversed the decision to include all international revenues in the assessment base, *see TOPUC I*, 183 F.3d at 434-35 (reversing and remanding the Commission’s decision to assess all international revenues of interstate carriers, because certain carriers’ universal service contributions would have exceeded their annual interstate revenues), it did not proscribe the FCC’s partial “international exemption.”

user interstate and international telecommunications revenues, but not the international revenues of other carriers.⁹⁵

As a result of this exemption, competition in international telecommunications is skewed in favor of “pure play” international telecommunications providers. “Pure play” international telecommunications providers can provide services without a universal service contribution fee, or without building such recovery into their rates: international telecommunications providers that do not qualify for the exemption cannot do so because they will be assessed universal service contributions. As the universal service contribution factor increases, this discriminatory skew will only increase.

The only way to end this discriminatory effect would be to exclude all international revenues from the contribution base for universal service. Doing so would, however, increase the universal service contribution factor still further, aggravating the already-started universal service contribution “death spiral.” The only alternative that meets the statutory requirement that contributions be “equitable and nondiscriminatory” and that will break the universal service “death spiral” is to discard an end user interstate and international telecommunications revenue-based contribution methodology and to shift to a connection-based formula.

III. THE COSUS PROPOSAL IS SUSTAINABLE, PREDICTABLE, SUFFICIENT, EQUITABLE AND NONDISCRIMINATORY.

In stark contrast with the current end user interstate and international telecommunications revenue-based contribution system, a connection- and capacity-based approach to allocating universal service responsibility among carriers is consistent

⁹⁵ See *FNPRM* at ¶¶ 123-26.

with the statute's command that contributions be "equitable and nondiscriminatory," will continue to be "predictable and sufficient," and is superior to the existing revenue-based mechanism. The connection-based contribution mechanism proposed by CoSUS is more economically efficient, adaptable to changes in the marketplace and thus sustainable over time, competitively neutral, and relatively simple to administer. Finally, consumers will benefit because a connection- and capacity-based approach will better ensure sufficient universal service funding without imposing inequitable burdens on any particular class of end user.

A. Under a Connection-Based Mechanism, USF Contribution Will Be Sustainable and Avoid the USF "Death Spiral."

In contrast with today's end user interstate and international telecommunications revenue based contribution system, a connection-based contribution will be sustainable and will avoid the universal service "death spiral" because connections, unlike revenues, are growing overall, and a connection-based assessment cannot be easily avoided by allocating fewer bundled revenues to interstate telecommunications. A connection-based assessment, unlike an interstate revenue-based assessment, therefore is sustainable, and meets the statutory directive the universal service mechanisms be "specific, predictable and sufficient."⁹⁶

1. Connections, Unlike Revenues, Continue to Grow.

While end user interstate and international telecommunications revenues shrink, end user connections to public networks continue to grow. Interstate connections increased from 1999 to 2001 -- the same period over which assessable end user interstate

⁹⁶ 47 U.S.C. § 254(d).

and international telecommunications revenues peaked and then began declining. Between December 1999 and June 2001, total end user switched access lines increased from 189.5 million to 191.7 million.⁹⁷ During the same period, total mobile wireless subscribers grew from 79.7 million to 114 million, an increase of over 43 percent.⁹⁸ Special access lines also increased dramatically in 1999 and 2000, growing from 35.9 million at the end of 1998 to over 70.6 million at the end of 2000.⁹⁹

Verizon's analysis helps to confirm the stability of a connection-based assessment mechanism as compared to a revenue-based assessment mechanism. Verizon's study discusses numerous forms of service substitution, some of which are occurring more quickly than others.¹⁰⁰ A connection-based assessment is agnostic as to the provider of the public network connection. Unlike today's revenue-based mechanism, with its hodge-podge of exceptions and exemptions, the size of the assessment base in a connection-based mechanism will not change if the user switches from a wireline to a wireless connection, or from an ILEC to a CLEC. The connection-based mechanism is also sufficiently flexible to cover technology migration to optical connections.

Because the number of interstate connections is growing, rather than shrinking, the amount of the per connection USF assessment rates will increase no faster than the

⁹⁷ 2002 FCC Local Competition Report at Table 1. Report may be found online at <<http://www.fcc.gov/wcb/iatd/recent.html>>.

⁹⁸ *Id.* at Table 10.

⁹⁹ Industry Analysis Division, Common Carrier Bureau, 1998 Statistics of Common Carriers, Table 2.5; Industry Analysis Division, Common Carrier Bureau, 2000 Statistics of Common Carriers, Table 2.4 ("2000 SoCC"). The FCC has not yet released statistics for special access lines as of December 31, 2001. Reports may be found at <<http://www.fcc.gov/wcb/iatd/socc.html>>.

size of the fund. If, as the Administration's FY 2003 Budget predicts, universal service funding increases from an estimated \$5.8 billion in FY2002 to \$7.2 billion in FY2006,¹⁰¹ connection-based assessments will not grow so long as the total number of connections also grows by approximately 5 percent per year. This is a much more stable assessment base than end user interstate and international telecommunications revenues, and it meets the statutory directive that universal service mechanisms be "specific, predictable and sufficient."

2. *Connection-Based Assessments Cannot Be Easily Avoided.*

As discussed previously, one of the critical flaws of the end user interstate and international telecommunications revenue-based contribution mechanism is that carriers and customers can work together to avoid carrier assessments and end user universal service charges, by constructing contracts that allocate more revenue within a bundled offering to services other than interstate telecommunications.¹⁰² Customers can also avoid charges by shifting to providers, such as wireless or "pure play" international carriers, that are subject to a favorable "safe harbor" or exemption that reduces or eliminates the universal service contribution. An interstate connection-based assessment is much more difficult to avoid, and in any event the proposed connection-based assessment rates are much less likely to trigger a search for avoidance mechanisms.

¹⁰⁰ Verizon Oct. 26, 2001 *Ex Parte* at 24-33. The Coalition does not in any way endorse Verizon's assertions with respect to the magnitude or competitive significance of these potential substitutions.

¹⁰¹ FY2003 Budget, Analytical Perspectives at 676.

¹⁰² Under the existing revenue-based mechanism, the business and residential customers with less intensive usage will have both less opportunity and less incentive to bypass the system, and therefore are more likely to be stuck paying an increasingly growing portion of universal service fees.

- a. All telecommunications require a connection.

All telecommunications require the end user to have a connection to a network. That connection can be wireless or wireline, circuit-switched, packet switched, or dedicated, but there still must be a connection to a network. Moreover, there are few purely private, intrastate networks. Ordinary wireline telephone service and wireless service are interconnected into public, carrier-based networks. Thus, while there will be some wholly intrastate private lines that would lie outside a universal service contribution system based on interstate connections to a public network, these will be relatively few in number.¹⁰³

The ubiquity of connections is significant because it means that a connection-based universal service assessment mechanism cannot be easily by-passed. Moreover, it means that a connection-based assessment mechanism will be robust, and adaptable to changes in industry structure and technology.

- b. Issues of contribution by broadband Internet access connections should be resolved in the *Framework NPRM*, not in this proceeding.

As the *FNPRM* notes, the Commission also has pending before it the *Wireline Broadband Internet Access Framework NPRM*, in which it has expressly sought comment on the appropriate treatment of offerings of broadband Internet access services for the purposes of federal universal service fund contributions.¹⁰⁴ Although the universal service issues raised in that *NPRM* are important, they are a small subset of the

¹⁰³ See 47 C.F.R. § 36.154(a) (treating a special access or private line as interstate if interstate traffic constitutes more than 10 percent of the total traffic on the line).

¹⁰⁴ *Wireline Broadband Internet Access Framework NPRM* at ¶¶ 75-83.

challenges facing the current universal service contribution mechanism, and they are mostly of prospective impact only. These issues do not at all address the shrinkage in the existing contribution base of end user interstate and international telecommunications revenues, or the impact that rising USF contribution rates will have on incentives to structure offerings and transactions to avoid federal universal service contribution. The bottom line is that this proceeding should not be held hostage to the broadband debates.

At the core of the universal service issues in the *Wireline Broadband Internet Access Framework NPRM* is the question of whether the Commission should alter its treatment of telecommunications that an information service provider provisions for its own use, or of telecommunications that compete with such providers.¹⁰⁵ As the *Wireline Broadband Internet Access Framework NPRM* reflects, that issue is intertwined with other issues considered in that *NPRM*, including the appropriate statutory categorization of wireline broadband Internet access services and the applicable safeguards when such services are provided by entities that are also facilities-based common carriers.

Most significantly, shifting from a revenue-based contribution mechanism to a connection-based contribution mechanism does not prejudge or require any specific outcome of the issues presented in the *Wireline Broadband Internet Access Framework NPRM*, and thus this proceeding and the *Wireline Broadband Internet Access Framework NPRM* are logically independent and can be decided separately. A connection-based contribution mechanism can be implemented so that it excludes universal service contributions from ISPs that self-provision telecommunications, or it can include those connections, and/or other telecommunications that ISPs provide to themselves.

¹⁰⁵ *Wireline Broadband Internet Access Framework NPRM* at ¶ 77 & n.134.

Indeed, it may be helpful for the Commission, in considering the range of issues presented by the *Wireline Broadband Internet Access Framework NPRM*, to decide the issues presented in this *FNPRM* first. If, for example, the Commission decides to move from an end user interstate and international telecommunications revenue-based assessment mechanism to a connection-based mechanism, the issues related to the classification of revenues derived from a bundled integrated package of an information service and underlying telecommunication could be simplified.

Moreover, resolution of the question of whether broadband connections should contribute to universal service is simply not necessary to stabilize the universal service fund contribution base in the short-to-medium term. Unlike the erosion in the interstate and international end user telecommunications revenue base, even if high-speed lines are excluded, the number of assessable connections continues to grow. According to the Commission's last report on high-speed lines, as of June 2001 there were only about 10 million such lines, as compared to a total of approximately 300 million switched wireline and non-paging CMRS connections.¹⁰⁶ Although the Commission has appropriately asked about the impact of broadband growth and potential migration on the universal service system, such migration is not so imminent as to create an immediate threat to the preservation of universal service, unlike the erosion of the end user interstate and international telecommunications revenue base.

¹⁰⁶ Industry Analysis Division, CCB, High-Speed Internet Access: Subscribership as of June 30, 2001, at Table 1 (Feb. 2002). Report may be found online at <<http://www.fcc.gov/wcb/iatd/recent.html>>.

B. The Coalition’s Proposed Connection- and Capacity-Based Assessments Are Competitively and Technology Neutral and Therefore Nondiscriminatory.

The Coalition’s proposed connection- and capacity-based approach is competitively neutral because it does not distinguish between particular categories of service providers or the technologies they use in providing service. Accordingly, a connection- and capacity-based contribution mechanism will be equitable and nondiscriminatory as between different providers of competing services, and thus meet the statute’s commands.

A connection- and capacity-based approach will not distort how carriers choose to structure their businesses or the types of services that they provide. As markets converge and customers have the opportunity to choose among providers that use different technologies to provide similar, but not identical services, it becomes especially important that the universal service assessment not in any way distort the choice that customers make among alternative providers. Indeed, identification of what constitutes a competitively neutral – and therefore an equitable and nondiscriminatory – funding mechanism must be made in the context of market dynamics. Discrimination will occur if two carriers offer competing services (*e.g.*, wireline interstate telecommunications service and wireless interstate telecommunications service), but the assessment is placed on only one of the carriers or is higher for one of the carriers, because then one carrier has a cost imposed on it that the other carrier does not, and the harmed carrier must either add charges that its competitor does not have to add or absorb costs that its competitor does not have to absorb.

Under the Coalition proposal, the contribution burden falls only on the interstate carrier that provides the connection, and then only on a collect-and-remit basis. This

ensures that a carrier providing the end user's public network connection will not be placed at a competitive advantage or disadvantage vis-à-vis other carriers also providing end user connections. A carrier with a growing base of connections does not escape universal service contribution during the period of the USF lag, and the carrier with a shrinking base of connections is not required to recover its contributions on a customer base that is smaller than during the period for which universal service was assessed.

Moreover, carriers providing the same service (*e.g.*, interstate long distance) over different technologies (*e.g.*, wireline and wireless) are not subjected to differing universal service assessments, as they are under the current system. Using the example of wireline and wireless, a carrier providing an end user connection and interstate long distance service over a residential wireline connection would pay the exact same universal service contribution as a carrier providing a cellular or PCS-based connection and interstate long distance service to the same customer. Wireless substitution for long distance (or even local) service would no longer result in a lower USF contribution than if that service had been provided over wireline connections.

In addition, a connection-based universal service formula would prevent a provider from attempting to improve its competitive position by recharacterizing the portion of its service revenue assigned to interstate telecommunications. A CLEC, or an ILEC with Phase I pricing flexibility for common line rates, would no longer be able to avoid universal service contributions simply by increasing the amount of its intrastate service charge, while decreasing the amount of its interstate service charge. This puts CLECs, ILECs with pricing flexibility, and ILECs without pricing flexibility all in the same competitive position with respect to universal service contributions – none is

advantaged or disadvantaged under the Coalition’s connection-based proposal. The fact that the residential universal service charge would go up by at most \$0.59¹⁰⁷ a month for a small subset of customers and the fact that Lifeline customers would not have to pay any charge means that customer decisions (and the market in general) are not distorted by requiring the carrier providing the connection to pay the assessment. Since the customer could not evade the universal service surcharge by changing its choice of carrier, no carrier is placed at an inequitable or discriminatory competitive disadvantage.

The Coalition’s proposed connection-based mechanism stands in stark contrast to the current end user interstate and international telecommunications revenue-based mechanism, which relies on complex, outdated, and increasingly irrelevant jurisdictional allocations. The current system treats wireless services differently than wireline services, it allows CLECs and ILECs with pricing flexibility to treat themselves differently than other incumbent LECs, and it penalizes mature companies that are shrinking versus their newer, and still growing, competitors.

It should be noted that the relative burden on industry segments is not a relevant measure of nondiscrimination or equity. As long as carriers are allowed to fully recover their costs associated with the federal universal service fund, relative industry segment burden is irrelevant to an analysis of whether a contribution mechanism is “equitable and nondiscriminatory.” The end user pays the “LEC” contribution, the “IXC” contribution, and the “wireless” contribution. Moreover, as discussed further below, splitting the universal service contribution between IXCs and ILECs, as some have proposed, would

¹⁰⁷ This increase applies only to the small minority of customers who consistently made no interstate or international long distance calls. *See Zero-Volume Long Distance*

be both backward-looking in terms of industry structure and inefficient, imposing significant information-sharing transactions costs without a purpose.¹⁰⁸

The relevant inquiry as between different industry participants is the relative burden on competitors seeking to provide the same service to the same customer in the same market. If those relative burdens are the same, as they are under the Coalition's connection-based proposal, then the contribution mechanism is competitively neutral and therefore nondiscriminatory. If the relative burdens are different, as under the current system, then the contribution mechanism fails the statutory test, and is not consistent with the Commission's universal service principles.

C. A Connection-Based Contribution Mechanism Is More Efficient and Minimizes Deadweight Loss.

There can be no disputing that a connection-based contribution mechanism is more economically efficient, and maximizes social welfare by minimizing deadweight economic loss. As the Ad Hoc Committee pointed out in its initial comments in this proceeding, the current system of assessing USF contributions is economically inefficient because it effectively seeks to recover non-traffic sensitive costs – the bulk of costs supported by universal service mechanisms – on a usage-sensitive basis.¹⁰⁹ This inefficiency is especially acute, given that long distance carriers generally recover their universal service contributions in fees set as a percentage of the customer's bill.

Customers, AT&T, appended hereto as Attachment 3, at 2 (“*Zero-Volume Long Distance Customers*”).

¹⁰⁸ See Section IV.C, *infra*.

¹⁰⁹ Ad Hoc Comments at 7.

In an article critiquing the economic welfare effects of the existing end user interstate and international telecommunications revenue based recovery mechanism, Jerry Hausman, an economist who frequently testifies on behalf of RBOCs, and former FCC Chief Economist Howard Shelanski estimated that for every \$1 billion of universal service support collected through long distance rates, the U.S. economy will suffer *an additional* efficiency loss of \$1.25 billion.¹¹⁰ In 2000, long distance carriers paid approximately \$3.2 billion in contributions that they then collected from their subscribers.¹¹¹ This equates to an additional efficiency loss of over \$4 billion above and beyond the amount of the support itself.

Hausman and Shelanski also calculated the additional efficiency loss from an increase in end user charges. They estimated that a \$1 increase in an end user charge caused an additional \$0.0006 in additional efficiency losses, or approximately \$60,000 for every \$1 billion in subsidy.¹¹² There is no question that assessing universal service contributions based on end user connections to the public network will be more economically efficient.

The 99.995 percent reduction in economic efficiency losses from the universal service contribution mechanism, from over \$4 billion to approximately \$200,000, based

¹¹⁰ J. Hausman & H. Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal Service Subsidies*, 16 YALE J. REG. 19, 43 (1999) (“*Hausman/Shelanski*”). The average efficiency loss, as opposed to the marginal efficiency loss, was approximately \$650,000 for every \$1 billion in subsidies. *Id.*

¹¹¹ According to FCC statistics, toll carriers had a potential universal service contribution assessment base of \$56.586 billion in 2000, or approximately 70 percent of the total assessment base. *Telecommunications Industry Revenue 2000* at Table 8. The USF Contribution Factor averaged 5.6980 percent during 2000. Thus, the long distance paid approximately \$3.2 billion in universal service contributions in 2000.

¹¹² *Hausman/Shelanski*, 16 YALE J. REG. at 45.

on 2000 contributions, further demonstrates that the Coalition's connection-based proposal is more equitable, in addition to being much less discriminatory.

In addition to distorting a customer's purchasing decisions, the revenue-based universal service assessment imposes deadweight administrative costs. It is far more difficult to identify interstate telecommunications revenues than it is to identify network connections. Every provider of any telecommunications service must determine whether each and every service it offers is an assessable interstate or international telecommunications service, or a non-assessable service. Moreover, the transactions costs of billing and recovering universal service contributions are imposed on a broader range of transactions under a revenue-based assessment mechanism, than on a connection-based assessment mechanism.

D. Collect and Remit Eliminates Inequity and Discrimination from Reporting Lags.

Assessing universal service contributions on a "collect and remit" basis, as proposed by the Coalition, is necessary to eliminate the discriminatory and competitively non-neutral impact of assessing universal service contributions based on historical performance. As previously discussed, any lagged collection mechanism creates a competitive skew between providers who are growing, and who therefore are assessed contribution in the current period based on their lower performance in a prior period, and providers who are retrenching, and who therefore are assessed contribution in the current period based on their higher performance in a prior period. This discrimination harms the ability of the retrenching carrier to compete, and creates an artificial competitive advantage for the growing carrier.

The Coalition’s proposal addresses this problem by assessing carrier contributions on a collect and remit basis. Collect and remit treats the growing and the shrinking carrier equally, and thus satisfies the statute’s command that universal service contributions be made on a “nondiscriminatory” basis.

E. Connection-Based Assessments Reduce Consumer Confusion and Facilitate Price Comparisons, Especially Under Collect and Remit.

The Coalition proposal, by using a collect and remit mechanism that eliminates problems associated with the USF lag and with carriers’ projecting uncollectibles with respect to USF recovery fees, would clearly simplify consumer bills and facilitate price comparisons. Because there would be substantially less variation in carriers’ costs with respect to universal service recovery, there would likely be less variation in the manner in which they recovered their universal service contributions.¹¹³ Consumers therefore could more easily and directly compare carriers’ service prices.

On average, under the Coalition proposal including collect and remit, residential consumers will see their total universal service charges on their primary residential lines fall by approximately \$0.40.¹¹⁴ Low income consumers that are not Lifeline subscribers would see a similar decrease, on average.¹¹⁵ Moreover, because the Coalition’s proposed collection-based assessment would be levied only at one point – the public network

¹¹³ In addition, because a collect and remit contribution mechanism eliminates the carrier’s risk of uncollectible USF recovery fees, the carrier can reduce the USF recovery fee it charges to its customers. This benefits the vast majority of consumers who actually pay their bills in a timely manner.

¹¹⁴ See Declaration of Martha Behrend (“Behrend Declaration”), appended hereto as Attachment 2, at ¶ 11. The precise amount of savings for the average consumer will depend on whether mark-ups for administrative costs continue to be permitted, and, if so, the extent of such mark-ups.

¹¹⁵ *Id.*

connection – rather than across all telecommunications services, consumers would not face multiple universal service fees. Today, a consumer receives a universal service recovery fee on her local service bill for universal service contributions associated with the SLC, and another universal service recovery fee on her interstate long-distance bill. Consumers would be less likely to feel like they are paying twice for the same universal service support.

F. The Coalition Proposal Can Be Implemented.

The Coalition's proposed approach, with three easily identified capacity levels, also would be relatively easy to administer. Although time will be needed for carriers to develop the systems needed to implement the capacity portion of a connection- and capacity-based contribution system, carriers can easily determine the number and capacity of connections that serve their customers. By contrast, the task of determining interstate revenues is much more complicated in an industry where prices are increasingly insensitive to distance or jurisdiction and services are combined in packages at unitary prices.

In the *FNPRM*, the Commission asked a number of questions regarding how a connection-based system would be implemented. Each of these issues can be fully and fairly addressed, and none presents a barrier to the rapid implementation of the Coalition's proposal.

1. Definition of a “Public Network.”

In the *FNPRM*, the Commission seeks comment on what would constitute a public network for the purposes of a per-connection universal service assessment.¹¹⁶ The Coalition believes that, at a minimum, a public network is any network over which a private or common carrier provides telecommunications services to an end user.

Although there is no statutory definition of a public network, the definition of telecommunications service covers services that are offered “for a fee directly to the public, or to such classes of users as to be effectively available to the public.”¹¹⁷

Defining a public network as one over which telecommunications services are offered reflects the fact that these networks are used to provide services to the public generally.

Moreover, in the *Universal Service First Report and Order*, the Commission used its permissive authority to extend contribution obligations to private carriers that “offer their services to others for a fee and payphone aggregators.”¹¹⁸ The Commission reasoned that “[w]hether a business decides to sell telecommunications to others on a common carrier or private contractual basis or through a separate corporate entity should not determine contribution obligations, because in either event the entity offers telecommunications to others for a fee.”¹¹⁹ The Coalition believes that there is no reason at this time that the Commission should, in this proceeding, overturn that determination. Accordingly, assessable connections to “public network” should also include end user

¹¹⁶ *FNPRM* at ¶ 42.

¹¹⁷ 47 U.S.C. § 153(46).

¹¹⁸ *Universal Service First Report & Order*, 12 FCC Rcd at 9183 (¶ 794).

¹¹⁹ *Id.* (¶ 795).

connections provided by a third party for a fee, but that are interconnected in such a way as they could be used to originate or terminate interstate telecommunications.

2. *Definition of a “Connection.”*

The Coalition generally agrees with the Commission’s suggestion in the *FNPRM* that a connection be defined as “a facility that provides an end user with independent access to a public network, regardless of whether that connection is circuit-switched, packet-switched, or a leased line (*e.g.*, special access).”¹²⁰ An “end user” should be defined according to existing Commission definitions of that term, and include retail purchasers, whether those purchases are individual or in bulk, and exclude parties that purchase interstate telecommunications or telecommunications services and then resell those services as an offering of telecommunications to third parties for a fee.¹²¹ A long-distance reseller, or a carrier that purchases telecommunications services for resale under Section 251(c)(4), would therefore not be an end user, and it would be subject to connection-based universal service assessments, as would any other telecommunications carrier.

The Coalition also agrees with the Commission’s proposal that a connection should be considered “independent” if it does not require the presence of any other activated end user connection to provide access to a public network.¹²² The Coalition agrees that two voice-grade lines provisioned over the same loop should be treated as two connections. In general, the universal service connection assessment should be based on

¹²⁰ *FNPRM* at ¶ 41.

¹²¹ *Id.* at ¶ 41.

¹²² *Id.* at ¶ 42.

the service that is sold to the end user, rather than how it is provisioned. Thus, if a customer seeks 7 multiline business lines, and the carrier happens to choose to provision those 7 lines over a T-1 line, the carrier would be assessed 7 basic multiline business USF charges. On the other hand, if a customer directly seeks a T-1 and wants to have that T-1 channelized into 7 voice grade circuits, the carrier should be assessed the Tier 2 contribution rate for that T-1 connection, or 5 basic multiline business USF charges.

The Coalition recognizes that there is a substantial issue as to how DSL links, which are generally sold by ILECs to the ISP rather than being sold to the end user, should be treated for the purposes of a connection-based assessment. However, there are many other uncertainties at present with respect to DSL offerings because of both the pendency of the *Wireline Broadband Internet Access Framework NPRM* and the *Triennial Review NPRM*, in which the Commission has asked whether the high-frequency portion of the loop should remain an unbundled network element.¹²³ Providers serving ISPs that connect to public networks, such as through ordinary business lines, frame relay or ATM, should pay a connection/capacity based universal service contribution assessment for those connections – e.g., the connection from the ISP premises to the public network.

As an interim matter, pending the Commission's completion of its *Wireline Broadband Internet Access Framework NPRM*, the Commission should not assess any independent connection from the ISP's customer to a public network used for residential

¹²³ *Wireline Broadband Internet Access Framework NPRM*, at ¶ 8; *In re Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications*

high-speed Internet access services. Where the broadband Internet access service is provided over a facility that is also used to provide an independent voice connection to a public network, for example, the carrier providing the voice connection would be assessed a USF contribution assessment, but the carrier providing the independent high-speed broadband channel would not. In addition, under this interim proposal, the carrier that provides an ISP with a high-speed connection over a UNE loop, separate from the loop used to provide the retail customer's voice service, would also not be assessed a universal service assessment for that connection where the ISP uses that high-speed connection to provide a broadband Internet access service. This interim arrangement would allow the Commission to move forward to implement a connection- and capacity-based universal service assessment mechanism, while preserving its ability, in the *Wireline Broadband Internet Access Framework NPRM* to assess universal service contribution against all such connections or none, or some other solution. In the interim, all providers of broadband Internet access would receive the same treatment under the Coalition's interim connection- and capacity-based assessment mechanism.

3. *Exemptions for Systems Integrators and De Minimis Carriers Should Be Retained.*

The Coalition agrees that the Commission should preserve the limited exemption for systems integrators, as well as the *de minimis* exemption. The *de minimis* exemption implements the second sentence of Section 254(d), and recognizes that universal service contributions should not be compelled where the provider's contribution is so small as to make collection too costly. The limited exemption for systems integrators recognizes

Capability, Notice of Proposed Rulemaking, 16 FCC Rcd 22781, at 22805 (¶ 53) (2001) ("*Triennial Review NPRM*").

that entities not substantially in the business of telecommunications should not be unnecessarily subject to regulatory obligations. Nothing about the Coalition's per-connection assessment proposal necessitates a change to the limited systems integrator or *de minimis* exemptions.

4. *Pre-paid CMRS, Emergency Wireless and Temporary Wireless Connections Can Be Addressed.*

The Commission, in the *FNPRM*, seeks comment on how wireless connections should be assessed. The Coalition agrees with the suggestion in the *FNPRM* that wireless contributors be assessed based on the number of activated handsets they provide to customers.¹²⁴ The Commission, however, also seeks comment on how certain mobile offerings, such as emergency-only phones, prepaid wireless service and convention center and other temporary service arrangements should be treated.¹²⁵

The Coalition recognizes that these types of connections may not be charged on a monthly subscription basis, and thus, a per-connection per month assessment would be difficult to apply. With respect to prepaid wireless services, the Commission should include a connection assessment when the service is first purchased and an additional USF assessment whenever prepaid service is renewed. The Commission may need some kind of "rule-of-thumb" to determine the amount of the time-of-sale assessment.

The Coalition is willing to work with the wireless industry to develop appropriate conventions to ensure that prepaid services are not advantaged or disadvantaged with respect to wireless subscription services. In any event, the difficulties in applying a per-connection based assessment to services with no monthly subscription should not deter

¹²⁴ *FNPRM* at ¶ 45.

the Commission from adopting a per-connection assessment mechanism for all connections sold on a recurring basis.

5. *SLCs Provide a Basis to Distinguish the Vast Majority of Single-Line from Multiline Businesses.*

The Commission also asks how single-line business connections can be distinguished from multiline business connections, particularly for carriers that do not face a regulatory requirement that they charge a SLC.¹²⁶ The concern that CLECs are not required to charge SLCs is largely hypothetical. Virtually all CLECs charge SLCs, so that when they market services, retail consumers can more easily compare their offerings to those of the ILEC. These SLCs are often tariffed as part of the CLECs' access tariffs, just as the ILEC SLCs are. Moreover, CLECs often have marketplace-pricing incentives to know whether they are serving a single-line business or a multiline business. In many areas, the incumbent LEC's multiline business SLC is higher than its single-line business SLC, and by distinguishing its single-line business from its multiline business customers, a CLEC can charge up to \$4.20 more per month to the end user while still mirroring the ILEC's rates.

In any event, the connection provider is the only entity able to determine whether the end user is a single-line or multiline business customer. An IXC, for example, would not necessarily be able to determine whether a customer is a single- or multiline business customer when it is not providing the end user's network connection. The Commission retains the power to audit carriers to ensure that they are not misreporting the number of multiline business customers.

¹²⁵ *Id.*

6. Centrex/PBX.

The Commission sought comment on how connections should be defined for multiline business connections, and, in particular, on how it should address Centrex connections as compared with PBX connections. As discussed previously, multiline business connections should be assessed based on the connection purchased by the customer. If the customer purchases a line, then the USF assessment to the carrier should be the Tier 1 assessment for a line. If the customer purchases a DS-1 trunk, then the USF assessment should be the Tier 2 (5X) assessment for a connection of 1.5 Mbps but less than 45 Mbps.

To ensure competitive neutrality, however, Centrex merits different treatment. The Commission has twice previously used a one-ninth conversion factor for applying subsidy elements to Centrex lines.¹²⁷ Rather than developing yet another conversion factor, the Commission should simply apply these factors to Centrex lines, so that a provider would be assessed one-ninth of a Tier 1 assessment for a Centrex line.

7. Proposed Capacity Tiers Are Reasonable and Can Be Implemented.

The contribution assessments on higher-capacity connections should be set according to two criteria: (1) minimizing administrative burdens and complexity by creating a simple system with a few contribution levels; and (2) ensuring that the USF contribution charges do not materially change the “crossover” point between different facility types or otherwise distort customer choices.

¹²⁶ *Id.* at ¶ 58.

¹²⁷ 47 C.F.R. §§ 69.153(e), 158.

The Coalition's three capacity tiers for multiline business, special access and private line connections satisfy these two criteria. The DS-0, DS-1 and DS-3 are the core elements of the public networks. Capacity, rather than voice-grade equivalents, makes sense for a universal service contribution assessment because a capacity-based charge can be scaled so as to mirror the existing relationship of facilities charges in the marketplace, so that universal service contribution charges do not materially change the "crossover" point between different facilities. By contrast, a voice-grade equivalents connection-based charge would greatly inflate the charges on DS-1's and DS-3's, and encourage end users to make inefficient facilities-purchase decisions.¹²⁸

In setting these capacity levels, the Commission should ensure that they encompass the same level of service. The Commission could adjust these levels slightly to take note of marginal variations in the conventional network break points, such as setting DS-3's at 44.7 Mbps instead of 45 Mbps. However, by limiting the number of tiers to the principal levels in use in the network for end user connections, the Commission minimizes the opportunities for gaming and maximizes the administrative simplicity of the plan.

Capacity tiers, such as suggested by the Coalition, are also technologically neutral, in keeping with the Commission's added principle for universal service. A capacity-based assessment would not differentiate between different means of delivering a 1.5 mbps service, whether over a wireline or wireless connection, for example. Both connections would be assessed a Tier 2 (5X) assessment.

¹²⁸ A DS-3 has 672 voice-grade equivalents (VGE). A \$2 base USF assessment per VGE would result in a \$1344 USF assessment for a DS-3.

8. *A Two-Stage Transition for Special Access/Private Line Eases Implementation.*

In analyzing any universal service funding mechanism, it is important to consider its impact on capital-intensive information technology (“IT”) resources. The scarcity and expense of these resources drive many industry decisions. Before any product can be offered, carriers must develop mechanisms for provisioning services and billing customers. In current market conditions, with access to capital highly constrained, it is essential that the federal USF contribution mechanism not unnecessarily harm the telecommunications industry by diverting a substantial portion of scarce IT resources to the implementation of regulatory requirements that are unnecessarily complicated and inefficient.

As an initial matter, converting to a connection- and capacity-based system will require carriers to deploy scarce IT resources for the development of new contribution and collection systems. But if carriers are given an appropriate transition period in which to develop the necessary systems, this one-time effort pales in comparison to the ongoing time and resources required to determine contributions under the existing revenue-based approach.¹²⁹

The Coalition proposal provides such a transition. Carriers would have twelve months to develop the necessary systems before a capacity-based assessment would be implemented. During those twelve months, special access and private line services would continue to be assessed as they are today, initially using the Commission’s last

¹²⁹ The Coalition has suggested 12 months in order to permit carriers to include the necessary systems changes in their capital budgets with a reasonable opportunity to schedule the development that must be done.

contribution factor before the connection-based system was implemented.¹³⁰ Carriers would have an incentive to do so because, once connection-based assessments are fully implemented, they would no longer have to determine how to track end user interstate and international telecommunications carriers. This is a significant benefit, especially for carriers that are offering new products that may be difficult to classify.

9. *Collect and Remit Does Not Mean Carriers Can Avoid USF Contributions By Refusing to Collect USF Recovery Fees.*

Although collect and remit contemplates that carriers would only pay contributions based on the number of connections for which they collect USF recovery fees, collect and remit does not and should not mean that carriers can avoid universal service contributions simply by refusing to collect their USF recovery fees. First, carriers should be required to charge and to take reasonable steps to collect universal service recovery fees. These reasonable steps to collect universal service recovery fees may include, but should not supplant, the dispute resolution processes that are built into many provider-user agreements. Second, carriers should be precluded from suggesting or agreeing that an end user is not obligated to pay the federal universal service recovery fees.

It is the Coalition's experience that the vast majority of carriers and users are law-abiding, and that even these two rules are likely to be unnecessary. A number of states have imposed mandatory end user surcharges – including six in California alone – and there is no evidence that selective failure to pay has been a problem.¹³¹ Nonetheless, if

¹³⁰ See Process & Mechanism Description at 3.

¹³¹ California has six intrastate universal service mechanisms (California High Cost Fund-A, California High Cost Fund-B, California Teleconnect Fund, Deaf & Disabled

the Commission believes this is an issue that it must address, clear and unambiguous Commission rules can deter unwanted conduct. Moreover, if the Commission were to adopt the rules suggested, it could audit carriers to determine whether the carrier was experiencing a significantly higher uncollectible rate with respect to universal service recovery fees than with respect to other charges, and, if such a differential was detected, seek appropriate explanations. Particularly in the consumer markets, bills tend to be paid or unpaid, and it would be rare that a customer would single out for non-payment a particular line item (other than a call she didn't make or a service she did not order).

If these two additional rules still do not provide the Commission with sufficient confidence that providers will make strong attempts to collect their universal service recovery fees, the Commission could require carriers to disconnect a customer that fails to pay the amounts that the Commission requires the provider to contribute to federal universal service support mechanisms attributable to that customer's connections. The Coalition believes, however, that such a requirement is unnecessary and would be regulatory overkill.

Telecommunications Program, Telecommunications Devices Placement Program and Universal Lifeline Telephone Service program), all of which are funded by all-end user surcharges (AEUS), billed and collected by telecommunications carriers which, in turn, remit the surcharge monies to a financial institution as directed by the California Public Utilities Commission or its representatives. *See, e.g., Rulemaking on the Commission's Own Motion into Universal Service & to Comply with the Mandates of Assembly Bill 3643*, Decision No. 96-10-066 (Cal. PUC 1996) (noting that an AEUS is used to collect funds for both the ULTS and the CHCF-A, and adopting the use of an AEUS to collect funds for the CHCF-B and CTF). *See also* Vt. Stat. Ann. tit. 30, § 7521 (2001) ("The charge is imposed on the person purchasing the service, but shall be collected by the telecommunications provider.").

10. *The Use of Straightforward Assessments Will Simplify Universal Service Administration.*

As noted above, switching to a connection- and capacity-based universal service assessment will simplify universal service administration simply because it is far more difficult to identify interstate telecom revenues than it is to identify network connections. In similar fashion, the use of clear-cut, easily applied assessment rates will minimize administrative deadweight loss from transaction costs.

G. *The Coalition's Proposed Initial USF Assessment Rates Are Reasonable.*

Each of the Coalition's proposed initial USF assessment rates is rational.

1. *The Initial Residential, Single-Line Business and Non-Paging CMRS Assessment Rate of \$1.00 Is Reasonable.*

The initial starting point assessment rate of \$1.00 per connection per month for wireline residential, single-line business and non-paging CMRS connections is reasonable. As an initial matter, it makes sense to consider residential, single-line business and wireless lines together for this purpose. Residential second lines and wireless have some degree of substitution today, as do residential first lines, although to a lesser extent.¹³² The same is likely true between single-line business and non-paging CMRS connections, and in any event, the Commission has always treated residential and single-line business lines together for the purposes of its interstate access charge rules.¹³³

¹³² Verizon Oct. 26, 2001 *Ex Parte* at 25-26. Again, the Coalition does not endorse Verizon's estimates as to the magnitude or competitive impact of these effects.

¹³³ In addition, it is reasonable to apply a \$1 per month assessment to all non-paging CMRS connections rather than to just residential CMRS connections. The CMRS industry has not generally distinguished residential/single-line business connections from multiline business connections. There is no real competitive equity reason to force such a

By assigning the assessment rate to all these connections, the Coalition proposal ensures that there would be no distortion of whatever consumer substitution occurs between residential lines, single line business lines and non-paging CMRS connections.

The average total universal service assessment paid by universal service contributors today for all telecommunications services—including local and long distance service—rendered over residential and non-paging CMRS connections today is approximately \$1 per connection. As is more fully documented in Attachment 5, at the current USF contribution rate of 7.28 percent, universal service contributors will pay approximately \$2.2 billion in revenue-based USF assessments for end user interstate and international telecommunications services provided to residential customers.¹³⁴ Non-paging CMRS providers will pay approximately \$643 million in USF assessments.¹³⁵ When these USF assessments are divided by the estimated number of connection months, the average revenue-based assessment paid by contributors for wireline residential and non-paging CMRS customers is approximately \$0.96 per connection per month. As the contribution factor will likely increase on July 1, 2002, with the implementation of the *MAG Order*, it is reasonable to round this initial starting point up to \$1.00 per connection.

distinction now. For the most part, in the business market, CMRS is a complement and not a substitute for multiline business line service. If, in the future, with the development and deployment of third generation wireless technology, wireless connections with broadband capability are widely used to provide services that compete with wireline broadband services offered over wireline connections, then the Commission would have to consider whether to impose the same capacity-based charges on non-paging CMRS.

¹³⁴ See AT&T Analysis: Weighted Average Monthly USF Assessment Per Wireline Residential & Non-Paging CMRS Connection (2001 Data) (“AT&T Average Assessment Analysis”), appended hereto as Attachment 5, at 3. This is based on estimated 2001 revenues. Because no data exist on the split of business toll revenues between single-line businesses and multiline businesses, no similar estimate of USF assessments for single-line business connections can be made.

¹³⁵ See *id.* at Line C.

An initial \$1 per month residential assessment to contributors will also *reduce* the average universal service charge paid by consumers both as a whole and specifically in those households with average income of less than \$15,000.¹³⁶ A \$1.00 per connection assessment for wireline residential and single line business and non-paging CMRS will likely result in lower average USF recovery charges for customers across all income groups.¹³⁷ The customer impact is even more beneficial within the very low-income group of households with less than \$15,000 annual income. Some of these very low-income consumers use a significant amount of interstate and international long distance service, and thus can be at risk of being disconnected for non-payment of toll bills in states where that is permitted. The top 1 percent of these very low income consumers in terms of their interstate and international usage would see a nearly \$10 reduction in their universal service recovery fees with a shift to a \$1 carrier assessment per residential connection.¹³⁸

Moreover, the TNS bill harvesting data indicates that, even if carriers were permitted to mark-up the connection assessment to the carriers, the resulting USF recovery charge to the customer would be at approximately the median level for the first wireline connection and would be well below the average level for the first wireline connection.¹³⁹ Together with the data on average universal service recovery fees, this

¹³⁶ Behrend Declaration at ¶ 4(a), (b).

¹³⁷ *Id.* at ¶ 11.

¹³⁸ *See Zero-Volume Long Distance Customers* at 2.

¹³⁹ *See* Behrend Declaration at Table 1. Again, the precise amount of this increase depends on the extent to which mark-ups are permitted and, if so, whether the Commission adopts a collect-and-remittance mechanism that eliminates providers' risk of uncollectible USF contributions. As discussed in Section III.H, moving to a per-connection assessment mechanism will provide substantial consumer benefits.

confirms that an assessment of \$1 per wireline residential and single line business and non-paging CMRS connection will not have significant redistributive effects among consumers.

In addition, as Hausman and Shelanski note, a \$1 increase in residential charges creates almost no deadweight economic efficiency losses.¹⁴⁰ A residential USF assessment of approximately \$1 per connection per month will have virtually no impact on subscribership, both because all Lifeline connections are exempted from the assessment and because of the cross-elastic effects from lowering long-distance charges by eliminating the percentage USF recovery surcharges.¹⁴¹

Although the initial residential/single line business/non-paging CMRS contribution rate is a reasonable starting point for universal service assessments, the Commission should not freeze universal service assessments for these connections at \$1, notwithstanding increases in the fund. If the fund increases, all consumer segments should bear the impact of such increases proportionately. Otherwise, business users could become subject to exorbitant universal service recovery fees. On the other hand, to maintain symmetrical incentives, all user segments should benefit if fund growth is held down relative to growth in total connections. Thus, the Coalition's proposal to raise or lower all assessment rates proportionally is rational.

¹⁴⁰ *Hausman/Shelanski*, 16 YALE J. REG. at 45.

¹⁴¹ *Id.* at 48.

2. *The Initial Pager Assessment of \$0.25 Is Reasonable.*

The initial pager assessment rate of \$0.25 per month is reasonable. Paging carriers have argued that they have lower revenue per subscriber than other carriers and face more competition from other types of carriers.¹⁴² While the FCC's CMRS Competition Report indicates that there has been substantial growth of high revenue advanced paging services, there are also some low-priced paging services.¹⁴³ In order to avoid an undue burden on paging carriers that provide end user connections, assessing one-fourth of the connection charge applicable to other CMRS providers reflects the paging industry's claimed unique situation.

3. *The Initial Assessment for Tier 1 Connections Is Reasonable.*

Using a residual approach on a one-time basis to set the level of the assessment for switched multiline business lines during step 1 of the transition, which then feeds into the calculation of the Tier 1 connections assessment rate, is reasonable in light of the rest of the Coalition's proposal. A permanent residual mechanism would not be reasonable. As discussed previously, this would place all risk of an explosive increase in the fund on the multiline business, special access and private line customers. That could result in extremely inequitable end user recovery burdens, without any mechanism quickly to reallocate the burden among different groups of end users. The Coalition proposal, in which all classes of end users bear proportional risk of fund increases in the future, is a more equitable approach.

¹⁴² Personal Communications Industry Association/Arch Wireless *Ex Parte*, dated Nov. 19, 2001, at 1.

4. Capacity Differentials of 5x and 40x Are Reasonable for Tiers 2 and 3.

The Coalition's proposal for three capacity levels – Tier 1 for connections of less than 1.544 Mbps, Tier 2 for connections 1.544 Mbps or greater but less than 45 Mbps, and Tier 3 for connections of 45 Mbps or greater – is based on the following market information:

The 5:1 ratio between the Tier 2 and Tier 1 charges is consistent with the price cap LECs' current practice of assessing a PRI ISDN USF charge that is five times higher than the base USF charge.¹⁴⁴ The 5:1 ratio also is consistent with the 5:1 ratio that the Commission has established between the PRI ISDN multiline business PICC charges and switched multiline business PICC charges, and also between the PRI ISDN multiline business end user common line charges ("EUCL") and switched multiline business EUCL charges.¹⁴⁵

The 40:5 or 8:1 ratio between Tier 3 and Tier 2 charges approximates the "crossover" point between DS-3 and DS-1 facilities purchased from ILEC special access tariffs. By using this ratio, the "crossover" point is maintained, rather than distorted by the USF contribution assessment. These are robust, market-generated capacity levels that are simple to identify and administer. There is no indication that implementation of these three tiers would in any way distort customer and carrier market decisions.

¹⁴³ *In re Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report & Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Sixth Report, 16 FCC Rcd 13350, at 13405-6 (2001).

¹⁴⁴ PRI ISDN facilities have a capacity of 1.544 Mbps.

¹⁴⁵ 47 C.F.R. §§ 69.152(1)(2); 69.153(d).

H. The Coalition’s Proposal Benefits Consumers and Will Not Harm Universal Service or Unduly Suppress Demand.

On the whole, consumers benefit from reform of the current inefficient and unsustainable revenue-based assessment mechanism to a connection- and capacity-based mechanism. On average, consumer payments will drop across all income groups, especially when likely future increases in the USF contribution factor and ILEC per line USF recovery charges are considered. There is absolutely no evidence that the Coalition’s proposal will harm universal service in any way, or suppress telecommunications demand. Quite to the contrary it is likely that the Coalition proposal will make telecommunications more affordable for those consumers most in danger of losing their basic telephone service.

1. USF Assessments to Non-Lifeline Residential Customers Will Fall.

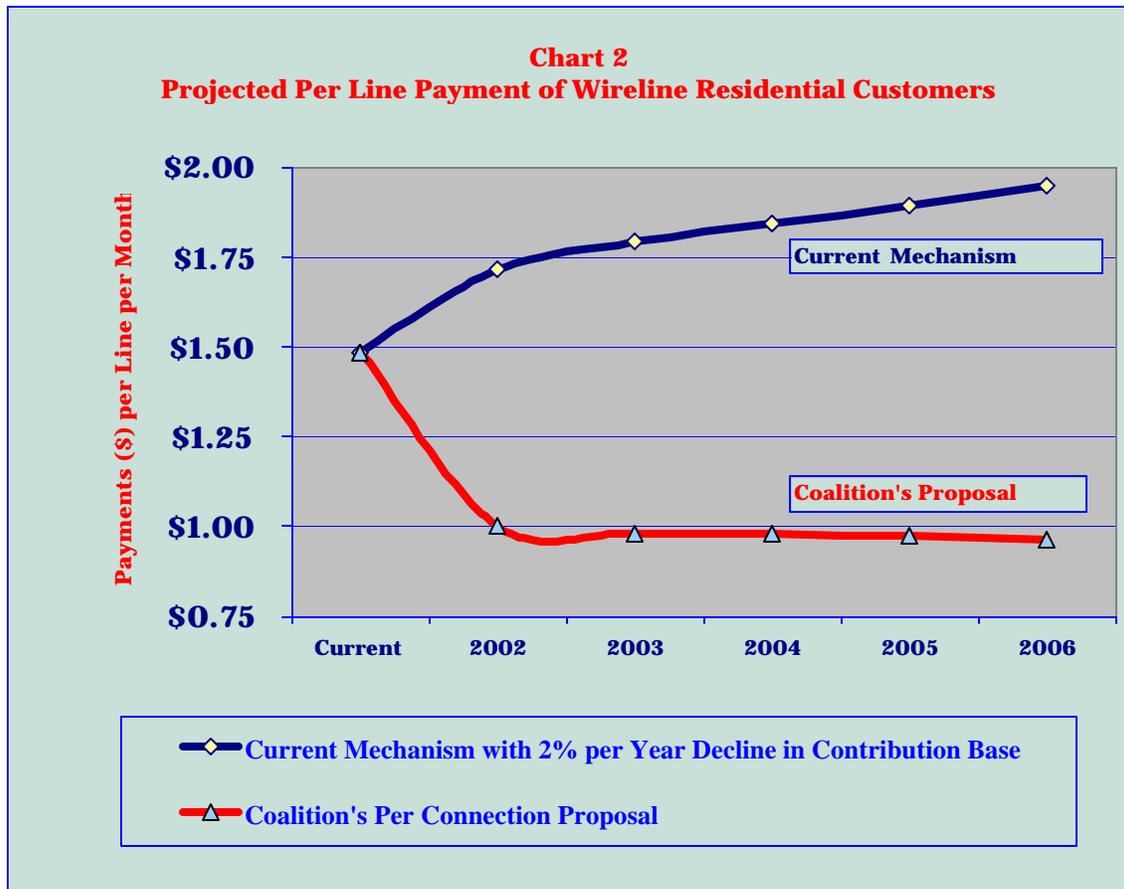
At every income level, the average residential universal service assessment will be less under the Coalition’s proposal than under the current mechanism.¹⁴⁶ This is true both for the primary residential line, and also when additional lines and wireless connections are included, especially in light of likely continued increases in the USF contribution factor and the ILEC per line USF recovery fees.¹⁴⁷ In the lowest income group (households with income below \$15,000 per year), the average household will likewise pay \$0.40 *less* for their primary residential line.¹⁴⁸

This is particularly true because of the universal service “death spiral.” As contribution factors spiral upward as end user interstate and international revenues spiral

¹⁴⁶ See Behrend Declaration at ¶ 4(a).

¹⁴⁷ See *id.* at ¶¶ 15-16.

downward, the USF recovery fees paid by residential consumers on both their local wireline connection and their interstate and international long distance bill will continue to escalate. The following chart illustrates the impact of a 2 percent annual decline in the end user interstate and international telecommunications revenue base over the next five years:¹⁴⁹



The chart is composed from the perspective of the average wireline residential user, who today is paying nearly \$1.50 in carrier universal service recovery fees on her

¹⁴⁸ *Id.* at ¶¶ 4(b), 11(b).

¹⁴⁹ Although the Coalition Proposal projection in this chart does not reflect a carrier mark-up, a mark-up would not materially change the results, but simply raise the bottom line by the amount of any mark-up, if permitted.

bill each month: approximately 50 cents on her local bill, and approximately \$1.00 on her long distance bill. The chart demonstrates that, if the Commission retains the current revenue-based mechanism, the average consumer's universal service recovery fees will increase over time. In 2002, fees will likely increase for the scheduled implementation of the MAG Plan¹⁵⁰ and CALLS-based increases in subscriber line charges,¹⁵¹ which will increase the ILECs' interstate telecommunications revenue per line, and thus the amount of USF assessments they need to recover on each line. The chart does not include any other changes in universal service programs, although there are many open proceedings, as well as proposed legislation, that could result in such changes and dramatically increase the fund size. In addition, the average consumer's payment continues to rise after 2002, due to the erosion in the contribution base – there will be less end user interstate and international telecommunications revenue from which to generate the USF revenue requirement, which mathematically requires USAC's assessment rate (and retail collection rates) to rise. In contrast, the Coalition proposal would have the effect of lowering consumers' payments from approximately \$1.50 to \$1.00 upon implementation (and to \$0 for lifeline recipients).¹⁵² Thereafter, assuming no further increases in the total size of the fund, the assessment rate will decline, fueled by the growth engine of an ever-

¹⁵⁰ See *MAG Order*, 16 FCC Rcd at 19642-44.

¹⁵¹ *In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, Sixth Report & Order in CC Docket Nos. 96-262 & 94-1, Report & Order in CC Docket No. 99-249, Eleventh Report & Order in CC Docket No. 96-45, 15 FCC Rcd 12962, 12964 (¶ 2) (2000) (“*CALLS Order*”), *aff'd in part and rev'd in part, on other grounds, Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001) (“*TOPUC II*”), *cert. denied sub nom. National Association of Regulatory Utility Commissioners v. FCC*, 2002 U.S. LEXIS 2361 (Apr. 15, 2002).

¹⁵² See n.149, *supra*.

increasing number of interstate connections. Five years out, the assessment rate is projected to be less than \$1.00, or about \$0.96.

2. *Lifeline Subscribers Would Be Exempted from the Assessment and from Collect and Remit.*

The Coalition proposal applies no universal service assessments for Lifeline connections, and it also precludes carriers from recovering universal service contributions from Lifeline customers. Under the Coalition proposal, Lifeline consumers never pay a universal service recovery charge for any service received over their Lifeline connection.

This is an improvement over the status quo. Although Lifeline consumers are not charged ILEC universal service recovery fees, unless their long distance carrier has a Lifeline waiver and the customer has notified its long-distance carrier that it is a Lifeline customer, the consumer will be billed universal service recovery fees. Under the Coalition proposal, these USF recovery fees associated with long distance service would be wholly eliminated.

3. *Connection Assessments Will Not Cause Residential and Business Users to Abandon Use of Public Networks.*

There is no evidence that, for non-Lifeline consumers, the Coalition's proposed connection-based universal service mechanism will lead residential and business users to abandon the network. As previously discussed, the cross-price elasticity of demand for basic local service with respect to the price of long-distance service is such that when long distance prices decline, the demand for local service actually increases.¹⁵³ In this case, the Coalition proposal leads to a decline in the price of long distance service because long-distance carriers would eliminate the end user surcharges levied to recover

universal service contributions. As these surcharges are between 9 and 12 percent of long distance charges, the savings for some consumers, including some low income consumers, will be substantial.¹⁵⁴

Moreover, studies have consistently showed that long-distance bills, not local bills, are more likely to lead consumers to lose telephone service.¹⁵⁵ By eliminating the USF recovery surcharge, thereby reducing the long-distance bill, the Coalition proposal will make it less likely that a poor, non-Lifeline subscriber will lose telephone service.

This is further confirmed by WorldCom's analysis of TNS bill harvesting data. That analysis shows that the average long distance carrier federal USF recovery fee paid by subscribers with less than \$15,000 in income was \$0.99, which means that these consumers could have been paying approximately \$1.50 in federal USF recovery fees for their primary residential line if they were not Lifeline subscribers.¹⁵⁶ Some of these very low income consumers pay substantial long distance carrier USF recovery fees; the top 1% of long distance users among households with less than \$15,000 in annual income

¹⁵³ *Hausman/Shelanski*, 16 YALE J. REG. at 48.

¹⁵⁴ See Behrend Declaration at ¶ 12.

¹⁵⁵ See Chesapeake & Potomac Telephone Company's Submission of Telephone Penetration Studies, Formal Case No. 850 (filed Oct. 4, 1993); Field Research Corp., *Affordability of Telephone Service – A Survey of Customers and Noncustomers* (1993) (study funded by GTE-California and Pacific Bell, mandated by the California Public Utilities Commission); Milton Mueller & Jorge R. Schement, *Universal Service from the Bottom Up: A Profile of Telecommunications Access in Camden, New Jersey*, 12 INFORMATION SOCIETY 273 (Apr. 1996); John Horrigan & Lodis Rhodes, *The Evolution of Universal Service in Texas* (Sept. 1995) (working paper, LBJ School of Public Affairs); see also Milton Mueller, Jr., *Universal Service: Competition, Interconnection, & Monopoly in the Making of the American Telephone System*, at 172 (M.I.T. Press 1997).

¹⁵⁶ See Behrend Declaration at ¶ 11.

pay almost \$10 per month, on average.¹⁵⁷ Subscribers of between \$15,000 and \$30,000 in income pay an average of \$0.75 in long distance carrier federal universal service recovery fees, or approximately \$1.25 in total USF recovery fees for their primary residential line. On average, the Coalition proposal reduces these charges.

4. *Low Volume Users Are Not a Protected Class, and, in Any Event, the Impact Is De Minimis.*

Several commenters, in the initial comments and in subsequent ex partes, have argued that the Coalition proposal would unfairly increase charges for so-called “low volume” interstate telecommunications consumers. These arguments are both analytically flawed because they do not take predictable changes into account, thereby understating charges to “low volume” consumers under the existing system, and they assume that relatively small distributional effects on these consumers are a matter of significant public policy concern. In fact, the maximum price changes for “low volume” consumers per month amount to less than the price of a pack of chewing gum, and merit no public policy consideration.

As Chairman Powell has observed, there is a reason to be skeptical about “whether ‘low volume consumers’ constitute some type of protected class.”¹⁵⁸ He noted correctly, “[o]ne might be misled to believe that low volume consumers are poor, elderly or rural individuals. In some cases yes, but by no means does low volume necessarily correlate with these groupings for which the government often accepts some social

¹⁵⁷ *See id.*

¹⁵⁸ *In re Low-Volume Long Distance Users*, Notice of Inquiry, Separate Statement of Commissioner Michael Powell, 15 FCC Rcd 6298, 6319 (1999).

responsibility.”¹⁵⁹ He further observed, “wealthy parents whose kids and family live locally may be low volume consumers.”¹⁶⁰

These observations are particularly powerful when so little is at stake. As has been previously discussed, the difference between the average USF recovery fee paid by a residential consumer who consistently makes no interstate long distance calls today, and the amount that customer would pay under the coalition plan, is only about 50-60 cents. With absolutely no evidence that this 50-60-cent differential will affect subscribership, the impact of the Coalition proposal on low-volume consumers simply does not merit serious attention.¹⁶¹ Of course, very few residential consumers would see a 50-60-cent increase in their total USF recovery fees. On average, residential consumers will see their total USF recovery fees fall under the Coalition proposal.¹⁶²

Moreover, low-volume users are not a static group. AT&T recently compiled a database of its zero-volume customers for March 2001, and tracked their long-distance usage over the six-month period between October 2000 and March 2001.¹⁶³ This longitudinal analysis of the same customers’ usage confirms that the TNS data, which is a snapshot analysis of consumer bills at a point in time, substantially overstates the number

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ In conjunction with the increases to the SLCs, and as end user interstate and international telecommunications revenues continue to fall, the 50- to 60-cent differential for the customer who consistently makes no interstate or international long distance calls will continue to shrink.

¹⁶² See Behrend Declaration at ¶ 15.

¹⁶³ See *Zero-Volume Long Distance Customers* at 1.

of zero-volume customers when usage over more than one billing period is considered.¹⁶⁴ Of those customers that had no long distance usage in March 2001, only 28.6 percent had no long distance usage during the entire six-month period. When Verizon's TNS data on the percentage of no-volume long distance consumers is adjusted in accordance with AT&T's analysis of low volume users over time, the percentage of total consumers that consistently make no long distance calls falls to under 8 percent. More importantly, the average monthly long-distance bill for these customers over the six-month period was \$3.48.¹⁶⁵ When existing long distance universal service USF recovery fees are applied against this average usage of \$3.48, and then added to the LEC USF recovery fees paid by the same customer, the result shows that even for these consumers that made no long distance calls in March 2001, when considered over time, the impact of the Coalition's proposed initial universal service assessment would differ from the current average payment by these customers by only pennies.¹⁶⁶

This analysis refutes Verizon hyperbolic claims that the Coalition proposal will lead to steep rate increases for low volume consumers. In addition, Verizon's study itself does not hold up to rigorous analysis. Verizon assumes that the contribution factor for universal service would rise from 6.8 percent to 7.8 percent in 2002, and then remain

¹⁶⁴ See Behrend Declaration at ¶ 13 & n.13 (describing the various reasons why the TNS data overstates the number of low volume long distance customers, including lack of longitudinal data and the inclusion of partial month data for customers that either began or ended service during the month).

¹⁶⁵ See *Zero-Volume Long Distance Customers* at 2.

¹⁶⁶ See *id.*

fixed through 2006. That assumption is unrealistically optimistic.¹⁶⁷ A decline in total end user interstate and international telecommunications revenues, likely due to declines in long distance revenue, has already caused the contribution factor for the second quarter of 2002 to jump to 7.2 percent. And the Commission has not yet implemented the Interstate Common Line Support fund established in the *MAG Order*, which was the primary reason why Verizon's study projected that the USF contribution factor would increase by 100 basis points to 7.8 percent. If total USF funding increases faster than Verizon projects, or end user interstate and international revenues decline faster than Verizon projects, the contribution factor will soar and both the ILEC universal service recovery fees and the long distance carrier USF recovery fees will increase. By itself, this would significantly alter Verizon's consumer impact analysis.

The attached Declaration of Daniel Kelley and David Nugent documents the extent to which Verizon's analysis over-estimates the level of end user interstate and international telecommunications revenues by understating the likely decline in interstate and international long distance revenues, and by overstating the likely revenues from business lines and wireless.¹⁶⁸ Both business and residential long distance rates are falling faster than Verizon has estimated, as Verizon has relied on a nearly two-year-old Commission study that was itself based on 1992-1998 data.¹⁶⁹ That is pricing information from a different world. Verizon's estimate of switched business line growth,

¹⁶⁷ See Kelley/Nugent Declaration at ¶¶ 7-9 (explaining various ways in which Verizon's assumptions are unrealistic, and noting that the Verizon Model revenue forecasts are *already* demonstrably incorrect, only six months after their publication).

¹⁶⁸ *Id.* at ¶ 30.

¹⁶⁹ *Id.* at ¶ 22.

which is based on historical growth rates from the 1990s, is also likely too high.¹⁷⁰

Verizon has also assumed that wireless average revenue per unit (“ARPU”) is more or less constant through 2006, but wireless competition is likely to cause future ARPU reductions.¹⁷¹

In addition, it must also be recalled that most ILECs’ end user interstate telecommunications revenue will increase in 2002 and 2003, assuming that the SLC caps are allowed to increase. This will further tend to increase the size of the USF contribution recovery line item charged by the ILECs. This further increases the baseline for any credible consumer impact analysis.

When these and other Verizon errors are corrected, there is a substantial change in the potential impact on residential subscribers.¹⁷² Under the existing system, residential USF recovery fees will continue to rise.¹⁷³ Under the Coalition proposal, they will actually fall.

As this evidence demonstrates, the impact of the Coalition proposal on low volume consumers is, for all intents and purposes, negligible. Relatively few consumers consistently make no long distance calls. Even for these consumers, the impact of the Coalition proposal is negligible, especially when likely future increases in ILEC USF recovery line items are also considered. These negligible impacts are certainly no reason to forego stabilizing the universal service contribution mechanism in light of the irrefutable evidence that the assessment base is now shrinking.

¹⁷⁰ *Id.* at ¶¶ 30-31.

¹⁷¹ *Id.* at ¶ 32.

¹⁷² *Id.* at ¶ 38.

¹⁷³ *See* Chart 2, *supra*.

I. Relative Industry Segment Burdens Are Not Relevant.

At several points in the *FNPRM*, the Commission seeks comment on the relative burdens imposed by the Coalition on different industry segments, and how the Coalition proposal would affect those burdens. Although such analyses might be politically revealing, they are irrelevant. The current interstate telecommunications revenues based system is inadequate not because it burdens long distance carriers significantly and relatively more than other industry segments, but because it is discriminatory and insufficient. The pleas by various favored stakeholders, including ILECs and CMRS providers, to freeze the current burden allocations, rather than focusing on making the universal service contribution system actually work, are crass, special-interest pleading. When the proposed system is competitively neutral and therefore nondiscriminatory, as is the Coalition's proposal, there is no legitimate basis for complaint.

IV. ALTERNATIVE PROPOSALS CANNOT WORK.

No party has yet submitted in the record a proposal that will adequately, equitably and non-discriminatorily address the flaws in the current universal service contribution mechanism. The reality is the current system is fundamentally flawed, and trying to "split the baby" will simply lead to a contribution system that is unfair, unpredictable and based on unsound economics.

A. Sprint's Proposal Is Inequitable and Discriminatory.

Sprint's proposal is a classic attempt to "split the baby." It is, however, unlawful. Sprint's proposal begins from the assumption that it is most important to preserve the relative "burden" imposed by universal service contributions on each industry segment. There is, however, no basis in the statute for using relative burden as the starting point for

designing a contribution mechanism. The statute contains two parameters that the contribution system must meet – it must be “equitable” and “nondiscriminatory.”

The Sprint proposal meets neither statutory test. It is both inequitable and discriminatory, because there is no longer any rational basis for the 15 percent safe harbor that the Commission set in 1998. As previously discussed, those safe harbors were set just as digital one rate plans were being rolled out, and they do not reflect the extent to which wireless calls may be disproportionately interstate, when compared with calls on wireline networks.¹⁷⁴ They also do not reflect the fact that wireline networks apportion the network access price as well as usage between interstate and intrastate jurisdictions, while the safe harbor is based only on usage.

Even more significantly, the wireless safe harbor was promulgated as an “interim” safe harbor, and was never intended to be permanent.¹⁷⁵ The Sprint proposal now would take the allocation of revenues based on this arbitrary, out-of-date, and interim safe harbor and make it permanent. It is hard to imagine a more illogical and arbitrary starting point.

Moreover, because the wireless safe harbors are arbitrary and out of date, the Sprint proposal would permanently enshrine a significant competitive bias in favor of wireless based services into the USF contribution mechanism. There is no way that such a permanent bias could be considered “nondiscriminatory,” and therefore the Sprint proposal fails to meet the requirements of Section 254(d).

¹⁷⁴ See Section II.C.3, *supra*.

¹⁷⁵ *Interim CMRS Safe Harbor Order*, 13 FCC Rcd at 21260 (¶ 15).

B. The Interstate and International Revenue-Based System Can't Be Fixed.

The reality is that the interstate and international end user revenue-based contribution system cannot be fixed: it must be scrapped. The *FNPRM* seeks comment on both a projected revenue methodology and a current revenue methodology for continuing with an end user interstate and international telecommunications revenue-based mechanism. Neither current revenue nor projected revenue, however, addresses the fundamental problem of a universal service contribution “death spiral,” and thus cannot assure that the universal service contribution mechanism will be sustainable, and therefore sufficient and predictable.

Paying universal service contributions based on current revenue would have the benefit of eliminating the USF lag, and therefore would help alleviate the competitive inequities that the current system creates between carriers that are growing and carriers that are shrinking. However, although moving to a current revenue base, rather than an historical revenue base, eliminates the lag effect, it does nothing to correct the “death spiral” caused by a declining revenue base.

As the Commission recognized in the *FNPRM*, moving to a current revenue base does nothing to address the core problem – that the USF contribution base is shrinking as traffic migrates from the wireline long distance providers to the wireless long distance providers and as providers structure bundles of interstate telecommunications and other services to avoid federal universal service contributions.¹⁷⁶ Shifting to a current revenue assessment base does nothing to stop the trend toward higher and higher USF contribution rates.

¹⁷⁶ *FNPRM* at ¶ 86.

C. The Commission Should Not Try to Split Connection-Based Universal Service Assessments between Connection Providers and Other Interconnecting Service Providers.

Some may propose splitting a connection-based universal service contribution between the long distance provider and the local provider, so that each bears a portion of the assessment in the first instance, and each must then recover its contribution from its customer. Such a proposal would be highly inefficient and would impose transaction costs without a purpose. First, long distance providers would have to bill their portion of the connection fee to customers who make no interstate or international long distance calls in a given month. This either creates an unnecessary billing expense, or results in the charges being billed on a multi-month bill, which increases the amount of the line item on the customer's bill in the month actually billed and causes consumer confusion and anger. This was one of the difficulties that arose with the residential and single-line business Presubscribed Interexchange Carrier Charge (PICC). Second, the long distance provider will not necessarily have the information necessary to determine whether the end user is a Lifeline or non-Lifeline residential customer, a single line business customer or a multiline business customer, unless it is also the local connection provider. The local connection provider, on the other hand, has that information. Third, splitting the connection creates difficult issues when a customer switches long distance providers. Given that customers frequently switch long distance providers, churn presents a much more significant administrability problem in the long distance market than in the local market.

The Commission has had extensive and negative experience with exactly such a "split-the-baby" solution. In its 1997 *Interstate Access Charge Reform First Report and Order*, the Commission established the PICC instead of increasing the SLC charged

directly by LECs to their residential and single line business customers.¹⁷⁷ Long distance carriers then instituted new charges to pass the PICC charge on to their customers. Three years later, the Commission reversed course, increase residential and single line business SLC, eliminated the residential and single-line business PICC and set the multiline business PICC on a downward path. The Commission found that the simpler path was the better path, noting that the change “reduce[d] consumers’ overall rates[] and simplifie[d] long distance bills,” resulted in “less consumer confusion,” and “eliminat[ed] some of the complexities involved in the administration” of the PICC.¹⁷⁸ In the end, splitting the baby didn’t work, and consumers paid for the Commission’s mistake.

Furthermore, splitting the universal service fee presumes that the industry structure is stable, when in fact it is not. Companies that historically provided long distance service are increasingly entering local markets, where possible, to provide a combination of local and long distance services. The Bell Companies, which historically had been barred from providing long distance services, are now securing approvals to enter the long distance market. Companies that historically provided long distance services, such as AT&T and WorldCom, now also provide local services. Structuring the universal service assessment mechanism and incurring unnecessary transactions costs solely to hold to a set of backward looking industry labels makes little sense.

¹⁷⁷ *In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges*, First Report & Order, 12 FCC Rcd 15982, 15999 (¶ 38) (1997) (“1997 Interstate Access Charge Reform First Report & Order”).

¹⁷⁸ *CALLS Order*, 15 FCC Rcd at 12993-94.

V. THE ACT PERMITS CONNECTION-BASED ASSESSMENTS.

Some opponents of universal service contribution reform have argued that the Section 254 essentially *compels* the use of an interstate telecommunications revenue based contribution mechanism. Nothing in the statute compels use of a revenue-based mechanism, particularly in light of the strong evidence that revenue-based mechanisms are inequitable, discriminatory and insufficient, thus failing Section 254(d)'s express requirements. In addition, Section 254(d) does not preclude the use of a connection charge. Similarly, "collect and remit" assessments are entirely consistent with the statutory language directing that "carriers" contribute to the universal service fund. In addition, a federal universal service assessment of interstate connections clearly falls on the interstate side of the intrastate-interstate regulatory divide, and thus cannot violate Section 2(b).

A. The Coalition Plan Fully Meets the Requirements of Section 254(d).

Opponents of universal service contribution reform argue that a connection-based universal service formula is unlawful because it might not require "every" single provider of interstate telecommunications services to pay *something*. In the first instance, their objection does not apply to the vast majority of carriers and cannot derail a connection-based universal service contribution mechanism for those carriers. In any event, they are wrong. All of the provisions of Section 254(d) must be given effect, including the requirement in the same sentence that contributions be made on an "equitable and nondiscriminatory basis" and the authorization in the second sentence to exempt carriers whose contributions would be *de minimis*. When Section 254(d) is read as a whole, the best reading of the statute's commands is that "every" telecommunications carrier must

be subject to the “equitable and nondiscriminatory” and “specific, predictable and sufficient” formula that the Commission develops for universal service contribution. This interpretation of Section 254(d) is consistent with Congress’ clear desire to avoid “bypass” of the universal service contribution mechanisms. This interpretation also harmonizes the first sentence of Section 254(d) with the second sentence granting the Commission the authority to exempt carriers whose contributions would be *de minimis*. That sentence makes clear, contrary to the contentions of the opponents of reform, that not every carrier must contribute to the fund.

1. Section 254(d) Requires Only that Every Carrier Be Subject to an Equitable and Nondiscriminatory Formula that Is Specific, Predictable, and Sufficient.

As the Commission recognizes in the *FNPRM*, the factual predicate of the argument that a connection-based assessment violates Section 254(d) is wrong with respect to the vast majority of telecommunications carriers.¹⁷⁹ Very few telecommunications carriers provide no connections to end users. Carriers such as AT&T and WorldCom provide significant numbers of connections to end users, both for local exchange service and for special access and private line services. The Commission can adopt a connection-based universal service contribution mechanism for the vast majority of telecommunications carriers without confronting the question of whether the first sentence of Section 254(d) requires every carrier to make a contribution payment, notwithstanding the second sentence of Section 254(d). The legal debate over the interpretation of the first sentence of Section 254(d) is therefore not of any substantial

¹⁷⁹ *FNPRM* at ¶ 66.

practical importance, but a question of only marginal significance affecting only a small number of carriers.

In any event, Section 254(d) of the Act does not preclude the Commission from adopting an equitable and nondiscriminatory contribution formula that applies to all telecommunications carriers even if the formula would result in some carriers making no contribution. It therefore does not compel the Commission to adopt some sort of “alternative minimum contribution.” In the *FNPRM*, the Commission asked whether a connection-based assessment methodology would be consistent with the Act’s statement that “every” interstate telecommunications carrier “shall contribute ... to [federal universal service] mechanisms...”¹⁸⁰ This truncated quotation, however, excludes two other critical requirements – that contribution shall be made “on an equitable and nondiscriminatory basis,” and that the contribution mechanism be “specific, predictable, and sufficient.”¹⁸¹ These provisions in the first sentence of Section 254(d) must be read and implemented as a whole, not in piece parts. Moreover, they must also be interpreted consistently with the second sentence of Section 254(d), which grants the Commission the authority to exempt a carrier or class of carriers from this requirement if their contribution would be *de minimis*.

When Congress enacted Section 254(d), it legislated against a backdrop in which incumbent LECs provided universal service and universal service was subsidized through implicit subsidies.¹⁸² This led to a situation in which a CLEC, particularly one that

¹⁸⁰ *FNPRM* at ¶ 65 (quoting 47 U.S.C. § 254(d)).

¹⁸¹ 47 U.S.C. 254(d).

¹⁸² Even the then-existing universal service funds for high-cost, Lifeline and Link-up were funded through charges in the ILECs’ interstate access tariffs.

targeted large volume businesses, could offer those businesses the ability to bypass the above-cost, subsidy-generating rates. CLECs at that time were not subject to any universal service contribution requirement. In adopting the first sentence of Section 254(d), Congress made clear that its purpose was to ensure that “competitive access providers,” and “carriers that concentrate their marketing of services or network capacity to particular market segments, such as high volume business users,” would be subject to contribution requirements.¹⁸³

The Conference Report explained that Congress contemplated that there would be a “formula for contributions selected by the Commission.”¹⁸⁴ In some cases, Congress recognized that the FCC’s formula would seek contributions that would be *de minimis*, and Congress therefore granted the Commission the authority to exempt those carriers from application of the formula.¹⁸⁵ Reflecting its concern about bypass, Congress also adopted the last sentence of Section 254(d), allowing the Commission to require other providers of telecommunications that are not telecommunications carriers to be subject to the Commission’s contribution formula.¹⁸⁶

The FCC does not have unconstrained discretion in adopting its formula. The plain meaning of the first sentence of Section 254(d) requires that the FCC’s formula be

¹⁸³ 1996 Act Senate Report at 27.

¹⁸⁴ 1996 Act Conf. Report at 131.

¹⁸⁵ *Id.*

¹⁸⁶ 1996 Act Senate Report at 28 (“In the event that the use of private telecommunications services or networks becomes a significant means of bypassing networks operated by telecommunications carriers, the bill retains the FCC’s authority to preserve and advance universal service by requiring all telecommunications providers to contribute.”); 1996 Act Conf. Report at 131 (“This section preserves the Commission’s authority to require all providers of inte[r]state telecommunications to contribute, if the public interest requires it, to preserve and advance universal service.”).

“equitable and nondiscriminatory.”¹⁸⁷ The contribution mechanism, as part of the Commission’s overall universal service mechanism, must also be “specific, predictable and sufficient.” The first sentence also states that “every telecommunications carrier shall contribute.” The “every carrier” requirement, however, does not override either the “equitable and nondiscriminatory basis” requirement or the “specific, predictable and sufficient” requirement. These three requirements would conflict if the statute were read to require every carrier to make a contribution, even if that would be inequitable or unnecessary to make the fund sufficient to fulfill its purposes. Moreover, there is no way to square the second sentence’s authorization that the Commission may exempt carriers with a requirement that every carrier must make a contribution. The statute -- which the Supreme Court found “is not a model of clarity” and “in many important respects [is] a model of ambiguity or indeed self contradiction” – need not be read in a manner that puts it at war with itself. It falls to the Commission to determine the most reasonable construction of the statute that harmonizes its provisions.¹⁸⁸

The current situation with universal service contributions presents this question. The current end user interstate and international telecommunications revenue-based formula is not equitable and nondiscriminatory, nor is it specific, predictable, or sufficient. Instead it is highly discriminatory, inequitable and—because it is unsustainable and less predictable than a connection-based system—insufficient. In addition, the current revenue-based formula, for a very few carriers, generates a required contribution of \$0, so it also does not compel “every telecommunications carrier” to

¹⁸⁷ 47 U.S.C. 254(d).

¹⁸⁸ *AT&T v. Iowa Utility Board*, 525 U.S. 366, 397 (1999); *Chevron USA, Inc. v. Natural Resource Defense Council*, 467 U.S. 837 (1984).

contribute.¹⁸⁹ The Coalition’s proposed connection-based contribution formula is equitable, nondiscriminatory and sufficient, but, with respect to a very few carriers, also would generate a required contribution of \$0. Neither the Commission nor any party in this proceeding has suggested a contribution formula that is equitable, nondiscriminatory, sufficient and that generates a positive required contribution for each and every carrier.

Interpreting the statute in light of these real world implementation issues, the best interpretation of the statute, consistent with Congress’ core policy concerns, is that “every telecommunications carrier” must be subject to the Commission’s universal service contribution formula. That formula must be “equitable and nondiscriminatory,” and it must be demonstrably sufficient. But the “every telecommunications carrier” language does not require the Commission to forge an alternative minimum contribution that might compromise the “equitable and nondiscriminatory” nature of the Commission’s formula.

This interpretation gives meaning to the second sentence of Section 254(d). In that sentence, Congress granted the Commission the authority to “exempt” a carrier or class of carriers from contribution if the contribution would be *de minimis*. Interpreting the first section of 254(d) to impose an alternative minimum contribution requirement would read the *de minimis* exemption out of the statute. If “every telecommunications carrier shall contribute” truly means that every telecommunications carrier must make a payment, even if the formula calls for no payment or a very small payment, then Congress would not have adopted a *de minimis* exemption, but would have adopted an alternative minimum contribution requirement.

¹⁸⁹ A carrier that provides services only to other carriers and that does not serve end users is not required to make any universal service contribution under the current end user interstate and international telecommunications revenue-based formula.

This interpretation is consistent with the Commission’s previous decisions with respect to universal service. When the Commission adopted its end user interstate and international telecommunications revenue formula, it believed that it was adopting an equitable and nondiscriminatory formula – although experience has shown that prediction was erroneous.¹⁹⁰ Moreover, the Commission expressly rejected assessing contributions based on gross revenues – which would have assured that every interstate telecommunications carrier would contribute – precisely because a gross revenues assessment would “count[] revenues derived from the same service twice” and therefore violate the Commission’s principle of competitive neutrality.¹⁹¹ If the “every telecommunications carrier” requirement overrode the “equitable and nondiscriminatory basis” requirement, the Commission could not have selected the current formula based on end user interstate and international telecommunications revenues.

2. *Carriers Providing Few or No End User Interstate Connections Can Be Exempted from Universal Service Contributions Under the Commission’s De Minimis Authority.*

Even if the first sentence of Section 254(d) had to be construed to require that every carrier, in the first instance, be theoretically required to pay some contribution, the Commission could still exempt that carrier from contribution under its *de minimis* authority and avoid creating an alternative minimum contribution system. The second sentence of Section 254(d) clearly states that the Commission may

exempt a carrier or class of carriers from [the contribution] requirement if the carrier’s telecommunications activities are limited to such an extent that the level of such carrier’s

¹⁹⁰ *Universal Service First Report & Order*, 12 FCC Rcd at 9206-07.

¹⁹¹ *Id.* at 9207 (¶ 845).

contribution to the preservation and advancement of universal service would be *de minimis*.¹⁹²

Nothing in the second sentence of Section 254(d) requires that a carrier's "telecommunications activities" must be measured according to end user interstate and international telecommunications revenues. End user interstate and international telecommunications revenues are certainly a possible metric of the level of a carrier's telecommunications activities, but they are also an incomplete metric as they excludes carriers' carrier activities. Interstate connections provide a different, but still reasonable metric of a carrier's "telecommunications activities."

The Conference Report of the Telecommunications Act of 1996 is helpful in construing this undefined statutory language. The Conference Report confirms that Congress intended to give the FCC discretion to exclude some interstate telecommunications carriers from the universal service scheme. While noting that the Commission *could* require all interstate telecommunications carriers to contribute, the conferees nevertheless included the *de minimis* exception because they recognized that "the administrative cost of collecting contributions from a carrier or carriers would exceed the contribution that carrier would otherwise have to make under the formula for contributions selected by the Commission."¹⁹³ Accordingly, the Conference Report thus clarifies that under the second sentence of Section 254(d), the Commission has the authority to exempt a carrier from mandatory contribution to universal service mechanisms whenever "the formula selected by the Commission" would yield a contribution of a *de minimis* amount.

¹⁹² 47 U.S.C. § 254(d).

¹⁹³ 1996 Act Conf. Report at 131.

Thus, Congress recognized that the Commission might adopt an equitable and nondiscriminatory contribution formula, such as the one proposed by the Coalition, and exempt a small number of interstate carriers from payment. Under the existing universal service rules, interstate telecommunications service providers whose annual universal service contributions are expected to be less than \$10,000 are completely exempted from the system.¹⁹⁴

It therefore is established -- and clearly permissible under the terms of the statute -- that the Commission may devise a formula that ultimately leads to some carriers paying nothing. Under the current system, a carriers' carrier that has substantial telecommunications revenues but either no end user telecommunications revenues or very small end user telecommunications revenues makes no payment. Under the Coalition's proposal, a telecommunications carrier with, for example, 100 end user connections would likewise not be required to contribute, assuming the *de minimis* threshold continued to be set at \$10,000.

The logic of the argument—that the Coalition's proposal is flawed because it does not require contributions from carriers that provide no connections—leads to the conclusion that the present system is unlawful because there must be a minimum contribution requirement for those carriers' carriers that have no end user revenues. Yet because of the *de minimis* provision, it is clear that a carriers' carrier with small end user revenues or (under the Coalition proposal) a carrier with very few connections need not pay into the fund. The argument of the opponents of reform therefore must be that carriers that would make small contributions under the applicable formula may be

¹⁹⁴ See 47 C.F.R. § 54.708.

permitted to pay nothing, but that carriers for which the formula calls for no contribution must make a minimum contribution. Such an approach would make no sense. Under the current system, it is reasonable that carriers with no end user revenues make no contribution, just as carriers with small end user revenues make no contribution. Under the Coalition's proposal, it is reasonable that carriers that provide no connections would make no contribution, just as carriers with very few connections would make no contribution.

Section 254(d) of the Act requires the Commission to adopt an equitable and nondiscriminatory contribution formula that will provide specific, predictable, and sufficient revenues and that will apply to all carriers, even if the application of the formula yields a result where a particular carrier will not owe a contribution. Every telecommunications carrier must be subject to the formula, and providers of telecommunications that are not telecommunications carriers may be subject to it in order to prevent bypass. If the formula calls for a telecommunications carrier or a telecommunications provider to make payments that are not *de minimis*, it must contribute. But if the formula calls for a very small payment or no payment, the carrier need not contribute. The Coalition's proposal satisfies those requirements. The opponents of reform, in contrast, favor a system that is inequitable and will lead to a fund that is insufficient. Their claim that the current system is compelled by the requirement that every carrier contribute is contrary to current practice, under which not every carrier contributes, and the terms of the statute, which plainly recognize that some carriers will not contribute.

3. ***No Other Provision in Section 254(d) Precludes a Connection- and Capacity-Based Contribution Formula.***

Both incumbent LECs and wireless companies have complained that a connection-based contribution mechanism would shift “contribution burden” from the long distance carriers to them. These arguments are predicated on a static view of a dynamic industry, and in any event have no statutory basis.

Nothing in Section 254(d) nor any other provision of the Act requires that once the Commission established a universal service contribution mechanism in 1997, and an interim wireless safe harbor in 1998, the relative contribution of industry segments became enshrined in stone forever. Indeed, the relative contribution of the CMRS industry always has been subject to revision and the “safe harbors” have never been anything other than interim. Section 254(d) requires only that the contribution formula be applied to all carriers in an equitable and nondiscriminatory manner, and it never specified a “burden” allocation.

Moreover, other carriers have no statutory basis for complaint simply because the Commission adopts a formula that increases their contribution and lowers someone else’s. So long as the formula is applied equally to all carriers, is equitable and nondiscriminatory, and is sustainable and therefore sufficient, there is no statutory basis for legal challenge to the Commission’s contribution formula. The Coalition’s plan is the only current or proposed contribution mechanism that satisfies these three statutory requirements.

B. “Collect and Remit” Does Not Violate Section 254(d)’s Direction that Carriers Contribute.

The *FNPRM* asks whether the proposed “collect and remit” approach improperly requires customers, rather than carriers, to contribute to federal universal service.¹⁹⁵ It does not. As required by the statute, the telecommunications carriers themselves—and not the end users—will continue to make the payments to the universal service fund. However, nothing in Section 254 prohibits carriers from recovering universal service contributions from end users. Indeed, Section 254(e) has been held to prohibit ILECs from recovering universal service contributions in interstate access rates, as that amounts to the maintenance of implicit universal service subsidies.¹⁹⁶ Congress has mandated that universal service subsidies be fully transparent;¹⁹⁷ making the universal service pass-through explicit does not conflict with Congressional intent—it fulfills it. Accordingly, collect-and-remit is neither contrary to the Act nor arbitrary and capricious.

C. Interstate Connection-Based Assessments Do Not Violate Section 2(b).

USTA and others argue that, because *TOPUC I* bars the Commission from including intrastate revenues in a revenue-based universal service formula, the Commission therefore cannot assess connections if it adopts a connection-based universal service formula.¹⁹⁸ This is a logical *non sequitur*, in that it equates interstate universal

¹⁹⁵ *FNPRM* at ¶ 102.

¹⁹⁶ See *COMSAT Corp. v. FCC*, 250 F.3d 931, 938 (5th Cir. 2001) (“[T]he plain language of Section 254(e) does not permit the FCC to maintain any implicit subsidies.”) (quoting *TOPUC I*, 183 F.3d at 425); see also *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000).

¹⁹⁷ See AT&T Comments at 7-8.

¹⁹⁸ See USTA Reply Comments at 4.

service assessments based on *intrastate* revenues with interstate assessments based on *interstate* connections to public networks. The Coalition proposal is fully consistent with Section 2(b).

Those commenters that argue that the Commission lacks legal authority to adopt such a per-line assessment¹⁹⁹ rely solely on *TOPUC I*.²⁰⁰ In *TOPUC I*, the court held that Section 254 did not provide an unambiguous grant of authority to assess intrastate revenues in the context of a revenue-based assessment scheme, and Section 2(b) of the Act therefore barred such an assessment.²⁰¹ But *TOPUC I* has no application here because, under the Coalition’s proposal, the assessment is based on lines, not revenues. An assessment that applies to lines providing interstate telecommunications cannot conceivably be deemed a “charge . . . in connection with intrastate communications service,” and therefore such an assessment would not run afoul of Section 2(b).²⁰²

The Fifth Circuit itself noted that “the text of the statute does not impose any limitation on how universal service will be funded.”²⁰³ The Fifth Circuit reasoned that the inclusion of intrastate revenues in the calculation for universal service contributions constituted a “charge . . . in connection with intrastate communications service” in contravention of Section 2(b) of the 1934 Act.²⁰⁴ The court did not hold – or even imply

¹⁹⁹ See, e.g., BellSouth Comments at 3; USTA Comments at 5; Verizon Comments at 2-4.

²⁰⁰ 183 F.3d at 393.

²⁰¹ *Id.* at 448; 47 U.S.C. § 152(b).

²⁰² *TOPUC I*, 183 F.3d at 447 & n.101 (quoting 47 U.S.C. § 152(b)).

²⁰³ *TOPUC I*, 183 F.3d at 447.

²⁰⁴ *Id.* at 447 (quoting 47 U.S.C. § 152(b)).

– that the Act mandated that the Commission implement a revenue-based assessment system.

The Fifth Circuit’s concern was that the particular revenue-based scheme adopted by the FCC in 1997 improperly intruded into the jurisdiction of state regulatory commissions. Specifically, the court was concerned that, because under a revenue-based system the amount of a carrier’s universal service contributions would increase as the carrier’s intrastate revenues increased, the Commission’s decision to include intrastate revenues in its USF assessment calculations would “affect carriers’ business decisions on how much intrastate service to provide . . .”²⁰⁵ In the court’s view, “[t]his federal influence over intrastate services is precisely the type of intervention that § 2(b) is designed to prevent.”²⁰⁶ The court therefore required the Commission to consider only interstate and international revenues in determining a carrier’s USF contributions in a revenue-based system.

The Coalition’s proposal is consistent with the Fifth Circuit’s decision in *TOPUC I*. Unlike the revenue-based system at issue in that case, the interstate connection- and capacity-based mechanism recommended by the Coalition would not in any way “affect carriers’ business decisions on how much intrastate service to provide . . .” or otherwise “influence” intrastate services.²⁰⁷ Indeed, one of the many advantages of an interstate connection- and capacity-based assessment is that carriers contribute a single flat-rated amount for each interstate connection and their contribution does not vary with, and thereby “influence,” the volume of intrastate services a carrier may also provide over the

²⁰⁵ *Id.* at 447 n.101.

²⁰⁶ *Id.*

²⁰⁷ *Id.*

connection. In short, because interstate connection- and capacity-based assessments would be unaffected by changes in a carrier's intrastate revenues, there is no risk that USF considerations would influence carriers' decisions regarding the provision of intrastate service.²⁰⁸

The only argument to the contrary advanced by the parties who oppose a connection-based contribution mechanism is that a flat-rate, per-connection charge would allegedly shift the burden of universal service funding in a way that resembles a total revenue approach. That is both irrelevant and, under the Coalition's proposal, mistaken. First, any such shift would be irrelevant under *TOPUC I*; as long as the assessment is directed to lines that provide interstate telecommunications services any shift would be related to services under the Commission's jurisdiction. Any connection to the public switched telephone network unavoidably includes an interstate component, and it has long been settled law that the Commission has authority to impose a flat-rate interstate charge on the interstate component of that connection to recover non-traffic-sensitive interstate costs.²⁰⁹ As the D.C. Circuit noted in affirming prior FCC assessments on end user connections to the interstate network:

The same loop that connects a telephone subscriber to the local exchange necessarily connects that subscriber into the interstate network as well. ... The FCC may properly order recovery, through charges imposed on telephone

²⁰⁸ See *id.*

²⁰⁹ See *NARUC v. FCC*, 737 F.2d 1095, 1113-14 (D.C. Cir. 1984); see also *Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) (upholding the Commission's decision to maintain a flat-rated Subscriber Line Charge ("SLC") on primary residential lines and increase the SLC for both non-primary residential lines and multi-line business lines).

subscribers, of the portion of those costs that ... have been placed in the interstate jurisdiction.²¹⁰

If the FCC were to impose an interstate fee on a purely intrastate line, such as an intrastate, private data-exchange line between bank branches with no connection to the public switched telephone network, Section 2(b) would be implicated. But it bears emphasis that universal service contributions under the Coalition's proposal would be calculated on the basis of the number and capacity of end user connections used or usable for *interstate* services. Such connections may be either wholly used or usable for interstate service (*e.g.*, interstate private lines) or partially used or usable for interstate service (*e.g.*, local loops). Connections that are used or usable solely for intrastate services (*e.g.*, intrastate private lines) would not be subject to federal USF assessments under the proposal made by the Coalition. Thus, the Commission's decision to adopt the interstate connection- and capacity-based approach recommended by the Coalition would not impinge in any way on the authority reserved to state commissions by section 2(b) of the Act.

VI. JOINT BOARD REFERRAL IS NOT STATUTORILY REQUIRED AND SHOULD NOT OCCUR.

In the *FNPRM*, the Commission raises the possibility that it may refer this proceeding to a Joint Board before taking final action. The Commission is not required by either Section 254(a) and (c)(2) or by Section 410 to refer this matter to a Joint Board. This proceeding does not involve either the initial changes in regulations necessary to

²¹⁰ *NARUC*, 737 F.2d at 1113-14; *see also NARUC v. FCC*, 746 F.2d 1492, 1499 (D.C. Cir. 1984) (“[T]he physically intrastate location of [WATS] service does not preclude FCC jurisdiction so long as the service is used for the completion of interstate communications.”).

implement Section 254 and Section 214(e), which Section 254(a) required to be referred to a Joint Board and which was accomplished in 1996, nor the definition of services to be supported by federal universal service mechanisms, on which the Joint Board may provide recommendations under Section 254(c). Moreover, this proceeding does not affect jurisdictional separations, which would be required to be referred to a Joint Board under Section 410(c). And nothing in this proposal would result in a federal assessment of an intrastate connection. For example, a purely intrastate private line would not be assessed under the Coalition's plan, which is crafted to apply *only* to interstate connections over which the FCC has jurisdiction. Thus, there is no legal requirement that the Commission refer this proceeding to a Joint Board.

Nor should the Commission exercise its discretion to refer this proceeding to the Federal State Joint Board on Universal Service. There is a serious, immediate problem with the universal service contribution mechanism, directly presented by the shrinkage of the contribution base of end user interstate and international telecommunications revenues. That problem makes the current universal service system unsustainable, and exacerbates the extent to which it is discriminatory and not competitively neutral. Delaying the resolution of this matter while the Joint Board considers it would likely unnecessarily delay critically needed reforms.

The Coalition recommends that, in lieu of a discretionary referral, the Commission consult expeditiously with the state members of the Joint Board and with the state commissions more generally. Like interstate access charge reform, which the Joint Board previously recognized was wholly within the Commission's jurisdiction, the question of how the federal jurisdiction should structure its universal service contribution

mechanisms and attendant recovery are wholly within the FCC's jurisdiction.²¹¹

Meaningful consultation will adequately protect the states' interest in ensuring the interstate universal service mechanisms are sustainable and sufficient, and do not encroach on the states' jurisdiction.

VII. CONCLUSION.

Universal service contribution reform is no longer an option. The current contribution assessment mechanism fails the statutory requirements that it be "equitable and nondiscriminatory" and "specific, predictable and sufficient." It is therefore unlawful and cannot be continued.

The Coalition has put before the Commission an alternative contribution mechanism that will meet all statutory requirements. It is equitable and nondiscriminatory. It is economically sustainable, and therefore "specific, predictable and sufficient." And it is not precluded by any other provision of Section 254(d) or the Act as a whole.

Moreover, because the Coalition proposal will replace a shrinking interstate telecommunications revenues base with an expanding connections base, it will benefit residential and business consumers. Residential consumers -- including low-income consumers -- will, on average, pay less in universal service recovery fees than they do today. Business users benefit because the contribution system is more stable and fair. The only victim of this change is an illegal and unsustainable status quo.

²¹¹ *In re Federal-State Joint Board on Universal Service*, Second Recommended Decision, 13 FCC Rcd 24744, 24762 (1998).

The Commission must move forward to adopt the Coalition proposal. It cannot continue to rely on its current, unlawful universal service assessment mechanism.

Respectfully submitted,

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ATTACHMENT 1

**Description of the Process and Mechanism for Setting Initial Assessment Rates,
Calculation and Remittance of USF Assessments under “Collect-and-Remit”
Changes to the Assessment Rate During the Transition, and Establishing and
Adjusting Assessment Rates After Capacity Tiers are Implemented**

Under the Coalition for Sustainable Universal Service (“CoSUS” or “Coalition”) proposal, the following process and mechanism would be used to determine assessments during the transition and then once the full reform is implemented after one year.

USAC would estimate the total amount of universal service support for the first quarter of implementation (third quarter 2002), according to the current process.

The initial assessment rates for residential and single line business wireline and for non-paging CMRS would be set by the FCC’s Order at \$1.00 per month per independent connection to the public switched network. Likewise, the initial rate for each pager would be \$0.25 per connection per month, to be set by the Order. The current revenue-based assessment would continue to apply to interstate special access and private line services, set under the Order at the previous quarter’s USF contribution factor (e.g. for an effective date of July 1, 2002, the USF contribution factor for second quarter 2002, which is 7.28%). For the purpose of setting the initial contribution rate for switched multiline business connections, the Commission and/or USAC would also have to adopt an administrative estimate of: (1) the number of residential and single line business connections; (2) the number of non-paging CMRS connections; (3) the number of paging connections; and (4) the number of switched multiline business connections.¹ The Commission and USAC, either in the Order or in a public notice process such as used to determine the existing USF contribution factor, would determine the initial switched multiline business line assessment rate by taking USAC’s projected size of the federal USF funding requirement, increase that estimate by a factor to create a reserve against the initial USF assessments not collected and remitted by the contributors,² subtracting the estimated revenues to be collected from residential and single line business, non-paging CMRS, paging and special access/private line, and dividing by the administrative estimate of switched multiline business lines. The Commission would issue a public notice containing all the initial assessment rates.

The Commission Order implementing the connection- and capacity-based federal universal service assessment mechanism would include a revised Form 499-M that carriers would use to report the actual number of Lifeline connections, non-Lifeline residential wireline connections, single line business wireline connections, non-paging CMRS connections, pager connections, and switched multiline business connections (and special access/private line

¹ For the first quarter, the estimates for line counts and revenues for all customer classifications would be based on the Commission’s analyses of various sources. Form 499-M is not expected to be available for setting the initial assessment rates.

² This would replace the existing reserve for amounts uncollectible from contributors. It would be prudent for the Commission to establish a small reserve to cover the initial adjustments for uncollectibles under collect and remit.

revenues during the initial twelve month transition)³ that they provided to their end user customers, along with estimated uncollectibles during that month. Carriers would submit this form to USAC at the same time they submitted their remittance for that month's contributions.

As an example, contributors would submit both Form 499-M and their remittance for connections as of July 31, 2002 (the July 2002 connections), on August 31, 2002. On that form, they would list the gross number of connections (or in the case of special access and private line, revenues) billed during the month, a historically based uncollectibles factor or percentage, and the net number of connections (or revenues, as applicable) billed during that month as adjusted by the uncollectibles percentage. The net number of connections (and special access/private line revenues) would then be multiplied by the relevant assessment rate or contribution factor to yield the total amount that the carrier had to remit that month.⁴

On September 30, 2002, contributors would submit a Form 499-M covering reportable connections and interstate and international telecommunications revenues, adjusted for uncollectibles, as of August 31, 2002. The carrier would transmit its remittance to USAC for its contributions. The same process would be followed in subsequent months.

The initial assessment rates would be used as the basis for future assessment rates as follows. Prior to the end of the first transition quarter, and prior to the end of each subsequent quarter during the one-year transition period, the Commission and USAC would calculate the amount of USF revenues that would be collected at the then-existing assessment rates from each of the four different assessment groups as follows:

- the number of non-Lifeline wireline residential, wireline single line business, and non-paging CMRS connections, less uncollectible connections, from the latest available Form 499-M multiplied by the then-current per connection assessment rate for non-Lifeline wireline residential, wireline single line business and non-paging CMRS connections (at the end of the first quarter, that would be \$1.00) times 3;
- the number of pagers from the latest available Form 499-M, less uncollectible connections, multiplied by the then-current per connection assessment rate (at the end of the first quarter, that would be \$0.25) times 3;

³ Alternatively, the Commission could modify the 499-Q and require reporting on a quarterly basis of the transitional special access/private line revenues.

⁴ These reported connections (and, in the case of special access/private line during the transition year, revenues) are filed in Form-499M's within 30 days of the previous calendar month. During the transitional year, the special access and reported revenues will be estimates of actual revenues from the previous month, as there is insufficient time to account for all of the USF assessable revenues. Adjustments between these estimates and actual revenues will be made in subsequent Form-499M's for the duration of the transition. This timeline results in only a small cash flow change for USAC. Under the current system, invoices for USAC's revenue-based assessment would be issued in mid-July by USAC, and paid by carriers on or about August 15. Under the collect and remit timetable, USAC receives its payments approximately two weeks later than under the current system.

- total interstate and international special access and private line revenues from the latest available Form 499-M, less uncollectible revenues, times the then-prevailing percentage contribution factor times 3;⁵
- the number of switched multiline business connections, less uncollectible connections, from the latest available Form 499-M multiplied by the then-current switched multiline business assessment rate times 3.

The Commission would then compare the total assessment revenues that would be collected using the current assessment rates with the USAC's estimate of the amount of universal service support during the upcoming quarter. If total assessment revenues differed from anticipated support, the Commission would divide the projected size of the quarterly USF support by the aggregate total assessment revenues that would be generated at existing assessment rates to calculate a percentage adjustment factor (F). That adjustment factor (F) would be applied across the board to all of the then-current assessment rates – both the per-connection assessment rates and the percentage assessment rate on interstate and international special access and private line revenues – to get the new quarter's assessment rates. This could result in an increase or a decrease in assessment rates for the new quarter; the per connection charges (and the percentage contribution factor for interstate and international special access and private line revenues) all would either go up by a fixed percentage or all go down by a fixed percentage, depending on whether connections grew faster or slower than the funding needs. If, for example, the adjustment factor (F) were 0.95 – i.e., the projected fund size was 5 percent less than anticipated aggregate total assessment revenue under the then-existing rates – then the \$1.00 assessment on residential, single line business, and wireless connections would decrease to \$0.95; the assessment on pagers would decrease to approximately \$0.24; the percentage assessment on interstate and international special access and private line revenues would decrease by 5 percent; and the prevailing assessment rate on switched multiline business lines would decrease by 5 percent. Contributors would use these new assessment rates when calculating their USF remittances on Form 499-M during the next quarter.

During the transition year, carriers offering interstate and international special access and private line connections would be required to develop systems capable of providing monthly reports on the number and capacity of these connections, using the three capacity tiers identified in the Coalition proposal. Also during the transition year, the Commission would further revise Form 499-Q and/or Form 499-M to include lines to obtain data, by capacity tier, on these special access and private line connections. Hence by the end of the fourth quarter of the transition year, all carriers would have to report in their Form 499-M their capacity-based interstate and international special access and private line connections as well as their switched access connections.

At the time that the permanent connection- and capacity-based mechanism is implemented, the process followed during the transition year would be slightly modified, in order to calculate a basic multiline business rate to be applied to all multiline business connections based on capacity. First, revenues that would be collected using the then-existing

⁵ If a revised form 499-Q is used to report these estimated revenues, then the quarterly total would be used, rather than a monthly estimate multiplied by three.

assessment rates would be calculated for the four assessment groups, using the same methodology described above. The total assessment revenues that would be generated at the then-existing assessment rates would be compared to the USAC estimate of total quarterly USF support in order to calculate the new adjustment factor (F). The adjustment factor (F) would be applied to the residential, single line business, wireless, and pager connections exactly as it had been applied during the transition year – the per connection assessment rate would increase or decrease by the adjustment factor (F). For multiline business connections, including switched, special access and private line, the adjustment factor (F) would be applied differently. First, the total aggregate assessment revenue that would be generated under the then-existing switched multiline business and revenue-based special access/private line assessment rates would be multiplied by the adjustment factor (F) to determine the total amount of assessment to be assessed against all multiline business connections, including switched, special access and private line. Then, using the carrier data reported in the latest available Form 499-Ms, the number of Tier 1 equivalents would be calculated by assigning a weight of 1 to Tier 1 connections, a weight of 5 to Tier 2 connections, and a weight of 40 to Tier 3 connections. The total assessment dollars to be assessed against multiline business connections then would be divided by the total number of Tier 1 equivalent multiline business connections to get the new Tier 1 multiline business federal universal service assessment rate. Tier 2 and 3 assessment rates would then be calculated accordingly.

Going forward under the permanent connection- and capacity-based mechanism, total aggregate assessment revenue would be calculated by taking the number of residential/single line business/wireless connections, pager connections, and Tier 1 equivalent multiline business connections, as reported in the latest Form 499-M, multiplying each by their respective then-prevailing assessment rates time three, and adding the three together. The USAC estimate of total quarterly universal service support would then be divided by the total aggregate assessment revenue under the then-existing assessment rates to get a new adjustment factor (F), which would be applied to the three assessment rates (for residential/single line business/wireless connections, for pager connections, and for basic multiline business connections), to get the assessment rates for the new quarter.

ATTACHMENT 2

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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

DECLARATION OF MARTHA BEHREND

I, Martha Behrend, pursuant to 28 U.S.C. § 1746, do hereby declare under penalty of perjury, that the following is true and correct:

1. My name is Martha Behrend. My current position is Senior Manager of Market Research for the MCI Group. In that capacity, I oversee all market research functions and support for MCI-branded Consumer Products and Services. My responsibilities encompass the procurement and management of secondary sources of data, such as TNS data. I joined MCI in 1992 as a research analyst. Prior to that, I worked in the field of market research for Rubbermaid and Geico.

2. The purpose of this declaration is to present industry-wide customer billing data collected by TNS Telecommunications that show how low income residential customers would be affected if the current end user interstate and international telecommunications revenue-based federal universal service assessment mechanism were changed to a connection- and capacity-based mechanism of the sort proposed in this proceeding by the Coalition for Sustainable Universal Service (“CoSUS” or “Coalition”).¹
3. Under the Coalition proposal, interstate carriers would be assessed for each connection to a public network that they provide to end user customers, rather than being assessed on the basis of their end-user interstate and international telecommunications revenues. Today, most interstate carriers – both interexchange carriers (“IXCs”) and local exchange carriers (“LECs”) – recover their universal service assessments and associated administrative costs through revenue-based federal universal service fee (“FUSF”) line items on their end user bills. Instead, under the Coalition proposal, it is likely that residential customers would be charged a single per-connection FUSF by their LEC.²
4. The customer billing data show that:
 - a. At every level of household income, residential customers would pay less FUSF both for their primary residential connection and for all telecommunications services on average under the Coalition’s proposed per-connection charge than they pay under the current revenue-based mechanism.
 - b. On average, households with very low income (below \$15,000 a year) would pay \$0.40 per month *less* in FUSF for their primary residential connection with the per-connection charge than under the current revenue-based mechanism, and would pay no FUSF if they were Lifeline subscribers.

¹ The Commission sought comment on the Coalition proposal. *See In re Federal-State Joint Board on Universal Service; 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 Mechanism; 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; Truth-in-Billing and Billing Format*, Further Notice of Proposed Rulemaking & Report & Order, 2002 FCC LEXIS 975, CC Dockets No. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, FCC 02-43, at ¶2 (rel. February 26, 2002).

² In addition, under the Coalition proposal, the current universal service assessment on the interstate revenues of commercial mobile radio services (“CMRS” or “wireless”) carriers would be replaced by per-connection assessments on those carriers. The implications of this change for residential customers are discussed in paragraph 15 below.

- c. Even those very low income households that consistently make no interstate or international calls, and thus do not currently have any FUSF charge on their long distance bills, would pay only slightly more FUSF under the connection-based system – at most \$0.59 more per month – than they currently pay on average for the FUSF charge on their local bill, which would be eliminated. In contrast, because a substantial portion of very low income households have very large interstate and international usage, the 1 percent of very low income households with the most interstate and international usage would save on average \$9.44 per month with a per-connection charge, the top 10 percent of very low income households would save on average \$5.35 per month, and the top 20 percent of very low income households would save on average \$3.08 per month.
 - d. Because there is such a strong correlation between the number of household wireless connections and household income, a connection-based FUSF is progressive.
5. Currently, all residential customers pay FUSF charges to their local exchange carrier. The average FUSF for the large ILECs and NECA is \$0.51 per line per month.³ Given the process put in place under the Commission’s *CALLS Order*⁴ and *MAG Order*,⁵ this amount will increase in the future as the caps on residential subscriber line charges (“SLCs”) continue to increase.⁶

³ Effective April 2, 2002, the large ILECs have tariffed the following per line end-user charges: Verizon East (Bell Atlantic), \$0.60; Verizon West (GTE), \$0.55; BellSouth, \$0.53; SBC/Pacific Bell, \$0.45; SBC/Nevada Bell, \$0.57; SBC/Southwestern Bell, \$0.50; SBC/Ameritech/Illinois, \$0.37; SBC/Ameritech/Indiana, \$0.43; SBC/Ameritech/Michigan, \$0.43; SBC/Ameritech/Ohio, \$0.41; SBC/Ameritech/Wisconsin, \$0.30; SBC/SNET, \$0.69; Qwest, \$0.56; Sprint, \$0.50. The NECA FUSF is \$0.37. The weighted national average is about \$0.51.

⁴ *In re Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report & Order in CC Docket Nos. 96-262 & 94-1, Report & Order in CC Docket No. 99-249, & Eleventh Report & Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (“*CALLS Order*”), *aff’d in part and rev’d in part, on other grounds, Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied sub nom. National Association of Regulatory Utility Commissioners v. FCC*, 2002 U.S. LEXIS 2361 (April 15, 2002).

⁵ *In re Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers & Interexchange Carriers*, Second Report & Order & Further Notice of Proposed Rulemaking, 16 FCC Rcd 19613 (2001) (“*MAG Order*”).

⁶ For example, the cap on residential subscriber line charges will increase from \$5.00 to \$6.00 in July 2002. Although some large ILECs will not increase their SLC a full dollar, it is likely that the average SLC increase will be in the vicinity of \$0.60 per month. The ILECs will

6. In addition, residential customers typically pay FUSF charges to their interexchange carrier, most frequently in the form of a percentage surcharge on their bill for interstate and international calling. The charge varies across IXCs; currently, MCI's FUSF is 9.9 percent and AT&T's is 11.5 percent. On average across the entire industry, the long distance FUSF is approximately 10.0 percent of revenues. Under the current system, this charge also is likely to increase in the future because, as described in the accompanying Declaration of Daniel Kelley and David Nugent, the rate of growth of the federal universal service fund is likely to exceed the rate of growth of interstate and international telecommunications revenues, and thus the USF contribution factor (assessment rate) will increase. IXCs use that factor to establish the percentage FUSF charges on their customers' bills.⁷
7. Under the Coalition proposal, each LEC⁸ would initially be assessed \$1.00 per residential line per month (but nothing for Lifeline residential lines) on a "collect-and-remitt" basis and, for the purposes of this analysis, I assume that the LEC would recover its universal service costs from non-Lifeline residential customers through a per-connection line item. The Coalition proposal does not address whether, or by how much, carriers should be allowed to mark-up the amount they are assessed by USAC (in this case, the initial \$1.00 per line assessment). But given that carriers currently are allowed to – and do – include mark-ups in their FUSF line items, in order to be conservative when evaluating the possible impact on low income households of moving from the current revenue-based mechanism to the Coalition's proposed connection-based mechanism, I have assumed that there also would be a mark-up over the per-connection assessment. Especially if the collect and remit feature in the Coalition's proposal were adopted, thus eliminating costs associated with uncollectibles and reporting lags, carriers should be able to recover all their associated universal service costs with a modest markup over the \$1.00 assessment. Therefore, for the purposes of this analysis, I have assumed the monthly FUSF would be \$1.10 per connection.
8. Because the current average revenue-based local FUSF on LEC bills for residential

report to USAC the additional interstate revenues generated by the SLC increase, beginning with the quarterly Form 499-Q submissions for the third quarter of 2002 that they will file in October 2002. Based on those additional revenues, the ILECs will have to pay more into the federal universal service fund beginning January 1, 2003 (other things held constant), and thus will increase the monthly FUSF charges on their residential customers' bills in January 2003, probably somewhere in the vicinity of 5 or 6 cents.

⁷ See Declaration of Daniel Kelley and David Nugent, Attachment 4 to Comments of the Coalition for Sustainable Universal Service, at ¶ 7.

⁸ This could be either an incumbent local exchange carrier ("ILEC") or a competitive local exchange carrier ("CLEC"). Other end user interstate connection providers would also be assessed a connection-based USF assessment fee.

customers is \$0.51 per line, per month, if the Coalition proposal were implemented today, residential customers would pay less in total federal universal service charges for their primary residential line under the Coalition proposal if they currently pay to their long distance carrier monthly FUSF charges of \$0.59 per line or more (\$1.10 less \$0.51).⁹ I therefore sought data on the monthly long distance FUSF charges of individual residential customers, as well as data on the household income of those customers, to allow me to compare the impact of the current and Coalition-proposed USF funding mechanisms on low-income customers.

9. The only industry-wide data on residential customer interstate telecommunications expenditures and household income are collected by TNS Telecommunications, an independent company that collects billing and demographic data from a large sample of customers and “mines” these billing data to construct a database that it sells to subscribers. MCI and many other telecommunications carriers, including RBOCs, subscribe to this database. The FCC also uses the database.¹⁰ TNS constructs its database by paying individual customers to provide it with the data from their bills.¹¹
10. As I explain below, the TNS database systematically understates revenue-based long distance FUSF charges,¹² especially for low usage customers. Therefore comparing the revenue-based FUSF charges in the TNS database to a \$1.10 connection-based FUSF charge will tend to overstate the proportion of households that are better off under the revenue-based mechanism. However, the TNS database is the only source of industry-wide interstate telecommunications spending by household income level and therefore it is reasonable to use it with the caveat that it will tend to understate the portion of households better off under the connection-based mechanism (and, for those households marginally worse off under the connection-based mechanism, overstate the extent to which they are worse off).
11. Table 1 presents, by income level for the third quarter of 2001, TNS bill mining data on customers’ average monthly long distance FUSF charges, and the percentage of customers with less than \$0.59 in long distance FUSF charges (who thus would be better off under the current revenue-based mechanism). The sample

⁹ As I indicated earlier, on-going implementation of the *CALLS Order* and the *MAG Order* will cause increases in future revenue-based FUSF charges on local bills. Both the LEC and IXC FUSFs could also increase if there is a decline in the total amount of assessable end user interstate and international telecommunications revenues.

¹⁰ *FNPRM* at ¶ 46.

¹¹ TNS pays households \$5.00, along with a chance to enter into a sweepstakes, for each returned bill package.

¹² See ¶¶ 13-14, *infra*.

consists of 6,743 households. The data show that:

- a. Although income and interstate telecommunications usage are positively correlated at the higher income levels, that is not the case at lower income levels. On average, households with income below \$15,000 a year incur higher revenue-based FSUF charges per month than households with income between \$15,000 and \$45,000. These very low-income households may have high revenue-based charges for a number of reasons. For example, they may be immigrant households that make international calls, families that make interstate or international calls to children in the military, or senior citizen households that make interstate calls to children who reside in other states.
- b. On average, households with income below \$15,000 per year would pay \$0.40 less per month (\$1.10 vs. the sum of \$0.99 and \$0.51) under a per-connection charge.

Table 1: Revenue-Based Long Distance FUSF Charges by Income Level

Average Revenue-Based LD FUSF Charges and % Customers with <\$0.59 Revenue-Based LD FUSF Charges											
<\$15K		\$15K to <\$30K		\$30K to <\$45K		\$45K to <\$70K		\$70K+		Average	
Average	%<0.59	Average	%<0.59	Average	%<0.59	Average	%<0.59	Average	%<0.59	Average	%<0.59
\$0.99	62%	\$0.75	58%	\$0.95	55%	\$1.10	50%	\$1.33	44%	\$1.01	54%

12. More detailed analysis of the FUSF paid by households with annual income below \$15,000 shows that those very low income households that would pay more FUSF under the connection-based system would pay on average only \$0.46 more per month, and at most would pay \$0.59 more per month. In contrast, because a substantial portion of very low income households have very large interstate and international usage, the 1 percent of very low income households with the most interstate and international usage would save on average \$9.44 per month with a per-connection charge, the top 10 percent of very low income households would save on average \$5.35 per month, and the top 20 percent of very low income households would save on average \$3.08 per month.
13. Although the foregoing analysis of the TNS data indicates that low income households on balance would be better off with respect to the FUSF paid for by their primary residential line under the Coalition's per-connection proposal than under the current revenue-based assessment mechanism, the TNS data in fact are biased in a manner that has the effect of understating FUSF charges paid by consumers. Thus, the TNS data provide a conservative portrait of the advantages of a connection-based mechanism. For example, the TNS data are mined from customer bills, but TNS does not have a reliable means of aggregating multiple bills for a single customer into a single bill for the month. Suppose, for instance, that a customer switched long distance carriers during a month and, consequently, received two separate bills for toll service. The TNS database is likely to handle the two separately, treating the usage reported in each partial month bill as usage

for the entire month, instead of aggregating the FUSF charges from the two bills. A significant portion of customers get two long distance bills in a given month, each of which covers only a portion of the month, for a wide variety of reasons: taking advantage of competitive options to change carriers; moving to a different home in the same geographic area, or in another area, for business, educational, familial, or recreational reasons; switching carriers because service is disconnected for non-payment; etc. In addition to understating customers' interstate telecommunications spending in general, the TNS database tends specifically to understate the interstate telecommunications spending of low usage households because of variability in monthly usage. Each monthly sample consists of different households and therefore customers are not tracked over time. It is well established that many households that have zero interstate telecommunications usage in a particular month have positive – and even substantial – interstate usage in subsequent months. (Similarly, many households that have extremely high interstate usage in a particular month have much lower interstate usage in subsequent months.) As a result, data from only a single month will accentuate the extremes – both low and high – of household interstate telecommunications usage, and thus will understate the average monthly FUSF payment of low usage customers under a revenue-based system and also overstate the average monthly FUSF payment of high usage customers under a revenue-based charge.¹³

14. Moreover, the TNS data do not identify Lifeline customers, most of whom have some interstate telecommunications usage and thus pay FUSF charges under the current revenue-based assessment – but would not pay any FUSF under the Coalition's proposed connection-based proposal and thus would be better off under that proposal. Almost 6 million households, or approximately 5.5 percent of all U.S. households, currently are Lifeline recipients.¹⁴ Since most recipients are low-income households,¹⁵ it is likely that a substantially higher percentage of the

¹³ There may be yet another way in which the TNS database understates revenue-based FUSF charges. According to the TNS bill-mining data, the average long distance FUSF charge for residential customers of IXC's other than AT&T, MCI, and Sprint is less than half that of those three carriers. This is at least partially explained by the fact that some small IXC's, rather than providing a separate FUSF rate element to explicitly recover associated federal universal service costs, simply recover the charge implicitly in their overall rates. If the current assessment on their interstate revenues were eliminated because the assessment were now imposed on the carrier providing the connection, then the cost reduction would be passed through to customers in the form of lower overall rates, but this would not appear in the TNS database of FUSF charges. The rate reductions would represent the implicit FUSF charges currently paid by customers of these small IXC's.

¹⁴ FCC Monitoring Report, Oct. 2001, Table 2.5.

¹⁵ More than half of the Lifeline households are in California, which has implemented an unaudited system of self-certification. Thus some of the recipients of this subsidy intended explicitly for low-income households may not be low income.

households with income below \$15,000 are Lifeline recipients. To the extent that these Lifeline households are identified in the analysis above as paying more FUSF under the per-connection mechanism, when in fact they will be paying nothing under that mechanism, the analysis overstates the magnitude of even a small negative impact on some low-income consumers.

15. The analysis presented above does not take into account the additional USF charges households bear when they have multiple connections. For example, under the current revenue-based assessment system, a customer with two wireline connections would pay two LEC local \$0.51 FUSF charges, but under the connection-based system that customer would pay two \$1.10 per-connection charges. Similarly, under the current system, customers would pay approximately \$0.50 for each wireless connection, but under the connection-based system would pay \$1.10 for that connection. I therefore sought data on the average number of wireline and wireless connections per household, by household income. The TNS database provides that information. Weighting the TNS sample data by industry market share,¹⁶ the average number of wireline and wireless connections per customer is as follows:

Table 2: Average FUSF Per Household – Current v. Coalition Proposal

Household Income	Wireline Connections per H/H (A)	Wireless Connections per H/H (B)	Current Local FUSF (.51 x A)	Current Wireless FUSF (.50 x B)	Long Distance per H/H (from Table 1)	Current Total FUSF per H/H	Coalition Proposal FUSF per H/H	Savings per H/H
<\$15,000	1.03	0.12	\$0.53	\$0.06	\$0.99	\$1.58	\$1.27	-\$0.31
\$15,000-<\$30,000	1.05	0.22	\$0.54	\$0.11	\$0.75	\$1.40	\$1.40	\$0.00
\$30,000-<\$45,000	1.09	0.33	\$0.56	\$0.17	\$0.95	\$1.67	\$1.56	-\$0.11
\$45,000-<\$70,000	1.16	0.55	\$0.59	\$0.28	\$1.11	\$1.98	\$1.88	-\$0.10
>\$70,000	1.33	0.71	\$0.68	\$0.36	\$1.33	\$2.36	\$2.24	-\$0.12
All	1.14	0.40	\$0.58	\$0.20	\$1.01	\$1.79	\$1.69	-\$0.10

These data show that:

- a. Very few very low income households (3 percent) will have to pay for more than one wireline connection charge;¹⁷

¹⁶ That is, if AT&T has 41 percent of subscribed residential long distance lines, I would assign the AT&T bills in the TNS sample a weight of 41 percent, etc.

¹⁷ It is likely, however, that those few low-income households with multiple wireline connections are among those low-income households that currently pay large revenue-based long distance FUSF charges because they are large users of long distance calls.

- b. Although approximately 12 percent of very low income households would pay an additional \$0.60 in FUSF charges for their wireless connections, a connection-based assessment mechanism and per-connection FUSF charge placed on wireless as well as wireline connections is progressive, because higher income households are far more likely to have wireless (and multiple wireline) connections; and
- c. On average, all consumers will still pay less under a connection-based assessment mechanism than under the current revenues-based mechanism.

16. In conclusion, actual customer billing data indicate that, on average, households with annual income below \$15,000 would enjoy a \$0.40 per month reduction in their FUSF for their primary residential line under the Coalition's per-connection proposal. While no very low income households would be made worse off by more than \$0.59 per month, fully 20 percent of very low income households would save on average \$3.08 per month and the 1 percent with the highest interstate and international usage would save on average \$9.44 per month. All Lifeline customers would be better off because they would be exempt from any FUSF charge. Given the strong correlation between household wireless connections and household income, a connection-based charge is progressive.

Executed by:



Martha Behrend



Date

ATTACHMENT 3

AT&T Study ZERO-VOLUME LONG DISTANCE CUSTOMERS

Verizon, in a study previously submitted in this proceeding, asserted that 25% of households had no interstate or international long distance usage, and thus would see significant increases in USF contributions under the connection-based proposal. Verizon drew its conclusion from its TNS Bill Harvest survey, which is a sample of individual bills. Although the Coalition does not dispute that 25% of household bills in the TNS database for a given month show no interstate and international usage, that statistic overstates the number of residential consumers that consistently have no interstate or international usage over time. First, the TNS data does not exclude partial month bills for customers that begin or end service during that month. Second, TNS data does not track a specific customer's usage over time, so it has no way to reflect variation in a particular customer's usage. In fact, that variation is significant, and when usage *over time* is taken into account, the number of residential consumers who consistently make no interstate and international calls drops dramatically. When customer usage over time is taken into account, the number of residential customers with no interstate or international long distance usage likely falls well below 8%.

To evaluate the extent to which TNS data, and therefore Verizon's study, may overstate the number of residential consumers with no interstate or international usage over time, AT&T examined the prior six months usage for all its residential customers who had no interstate or international long distance charge in their AT&T bill for the March 2001 billing cycle. AT&T excluded partial month bills and any customer who was not an AT&T customer for the entire six-month period.¹ The results are compelling, and confirm that the vast majority of customers with no usage in a single month have long distance usage in other months – and some have extremely significant long distance usage in other months. For the period from October 2000 to March 2001, these customers' average interstate and international monthly long distance bill is summarized as follows:

Six Month Distribution of March 2001 Zero Users
March 2001 Zero IS & INTL Users

<u>IS & INTL Toll Segment</u>	<u>Revised Cust. Dist.</u>	<u>Average Bill¹ Interstate & International</u>
0	28.6%	\$0.00
\$0.01-9.99	64.5%	\$2.40
\$10-24.99	4.8%	\$15.16
\$25+	2.1%	\$57.74
Total	100.0%	\$3.48

¹ Six month average, Oct. 2000 - Mar. 2001

¹ Theoretically, a customer could have left AT&T and returned in the same month, but this is very unlikely to have occurred. In any event, it would not have a significant effect on the results.

What this says is that of the customers who had no interstate and international long distance usage in March 2001, only 28.6% had no such usage over the entire six-month period. More importantly, the average monthly long distance bill for these March 2001 zero-volume long distance customers over the six-month period was \$3.48 per month.

When these results are taken into account, the Verizon's consumer impact assessment does not hold up. Instead of 26% of residential consumers having no long distance usage, the number of residential consumers with no interstate and international long distance usage is less than 8%.² All other residential consumers have at least some interstate and international long distance usage.

Moreover, in assessing the consumer impact on low volume interstate and international long distance customers, changes in the future USF contribution rate and therefore changes in the ILEC USF recovery fee must also be taken into account. When this is done, the consumers that had no interstate or international long distance usage in March 2001, as a group likely see little or no impact from a shift to the Coalition's proposal. Given anticipated third quarter 2002 increases to the universal service funding requirements due to implementation of the Interstate Common Line Support mechanism for rate-of-return carriers, along with a continuation of the current decline in the assessable revenue base, 7.8% is a *conservative* assumption for the July 2002 USF contribution factor. If assessable end user interstate and international telecommunications revenues shrink by two percent per year, instead of growing one percent as Verizon predicts, the contribution factor could be over 8% in July 2002. This suggests that the current average ILEC federal USF line-item charge of 51 cents will increase to 57 cents in the third quarter, and to over 65 cents once the July 2002 SLC increases are reported in ILEC revenue reports, assuming the ILECs increase their USF line charges to recover their increased contributions.³ Even assuming AT&T does not increase its 11.5% residential line-item USF recovery charge, these customers would contribute 40 cents (11.5% of \$3.48 = \$.40) on their average monthly interstate and international long distance usage, or a total local and long distance USF recovery fee of \$0.97 per month (\$.57 + \$.40 = \$0.97), growing to \$1.05 per month (\$.65 + \$.40 = \$1.05) once the SLC increases are reported in ILEC revenues.⁴ Thus, even a typical zero user in a given month has sufficient interstate and international usage over a six-month period so that the Coalition proposal is substantially a wash, and may even possibly be slightly advantageous.

² 28.6% (the percentage of no usage households in a single month that have no usage over six months) of Verizon's 25% of "no usage" households is approximately 7.7% of households. This still likely overstates the number of consistent "no-usage" households because of the inclusion of partial month bills in the TNS database.

³ By the time the increased ILEC SLC revenues are reported and incorporated within the assessment base, there may have been a further decline in the aggregate assessment basis. That would push the average ILEC line charge even higher.

⁴ To be conservative for the purposes of this illustration, these calculations do not include a mark-up.

ATTACHMENT 4

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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

DECLARATION OF DANIEL KELLEY AND DAVID NUGENT

We, Daniel Kelley and David Nugent, pursuant to 28 U.S.C. § 1746, do hereby declare under penalty of perjury, that the following is true and correct:

1. At the request of the Coalition for Sustainable Universal Service (“CoSUS”) we reviewed the model prepared by Cambridge Strategic Management Group (“CSMG”) as part of

Verizon's *ex parte* filing, "In Support of the Current USF Contribution Model."¹ We find that the Verizon Model fails to adequately reflect changes in telecommunications markets that will lead to significant increases in the USF contribution factor assessed on end-user interstate and international telecommunications revenues, beyond those predicted in Verizon's *ex parte* filing.

QUALIFICATIONS

2. My name is Daniel Kelley. My current position is Senior Vice President of HAI Consulting, Inc. (formerly Hatfield Associates, Inc.). My professional experience began in 1972 at the Antitrust Division of the U.S. Department of Justice, where I analyzed mergers, acquisitions and business practices in a number of industries, including telecommunications. While at the Department of Justice, I was a member of the *U.S. v. AT&T* economics staff. In 1979, I moved to the Federal Communications Commission ("FCC" or "Commission") where I held several positions, including Special Assistant to the Chairman, Senior Economist in the Policy and Rules Division of the Common Carrier Bureau and Senior Economist in the Office of Plans and Policy. While at the FCC, I was involved in both the Second Computer Inquiry and Competitive Carrier rulemakings. These two rulemakings considered the proper regulation of dominant telecommunications carriers. After leaving the FCC, I was a Project Manager and Senior Economist at ICF, Incorporated, a public policy consulting firm. From September 1984 through July of 1990, I was employed by MCI Communications Corporation as its Director of Regulatory Policy. I joined Hatfield Associates in 1990.

¹ Verizon first presented the results of the model in a meeting with Common Carrier Bureau staff on October 10, 2001, memorialized in an October 11, 2001 *ex parte* letter to Ms. Magalie R. Salas, Secretary of the FCC, from W. Scott Randolph, Verizon's Director of Regulatory Matters.

3. I conduct economic and policy studies on a wide variety of telecommunications issues, including local competition, dominant firm regulation, and the cost of local service. I have participated in most of the Commission's significant common carrier proceedings over the past 25 years, including the Third Computer Inquiry, Price Cap proceedings and proceedings involving the implementation of the Telecommunications Act of 1996 ("1996 Act"). My participation in these proceedings has generally been on behalf of new facilities-based entrants or information service providers that compete with the incumbent local exchange carriers ("ILECs") and depend on ILECs for supply of critical inputs. I have prepared economic studies of the wireless industry and have analyzed several telecommunications mergers. I have advised foreign government officials on telecommunications policy matters and have taught seminars in regulatory economics in a number of countries.

4. I have testified on telecommunications issues before state regulatory agencies in Arizona, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Maryland, Massachusetts, Michigan, Oregon, Pennsylvania, Utah and Washington, as well as the FCC and the Federal-State Joint Board investigating universal service reform. I received a Bachelor of Arts degree in Economics from the University of Colorado in 1969, a Master of Arts degree in Economics from the University of Oregon in 1971, and a Ph.D. in Economics from the University of Oregon in 1976.

5. My name is David Nugent. I have been employed by HAI Consulting, Inc. since 1994. My current position is Senior Consultant. I hold a B.S. degree in Computer Science from Ohio University and an M.S. in Telecommunications Science from the University of Colorado. At HAI, I have performed competitive analysis of the local telephone market for both wireline and wireless clients. In addition, I have engaged in extensive analysis of cable telephony

technology and competition. I have also been engaged in HAI's local telephone cost modeling projects.

6. HAI is an economic and engineering consulting firm that specializes in developing telecommunications cost models, performing market analyses, and constructing business case scenarios of the various industries that either offer interstate telecommunications services or offer non-telecommunications services that compete with interstate telecommunications services. HAI (and its predecessor firm, Hatfield Associates, Inc.) has been analyzing telecommunications markets for more than two decades.

SUMMARY

7. The current revenue-based USF contribution factor is calculated by dividing the size of the Universal Service Fund by interstate and international end user telecommunications revenues.² The Verizon Model estimates that the 6.8 percent contribution factor that was in effect for the first quarter of 2002 will increase to 7.8 percent in 2002 and then remain relatively constant through 2006.³ This relatively modest increase in the size of the contribution factor is the result of two key assumptions. First, Verizon assumes that the components of the fund and its overall size are relatively stable. Verizon assumes that no additional universal service programs will be funded and that the fund will grow at a compounded annual growth rate ("CAGR") of only 1.6 percent between 2002 and 2006, once the Commission implements the

² The Commission also makes an allowance for USF assessments that the USF Administrator will fail to collect from contributors.

³ The contribution factor increased to 7.28 percent for the second quarter of 2002. It had previously ranged between 6.8 and just over 6.9 percent between the second quarter of 2001 and the first quarter of 2002.

MAG Order.⁴ Virtually all of the growth in the fund assumed by Verizon is due to the phase-in of the *MAG Order*. Second, Verizon assumes that the interstate and international end user retail revenue base grows from \$79.3 billion in 2000 to \$86.5 billion in 2006, a CAGR of 1.5 percent. We show that with realistic changes to these assumptions, the Verizon Model generates substantially higher contribution factors. This is significant both in and of itself and because USF recovery fees charged to consumers by their incumbent local exchange carrier (“ILEC”), long distance provider and wireless provider will generally rise, which will in turn affect the Verizon Model’s consumer impact analysis.

8. Neither the Verizon analysis nor our sensitivity analysis is able to adequately account for another significant force affecting the industry. As we discuss below, the practice of bundling interstate telecommunications services on which USF contributions are assessed together with related telecommunications services, information services, and customer premises equipment will make it increasingly difficult to identify and collect the proper contribution. This will lead to further declines in the USF assessment revenue base, and further increases in the contribution factor.

9. It is important to note that the Verizon Model revenue forecasts are already incorrect after only six months from their publication. The actual 2001 contribution base was \$78.4 billion, compared to Verizon’s estimate of \$79.7 billion.⁵ This is a difference of 1.6 percent.

⁴ Verizon assumed that the Commission would implement the USF component of an order on January 1, 2002. The *MAG Order*, however, did not implement the Interstate Common Line Support until July 1, 2002. *In re Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers & Interexchange Carriers*, Second Report & Order & Further Notice of Proposed Rulemaking, 16 FCC Rcd 19613 (2001) (“*MAG Order*”).

⁵ FCC, “Telecommunications Industry Revenues 2000,” Industry Analysis Division, Common Carrier Bureau, Jan. 2002, at 32-34, Tables 12-14.

Moreover, the Commission's revenue numbers include the amount of contributors' USF contributions that they then collect from their customers. When the effect of these collections is removed from the data series, it becomes even more apparent that the trend of interstate revenues is negative, and not positive as the Verizon Model suggests.⁶

10. We present the results of a number of individual sensitivity runs on significant components of the model.⁷ We first examine the components of long distance revenue. We examine both Verizon's wireline long distance price and minute-of-use estimates. Then we examine Verizon's assumptions about business line growth, wireless revenues, and federal USF size.

11. We identify a range of alternative estimates for each input assumption. We then run Verizon's Model with the alternative input assumptions. We show the results obtained by

<http://www.fcc.gov/bureaus/common_carrier/reports/FCC-State_link/IAD/telrev00.pdf>; see also Public Notice, Proposed Second Quarter 2002 Universal Service Contribution Factor, CC Docket No. 96-45, DA 02-562 (rel. March 8, 2002).

⁶ The Commission, in the Order accompanying the *Further Notice of Proposed Rulemaking* in this proceeding, removed contributors' actual universal service contributions from the revenue base. *In re Federal-State Joint Board on Universal Service, 1998 Biennial Regulatory Review – Streamlined Contribution 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; Truth-in-Billing and Billing Format*, Further Notice of Proposed Rulemaking & Report & Order, 2002 FCC LEXIS 972, CC Dockets Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, FCC 02-43, ¶¶ 113-115 (rel. Feb. 26, 2002).

⁷ The sensitivity analysis consisted of changing the input value for one of the model variables while holding constant all other variable input values. We performed this sensitivity analysis separately for five key inputs, to show how modifications to each would impact the federal USF contribution factor. Then we modified all five inputs simultaneously to estimate their cumulative impact on the contribution factor.

varying the inputs studied individually and as a group. Using the midpoints of our sensitivity changes, the contribution factors increase from Verizon's estimate of 7.8 percent to 10.1 percent. Using the largest change in each series, the contribution factor increases to 12.9 percent, an increase of 65 percent. Even the largest changes used in our sensitivity analysis are reasonable given current industry trends. Before turning to the sensitivity analysis, we discuss general trends affecting interstate and international end user telecommunications revenues.

MAJOR FINDINGS⁸

12. Our analysis demonstrates that the conclusions presented by Verizon are critically dependent on its choice of input assumptions for its model. In many cases, Verizon based its projections on historical FCC data. In some cases, Verizon relied on FCC data series that extended only through 1998 or 1999. In general, even using the old data, the Verizon Model correctly identifies the general trends affecting interstate and international telecommunications revenue. For example, interstate long distance prices and minutes are falling and broadband growth is having a negative effect on the demand for lines. However, events in the past two years have accelerated many of the trends. Toll prices are falling even faster than the Verizon Model recognizes and broadband growth is having a larger impact on wireline demand. The Verizon projections change significantly if input values that reflect current market reality are used.

13. Sensitivity analysis is useful for identifying the impact of changes to variable inputs, but sensitivity analysis cannot correct for a fundamental flaw in the Verizon model that yields

⁸ In order to analyze the Verizon model, we reviewed all the documents made available by Verizon pursuant to the protective order adopted by the Commission in this proceeding on December 11, 2001. We corrected a calculation error we discovered in the Verizon Model before running the sensitivity analyses.

projections that overstate assessable revenues. The Verizon model is not able to take into account the impact of “leakage” from the system that is likely to occur as a result of the increasingly popular practice of bundling packages of interstate telecommunications services, intrastate telecommunications services, non-telecommunications services such as information services, and customer premises equipment under contract for a fixed charge. Customers have every incentive to negotiate a contract in which a relatively small portion of the total revenues in the package is identified as interstate telecommunications revenue. And individual carriers will have no choice but to accommodate their customers or risk losing them to competitors. Thus, even when corrected by our sensitivity analysis, the Verizon model overstates projected assessable interstate telecommunications revenues, which results in understating the contribution factor.

14. The structural and technological changes in the telecommunications industry, which continue unabated, have resulted in a marketplace that is nothing like the one that existed when the end user interstate and international telecommunications revenue-based federal universal service assessment mechanism was put in place less than five years ago – and nothing like the marketplace that generated the data that Verizon uses as the basis for many of its projections. Then, long distance revenues were growing at a sizeable rate and were expected to provide a sustainable source of federal universal service funding.⁹ Since then, both the underlying supply conditions and the underlying demand conditions have changed dramatically.

⁹ The original FCC USF assessment mechanism collected contributions for its high cost and low income support programs from end user interstate and international telecommunications revenues. Contributions for the program to support connections for schools, libraries and rural health clinics were collected on the basis of all end user telecommunications revenues, including intrastate revenues. The FCC modified its assessment mechanism to collect universal service contributions for all programs on the basis of end user interstate and international

15. Only a short time ago, there was broad consensus that there could never be too much long haul capacity and that demand would always keep up with supply. However, when long haul capacity increased exponentially as companies like Global Crossing, Level 3, Qwest, and others deployed new long haul fiber networks even as interexchange companies (“IXCs”) such as AT&T, WorldCom, and Sprint expanded their existing fiber networks, supply far outstripped demand. Credit Suisse First Boston estimates that less than one percent of laid fiber is in use.¹⁰ As a result, long haul carriers today have too much capacity, and that excess capacity has driven wholesale rates for long-haul interstate services toward marginal cost.

16. In addition to the explosive growth of long-haul capacity, other factors have contributed to the rapid decline in interstate toll revenues. E-mail and Instant Messaging services, provided over the Internet, have become significant non-telecommunications substitutes for long distance service.¹¹ Because traffic routed to the Internet is not considered interstate telecommunications traffic, this substitution results in a reduction in interstate telecommunications revenues that are subject to the federal universal service assessment.

telecommunications revenues following the decision of the United States Court of Appeals for the Fifth Circuit in *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

¹⁰ Credit Suisse First Boston, “LD Fears Justified but Not for Local-Intensive Cos Qwest, BRW; RBOCs Oversold,” June 19, 2001; see also *Lines Lie Silent as Demand Falls Short*, DENVER POST, Aug. 12, 2001, at 11; *How the Fiber Barons Plunged the Nation Into a Telecom Glut*, WALL STREET J., June 18, 2001, at A1 (“All told, about 39 million miles of fiber-optic cable stretch underneath [the] U.S., ... enough to circle the earth 1,566 times. Companies racing to build or expand nationwide networks laid some \$90 billion of fiber during the past four years. Merrill Lynch & Co. estimates that only 2.6% of the capacity is actually in use. Much of it may remain dark forever.”).

¹¹ See JP Morgan, “Sprint FON Group: Finding Solid Ground?,” Apr. 16, 2002, at 2 (“... the company indicated that they also witnessed a steep decline in minutes per user providing further evidence of the significant erosion of voice minutes due to wireless substitution, e-mail, instant messaging, etc.”)

17. Wireless service was until recently used primarily for local service. But now wireless companies successfully market regional and national service offerings of low priced buckets of “all-distance” minutes that include traditional long distance services.¹² Although interstate wireless revenues are subject to the federal USF assessment, wireless carriers are not required to report actual interstate telecommunications revenues. They are instead allowed to assume that only a relatively small portion of their total revenues (15 percent for cellular, broadband PCS and digital SMR) are interstate revenues, and are assessed contribution requirements only on that percentage. As a result, substitution of wireless long distance services for traditional wireline long distance services reduces the interstate telecommunications revenues subject to the federal universal service assessment.

18. The effect of wireless growth on the revenue base can be illustrated by looking at the effect of current pricing plans in the market. In New York, Verizon Wireless offers a mobile telephone calling plan with 300 minutes of anytime, anywhere usage for \$35.00 per month. It also offers a plan with 400 minutes for \$45.00 per month. The current “safe harbor” rules assume that at most 15 percent of this revenue is interstate. Suppose a high usage long distance customer decides to move her interstate wireline long distance calling to a wireless plan and switches to the Verizon Wireless 400 minute plan to accommodate the additional usage. If that customer displaces 100 minutes of a Verizon’s landline interstate long distance calling plan at 7.5 cents per minute, the USF contribution base falls by the \$7.50 in wireline long distance revenue lost. This is offset to a limited extent by the increase in interstate wireless revenues

¹² *In re Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, Sixth Report, 16 FCC Rcd 13350, 13382-83 (2001) (“Sixth Report on Mobile Services”).*

attributed through the wireless safe harbor. But in this case, the additional wireless contribution to the contribution base is only \$1.50 (15 percent of the incremental wireless revenues). In other words, by moving her interstate long distance traffic from wireline to wireless, this customer has lowered her interstate long distance contribution to the revenue base by 80 percent.

LONG DISTANCE REVENUE PROJECTIONS

19. We first reviewed wireline long distance revenues and found that they are declining, and will continue to decline, more rapidly than Verizon estimates. Based on overly optimistic assumptions about future minutes and prices, Verizon estimates that traditional interstate long distance revenues will decline at a CAGR of less than one percent over the period 2001-2006. Empirical evidence suggests that wireline interstate revenues are likely to fall substantially, not at the modest annual rate of one percent, because both prices and minutes of use are falling.

20. The large interexchange carriers are reporting significant revenue reductions.¹³ The year-to-year comparison from fourth quarter 2000 to fourth quarter 2001 shows that WorldCom's business and consumer revenues fell eight and nine percent, respectively;¹⁴ Sprint's long distance voice revenues fell more than 12 percent;¹⁵ and AT&T's consumer revenues fell 18 percent and its business revenues fell at a mid-teens percentage.¹⁶ Bell Operating Companies ("BOCs") that

¹³ See Table 1, *infra*.

¹⁴ WorldCom Fourth Quarter and Full Year 2001 Results, <http://www1.worldcom.com/global/investor_relations/financials/files/wcom_group_4q01_financials.xls>, viewed Mar. 27, 2002.

¹⁵ Sprint Corporation, Consolidated Statements of Operations for Quarter ended December 31, 2001, <<http://www.sprint.com/sprint/ir/fn/qe/4q01.pdf>>, viewed Mar. 27, 2002.

¹⁶ AT&T News Release, "AT&T Announces Fourth Quarter Earnings," Jan. 30, 2002, <<http://www.att.com/news/item/0,1847,4191,00.html>>, viewed Apr. 17, 2002.

have received Section 271 authority,¹⁷ and possible gains by smaller IXCs in the increasingly competitive long distance market, might account for some of the losses experienced by the larger IXCs. However, based on FCC data, it is evident that overall market revenues are declining. U.S. international and interstate end-user switched toll revenues dropped by 10.3 percent between 1999 and 2000.¹⁸ Available data through 2001 show that IXC revenues are falling at about 3 percent per quarter.¹⁹ The rapidly falling share of the larger IXCs creates another problem. These carriers are placed at a competitive disadvantage relative to carriers whose market share is growing because the assessments are backward looking. In other words, the larger carriers must collect their assessments from a declining customer base, resulting in larger per customer or per minute assessments. This, of course, may lead to even more rapidly falling market share for these carriers.

Table 1

Carrier	Consumer	Business
WCOM	-9%	-8%
Sprint ²⁰	-12.5%	-12.5%
AT&T	-18%	-“mid-teens”

21. Revenues will decrease if either rates per minute or minutes of use fall. The sensitivity analyses we performed to take account of rapidly falling long distance revenue focus on rates. As discussed below, we make more realistic assumptions about rates for both business

¹⁷ 47 U.S.C. § 271 (setting forth requirements for BOC entry into interLATA service).

¹⁸ This is exclusive of USF contributions. *See* FCC, “Telecommunications Industry Revenues 2000,” Industry Analysis Division, Common Carrier Bureau, Jan. 2000, at 27, Table 9.

¹⁹ *Id.*, pp. 32-34, Tables 12-14.

²⁰ Sprint reported an average revenue decline of 12.5% for both business and consumer services, without separately breaking out the decline in each segment.

and residential long distance service, both of which affect the long distance revenue estimated in the Verizon Model.

22. The Verizon pricing estimate is based in part on a now-outdated CALLS analysis of trends in interstate long distance rates that relied on pricing data from the period 1992-1998.²¹ Substantial interexchange carrier capacity has come online since the CALLS plan data were developed, and as discussed above, the deployment of that additional capacity, among other factors, has driven interstate long distance prices sharply downward since 1998.

23. International rates also have fallen rapidly and are continuing to fall. The average price for a U.S.-originated international minute declined by 10.6 percent annually between 1993 and 1999. However, between 1998 and 1999 the change was -13.6 percent.²² Liberalization throughout the world is yielding lower rates. Submarine cable investment costs have fallen dramatically. And there is substantial excess submarine cable capacity, which also drives international rates down.²³

24. Adding to the pressure on long distance rates is the fact that alternatives for wireline long distance services often are substitutes for some of the highest-priced minutes. Wireless is

²¹ FCC, Industry Analysis Division, CALLS Analysis, May 25, 2000, App. B.

²² FCC, "Trends in Telephone Service," Industry Analysis Division, Common Carrier Bureau, Aug. 2001, at 6-3, Table 6.1, <http://www.fcc.gov/bureaus/common_carrier/reports/FCC-State_link/IAD/trend801.pdf>.

²³ See Bryant Dunetz, *Glut in Capacity of Transoceanic Cables Is Driving Prices Down*, NETWORK WORLD, December 17, 2001, at 42 ("If you're looking for a circuit to connect a U.S. office to a site overseas, there's never been a better time to buy. While you might pay \$1,500 per month for a T-1 line spanning the 250 miles between New York and Washington, D.C., you'd only need to pay \$1,000 per month for a portion of a T-1 that crossed the Atlantic Ocean to link New York and London.").

increasingly a substitute for calling card and payphone minutes.²⁴ Internet protocol (“IP”) Voice is a substitute mainly for international calls.²⁵

25. To account for the downward pressure on business toll rates, we performed sensitivity analysis using more realistic business toll rate assumptions for 2006 than used by Verizon. That analysis produced a substantially lower estimate of interstate business toll revenues during the period and a substantial increase in the projected contribution factor. Given the substantial excess long haul capacity and competition from Internet, broadband, and wireless alternatives, the business toll price could approach short run marginal cost by 2006.²⁶

26. Verizon’s study uses \$0.09 per minute business toll rates in 2006. As shown in Table 2, we performed sensitivity analyses for rates ranging from \$0.08 to \$0.05. Even our lowest rate of \$0.05 exceeds currently available rates.²⁷ Our midpoint sensitivity analysis yielded

²⁴ See, e.g., AT&T News Release, “AT&T Third Quarter Reported Earnings Per Share are 35 Cents, Operational Profits are 38 Cents Per Share,” Oct. 25, 2000 (“Consumer Services’ revenue continued to decline given increased competition in the long distance market, movement of customers to optional calling plans and increased use of wireless services as a substitute for calling card and direct-dial wireline services.”) <<http://www.att.com/news/item/0,1847,3411,00.html>>.

²⁵ See, e.g., *Attacks Draw Attention to Voice Over Internet Services*, ELECTRONIC COMMERCE NEWS, Oct. 1, 2001 (“The biggest revenue, consumer spending on international VoIP traffic, is drawing already \$1 billion this year and will balloon to \$4.8 billion by 2006, Probe [Research] asserted.”).

²⁶ See Credit Suisse First Boston, “Sprint FON Group,” Dec. 6, 2001, at 3; see also Simon Flannery *et al.*, *Does Long Distance Make Cents for the Bells?*, MORGAN STANLEY, Nov. 2, 2001, at 13 (projecting \$0.05 business long distance revenue per minute by 2004).

²⁷ See <www.saveonphone.com> and <www.lowermybills.com>, both of which list current residential offerings with domestic rates of \$0.05 and even \$0.045 per minute, with no minimum and no monthly fee. Business customer rates typically are lower than residential rates. Verizon’s own LD rates are *currently* \$0.09 per minute for its offerings targeting low usage businesses, and are lower for businesses with higher volumes and with term commitments. See <http://www22.verizon.com/longdistance/business_east/plan_firmrate_east.jsp>, visited Apr. 17, 2002.

an increase in the contribution factor from 7.8 percent to 8.3 percent; our low rate sensitivity analysis yielded an increase to 9.0 percent.

Table 2

Business Toll Rate, Cents	Contribution Factor in 2006
9.0	7.8%
8.0	8.0%
7.0	8.3%
6.0	8.6%
5.0	9.0%

27. We also performed sensitivity analyses using more realistic residential toll rate reductions, which again yielded a higher projected contribution factor. Verizon's study assumes residential toll rates of \$0.12 per minutes in 2006. But rates of \$0.05 or less are widely available today.²⁸ Moreover, the wireless and broadband competition implied in the Verizon growth estimates for those services will put additional pressure on residential rates. Verizon itself argues in its Section 271 applications that RBOC entry will have the effect of reducing residential long distance rates.²⁹ We understand that some portion of IXC customers pay higher per-minute rates that reflect the fixed costs of serving customers with low usage. But overall long distance rates are headed down, and the customers who place most of the calls, and generate a disproportionate amount of total revenue, are paying less and less per minute.

28. As shown in Table 3, we performed sensitivity analyses for residential rates ranging from \$0.105 to \$0.06 per minute. It is noteworthy that our midpoint sensitivity, \$0.09 per minute

²⁸ See <www.ld.net>, listing long distance calling plans as low as \$0.03 per minute. Indeed, Verizon's own residential long distance plans have rates below \$0.12 per minute. See <www22.Verizon.com/ForYourHome/sas/res_fam_DomesticCallingPlans.asp>.

²⁹ Application by Verizon New England for Authorization to Provide In-Region, InterLATA Services in Massachusetts, CC Docket No. 00-176, filed Sept. 22, 2000, at 60.

by 2006, is consistent with the Morgan Stanley forecast of residential revenues of \$0.10 per minute by 2004.³⁰ Our lowest sensitivity price, \$0.06, is one-third higher than the per-minute rate currently offered by at least one carrier. The \$0.06 rate would increase the estimated contribution factor under Verizon’s model from 7.8 percent to 8.1 percent.

Table 3

Residential Toll Rate, Cents	Contribution Factor in 2006
12.0	7.8%
10.5	7.9%
9.0	7.9%
7.5	8.0%
6.0	8.1%

29. Even with the projected price reductions discussed above, wireline long distance minutes may still fall over the next five years, as they have in each of the past six quarters despite continuing reductions in retail long distance prices.³¹ The growth in CLEC interstate toll minutes is unlikely to offset this decline.³² If wireline long distance carriers lose more minutes to wireless, IP voice, e-mail, and instant messaging than Verizon assumes, the contribution factor will increase accordingly. As shown in Table 4, a significant substitution to alternative platforms could increase the contribution factor in 2006 by as much as 0.5 percent. We have chosen not to include this in our cumulative sensitivity analysis (shown in the results presented below), because it is possible that the significant price reductions we describe above may limit the

³⁰ Flannery, *et al.*, *supra* n. 26.

³¹ See Chart 1, *infra*.

³² Based on CLEC-owned lines reported by the FCC in Feb. 2002, *see* “Local Competition Status as of June 30, 2001”, FCC, Industry Analysis Division, February 2002, and Verizon’s minute per line estimate, the product yields a total for CLEC minutes that is less than the decline in ILEC minutes. http://www.fcc.gov/bureaus/common_carrier/reports/FCC-State_link/IAD/Icom0202.pdf.

amount of substitution that will occur. However, it is important to note that revenues will fall due to increased substitution if prices do not fall to the levels discussed above.

Chart 1³³

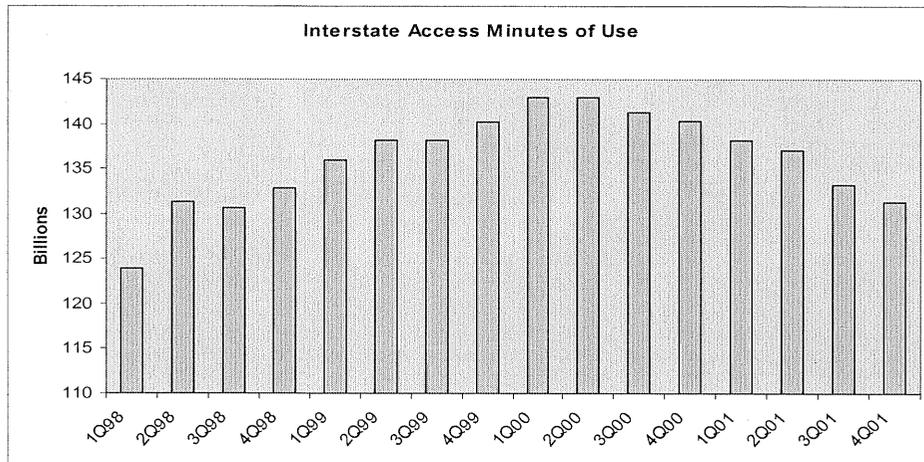


Table 4

Bus and Res Interstate Minutes 2006 (change)	Contribution Factor in 2006
N/A	7.8%
-5%	8.0%
-10%	8.1%
-15%	8.3%

SWITCHED BUSINESS LINE GROWTH

30. We next analyzed the rate of growth in demand for switched business lines. Based on historical data from the 1990s, Verizon assumes that switched business lines will grow at a cumulative annual growth rate of 4.7 percent through 2006.³⁴ Verizon does adjust this number

³³ 1998-2000 data from FCC; 2001 data from the NECA. FCC, "Trends in Telephone Service," Table 11.3, at 11-5 (Aug. 2001) available at <http://www.fcc.gov/bureaus/common_carrier/reports/FCC-State_link/socc/00socc.pdf>; National Exchange Carrier Association, Inc., "March 2002 Supplemental Report of Access Minutes."

³⁴ Verizon's October 26, 2001 *ex parte* indicates that it assumed business lines would grow by a CAGR of 4.0 percent. However, the actual data series used by Verizon shows a 4.7 percent CAGR.

downward to reflect broadband substitution. It is unrealistic, however, to use the high rate of growth of the 1990s as a baseline. Chart 2 shows that demand was relatively flat in the early part of the 1990s and then grew rapidly as the Internet developed and the economy expanded.³⁵ The pre-Internet (1990-1994) CAGR of wireline switched business lines was 2.4 percent. The post-Internet (1995-1999) CAGR of wireline switched business lines was 7.0 percent. Verizon uses the average growth rate for the 1990s to project the number of lines through 2006. But that represents a very optimistic rate of growth for what can be identified as the post-Broadband (2000-2006) period. We already see that the demand for Internet service provider (“ISP”) dial-up lines, for both businesses and residences, is slowing as customers choose broadband alternatives.³⁶ Also, the economy is unlikely to grow at the same rate in this decade as it did in the 1990s. Carriers and analysts already are reporting declines in number of lines.³⁷ Our

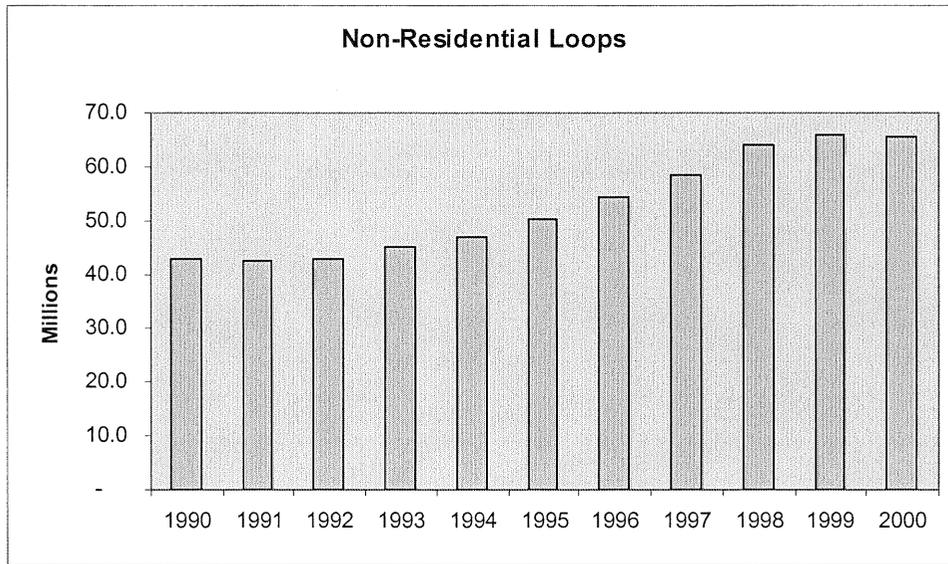
³⁵ Data for 1990-1999 are from FCC Industry Analysis Division, Common Carrier Bureau, “Trends in Telephone Service,” at 8-6, Table 8-4 (Aug. 2001) <http://www.fcc.gov/bureaus/common_carrier/reports/FCC-State_link/IAD/trend801.pdf>. Year 2000 is estimated by HAI based on CLEC-owned line data from the FCC’s Local Competition Report and Statistics of Communications Common Carriers data for ILEC lines. See FCC Industry Analysis Division, “Local Competition Status as of June 30, 2001”, Tables 3, 5 (Feb. 2002); FCC, “Statistics of Communications Common Carriers,” 2000/2001 Edition, Table 2.4 at 22.

³⁶ See Charles Haddad, *Telecom: The Bells Aren't Ringing*, BUSINESS WEEK ONLINE, Nov. 2, 2002 (“In the past, when consumers started using the [Internet], they often bought second and third phone lines. That helped drive the growth of local phone lines to 4.5% in 1999 and 1.1% in 2000. Now, many U.S. households are signing up for high-speed Net access -- more than 10 million have broadband connections so far. . . . about half of all high-speed Net surfers disconnect their second phone lines.”) (quoting telecom analyst Simon Flannery of Morgan Stanley Dean Witter & Co.).

³⁷ For example, in its Form 10-Q for the quarter ended September 30, 2001, at 21, Verizon reported negative business line growth. Dave Sterman reports that “the overall number of lines in the U.S. actually shrank by 1.3 percent in the third quarter according to industry researcher Precursor Group.” Dave Sterman, *Clinging to the Past*, THE TELECOM ANALYST, Dec. 20, 2001.

estimate of year 2000 lines shown in Chart 2 shows the beginning of a downward trend that current reports on business line growth confirm.

Chart 2



31. With future economic growth unlikely to match that of the period from 1995 to 1999 and broadband providing a substitute for switched business lines, it is reasonable to assume that overall growth will revert to a rate more in line with that experienced in the early 1990s. As shown in Table 5, we performed sensitivity analysis on the Verizon model using more reasonable switched business line growth rates ranging from 3.7 percent down to 1.0 percent. Holding all other variables constant and modifying only this one variable, our midpoint sensitivity assumption of 2.7 percent, which exceeds the pre-Internet growth rate of 2.4 percent, would increase the contribution factor in 2006 from the 7.8 percent to 8.2 percent. Our lowest switched business line growth assumption of 1.0 percent, which still exceeds the current growth rate, yields a 2006 contribution factor of 8.5 percent.

Table 5

Business Line Annual Growth Rate	Contribution Factor in 2006
4.7	7.8%
3.7	8.0%
2.7	8.2%
1.7	8.4%
1.0	8.5%

WIRELESS REVENUE

32. Verizon, relying on a 1999 analyst estimate,³⁸ assumes that wireless average revenue per unit (“ARPU”) will remain more or less constant through 2006. This is not consistent either with general economic experience or specific wireless market experience. The prices of competitive telecommunications services generally fall over time as technology improves and costs decline. Today there are six wireless carriers with national footprints, or close to national footprints, and these carriers have created a more competitive environment than existed in 1999.³⁹ The cellular CPI fell by over 10 percent between 2000 and 2001.⁴⁰ Some analysts expect significant cellular price declines as systems are built out. For example, ABN-AMRO reports that “. . . in coming years, we expect voice ARPUs to decline steadily as competition

³⁸ Cited as “Bear Stearns 1999” by Verizon in the October 26, 2001 *ex parte*, at 45.

³⁹ See *Sixth Report on Mobile Services*, 16 FCC Rcd at 13362 (“In the United States, there are six nationwide mobile telephony operators: AT&T Wireless, Sprint PCS, Verizon Wireless, VoiceStream Wireless Corp. (‘VoiceStream’), Cingular Wireless, and Nextel. In comparison, there were three nationwide mobile telephony operators at the end of 1999. In addition to the nationwide operators, there are a number of large regional players, including Western Wireless Corp. (‘Western Wireless’), US Cellular, Dobson Communications Corp. (‘Dobson’), and ALLTEL.”) (footnotes omitted).

⁴⁰ U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index for All Consumers, U.S. City Average for Cellular Telephone Service, year 2000 and year 2001. Data retrieved through BLS data extraction tool, Jan. 19, 2002, viewed at

stiffens and long-distance rates continue to fall.”⁴¹ The analyst goes on to suggest that additional revenues from new data services offered by wireless carriers may reverse the trend by 2003-2004. There is no guarantee, however, that mobile data will be the popular service that many wireless carriers are counting on.

33. We performed a sensitivity analysis on wireless ARPU by applying various trends to Verizon’s year 2000 ARPU assumption. Although the 2000 ARPU of \$44.20 used by Verizon is larger than the 2000 ARPU of \$39.60 cited in the Commission’s *Sixth Report on Mobile Services*,⁴² we used the higher number in our analysis.

34. Results of the sensitivity are shown in Table 6. The first entry in the table contains Verizon’s assumed year 2006 wireless ARPU. Given the likelihood that revenues per unit will decline, not grow, for the reasons discussed above, we performed additional analyses taking into account lower ARPUs. The lower ARPUs are calculated by trending Verizon’s year 2000 ARPU assumption downward through 2006, using the percentages shown below. If average ARPU resumes the downward trend experienced in the 1990-1999 time frame used by Verizon in other parts of its analysis, the effect will be an increase in the contribution factor from 7.8 to 8.4 percent.⁴³

<<http://data.bls.gov/servlet/SurveyOutput>>.

⁴¹ See Kevin Roe, *et al.*, US Wireless Telecom 2002: The Odds Are Better; Place Your Bets, ABN-AMRO, at 115, Feb. 7, 2002,; see also Serman, *supra* n. 37 (“Price wars may be looming in the wireless sector.... A review of Wall Street research in the sector doesn’t reflect the possibility of an imminent price war because most analysts simply look at current data to extrapolate future trends, rather than apply theoretical analysis.”).

⁴² See *Sixth Report on Mobile Services*, 16 FCC Rcd at 13377.

⁴³ According to data available from the CTIA, the average local monthly bill declined at a CAGR of -7.8 percent between 1990 and 1999. Cellular Telecommunications & Internet Association, Semi-Annual Wireless Industry Survey, Average Local Monthly Bill Table,

Table 6

Wireless ARPU in 2006	Contribution Factor in 2006
\$45.26	7.8%
2.0% annual reduction from 2001	8.0%
-4.0%	8.1%
-6.0%	8.3%
-7.8%	8.4%

FUND SIZE

35. Modest increases in the projected size of the federal USF result in large increases in the contribution factor. Verizon assumes that the total fund size will grow to \$6.6 billion by 2006, a post MAG plan compounded annual growth rate of only 1.6 percent. Historically, these subsidy programs have tended to grow much more rapidly than that, and there are a number of potential sources of fund increases on the horizon. There are open FCC proceedings that seek comment on whether to expand the universal service definition to include advanced services, expanded area service, and other services;⁴⁴ on how to increase low income participation in the lifeline program;⁴⁵ on how to determine when rural rates are “reasonably comparable” to urban rates, when a funding mechanism is “sufficient” to support the interstate jurisdiction’s universal service responsibilities, and how to provide inducements for state universal service mechanisms (in response to the remand of the Commission’s *Ninth Report and Order* by the Tenth Circuit Court);⁴⁶ and on the justification of the size of the High Cost fund created by the *CALLS Order*

<<http://www.wow-com.com/industry/stats/surveys/>>, visited Mar. 27, 2002.

⁴⁴ *In re Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Public Notice, FCC 01-J-1 (rel. Aug. 21, 2001).

⁴⁵ *In re Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Public Notice, FCC 01-J-2 (rel. Oct. 12, 2001).

⁴⁶ *In re Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking & Order, 2002 FCC LEXIS 831, FCC Document No. 02-41 (rel. Feb. 15, 2002).

(in response to the remand of the Commission's *Eleventh Report and Order* by the Fifth Circuit Court of Appeals).⁴⁷ Each of these proceedings could increase the size of the USF; it is extremely unlikely that any would reduce the fund size. In addition, under the Commission's existing high cost support mechanisms for rural carriers established under the *RTF Order*, the cap on such support is indexed for both inflation and line growth. Legislation is pending in Congress to eliminate that cap altogether.

36. In its proposed FY2003 budget, the Administration projects a fund size of \$7.2 billion in 2006.⁴⁸ In last year's FY2002 budget, the Administration projected a fund size of \$7.9 billion in 2006. The reduction reflects a desire for lower domestic spending in the new budget-deficit environment, but like everything else in a proposed budget, it is subject to congressional approval. All these factors suggest that the federal USF could grow to the \$7.2-\$7.9 billion range.

37. As shown in Table 7, we performed a sensitivity analysis of the impact of a larger fund size on the contribution factor. Using the revised figure in the Bush Administration's austere budget projections as the midpoint sensitivity level, a fund of \$7.2 billion would yield a contribution factor in 2006 of 8.6 percent. Using the larger number from last year's budget – \$7.9 billion – which may more accurately reflect congressional demand for the federal USF, the contribution factor in 2006 would be 9.3 percent.

⁴⁷ See Public Notice, *Common Carrier Bureau Seeks Comment on Remand of \$650 Million Support Amount Under Interstate Access Support Mechanism for Price Cap Carriers*, CC Docket Nos. 96-262, 94-1, 99-249, and 95-45 (rel. Dec. 4, 2001).

⁴⁸ The Fiscal Year 2003 Budget of the United States Government: Analytical Perspectives, at 336.

Table 7

USF Size in 2006 (Billions)	Contribution Factor in 2006
\$ 6.6	7.8%
\$ 6.9	8.2%
\$ 7.2	8.6%
\$ 7.6	8.9%
\$ 7.9	9.3%

CONCLUSIONS

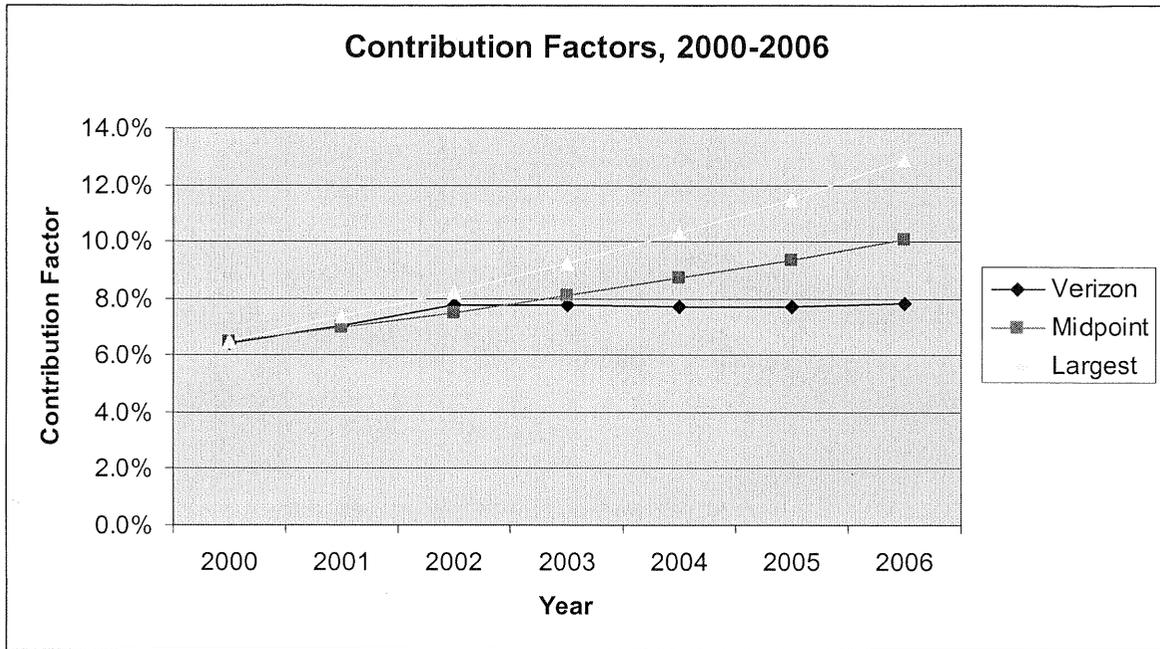
38. Each of the individual changes in input assumptions described above has a significant impact on the contribution factor. In each case, the largest change to the Verizon assumption is a plausible alternative given recent changes and current conditions in the industry. As shown in Table 8, if the midpoint changes to business switched line growth, business and residential long distance rates, wireless ARPU, and the size of the fund are cumulative, then the contribution factor increases to 10.1 percent in 2006. If the largest change in each sensitivity run is selected instead, then the cumulative contribution factor increases to 12.9 percent.

Table 8

Sensitivity	Contribution Factor in 2006	Percentage Increase
Verizon	7.8%	n/a
Midpoint	10.1%	29%
Largest	12.9%	65%

39. Chart 3 shows the cumulative effect of our changes to the five sensitivity categories for all years between 2000 and 2006.

Chart 3



40. As explained earlier, reporting issues associated with the current interstate telecommunications revenue-based federal assessment mechanism will put pressure on the size of the contribution factor that the Verizon model – even with sensitivity analysis – cannot address. Carriers already have service offerings that bundle interstate telecommunications services with intrastate services, with non-telecommunications services such as information services, and/or with customer premises equipment without distinguishing among those services.⁴⁹ These offerings become even more complex when offered on an individual contract basis. Customers have every incentive to look for packages that reduce the proportion of

⁴⁹ See, e.g., SBC-SNET, *All Distance*, <<http://www.snet.com/content/0,1335,41,00.html>>, viewed Jan. 22, 2002.

revenues attributed to interstate telecommunications services, which, in turn, will reduce interstate revenues. The end result will be an upward spiraling contribution factor as the incentive to evade the charge increases. Customers with the fewest alternatives or who do not need or cannot afford bundled service packages – principally residential and small business customers – will be negatively affected the most.

41. This sensitivity analysis shows that realistic input values in the Verizon model increase the projected contribution factor in 2006 by 65 percent, to 12.9 percent, and this does not take into account the further upward pressure on the contribution factor from leakage from the system. As the contribution factor hits double digits, customers will seek alternatives that fully or partially bypass the assessment, creating a spiraling effect. The current interstate telecommunications revenue-based federal assessment mechanism is not sustainable.

Executed by:

Daniel Kelley 4-18-02
Daniel Kelley Date

David M. Nugent 4-18/02
David Nugent Date

ATTACHMENT 5

AT&T Analysis
Weighted Average Monthly USF Assessment Per Wireline Residential
and Non-Paging CMRS Connection
(2001 Data)

In order to evaluate the reasonableness of an initial \$1.00 per connection per month Universal Service Fund (“USF”) assessment rate for wireline residential and non-paging CMRS connections, as proposed by the Coalition for Sustainable Universal Service (“CoSUS” or “Coalition”), AT&T compared this proposed initial assessment rate with the weighted average per connection per month of all USF assessments against end user interstate and international telecommunications services provided over those connections. AT&T determined that on average under today’s revenue-based mechanism, carriers are being assessed approximately \$0.96 per connection per month in federal universal service assessments for end user interstate and international telecommunications services provided over wireline residential and non-paging CMRS connections.¹

To make this calculation, AT&T began by annualizing the end user interstate and international telecommunications revenues reported by each group of contributors on Form 499-Q for the first three quarters of 2001.² Because, for wireline carriers, these revenues are not reported according to business and residential customer classes, AT&T had to estimate the percentage of total end user interstate and international telecommunications revenues for services provided to residential customers. To do so, AT&T split the annualized 499-Q end user interstate and international toll revenues between residential and business services according to a study by the Gartner Group.³ The end user interstate local revenues were split between residences and businesses according to relative SLC and, for some multiline businesses, PICC revenues. These revenues, with the breakout between wireline residential and wireline business, are shown on Line A of the attached chart.

AT&T then calculated the amount of USF assessment that would be due from each customer segment in each contributor group, using the current USF contribution factor of 7.28%. The total estimated contribution for each customer segment and contributor group is listed on line C of the attached chart.

¹ Because there was no publicly available data from which to estimate the proportion of total business interstate and international toll services revenue earned from serving single-line businesses, single-line businesses were not included with wireline residential and non-paging CMRS connections.

² FCC, “Telecommunications Industry Revenues: 2000,” Tables 12-14 (January 2002).

³ Dataquest/Gartner Group Inc., “Public Telecommunications Services North America Share and Forecast 2000 Market Statistics,” Table 4-4 (May 1, 2000) (indicating approximately 60% of toll revenues are for business, and 40% of toll revenues for residences).

AT&T then estimated the total number of wireline residential, wireline business and non-paging CMRS connections. These estimates are shown on line D of the attached chart.

Finally, AT&T calculated the weighted average USF contribution per wireline residential and non-paging CMRS connection by summing the contribution paid for local and toll services provided to wireline residential customers and the contribution paid by non-paging CMRS providers, dividing that sum by the total number of wireline residential and non-paging CMRS connections, and dividing that amount by 12 months. This average monthly USF contribution per connection is reflected on the attached chart in the box labeled "Average Consumer – Switched Residential Wireline and All Non-Paging CMRS (per Line/Handset per Month)." This weighted average was \$0.96 of USF assessment per connection per month.

An increase in the USF contribution factor will increase the total average assessment per connection. At a contribution factor of 7.8%, the weighted average USF assessment per wireline residential and non-paging CMRS connection per month would be \$1.03.

Average USF Assessment Per Wireline Residential and Single Line Business and Non-Paging CMRS Connection (2001 Data)

	Local Service Providers		Toll Service Providers		Payphone Service Providers		Total Wireline	Wireless Service Providers (including PCS, SMR, and Data)		Paging and Messaging Service Providers
	Residential	Business	Residential	Business	Business	Business	Residential	Business	Combined	
2001 USF Contribution Base by Type of Filers from FCC 499Q -- Three Quarterly Reported Data Annualized (millions)	\$ 9,239	\$ 8,193	\$ 20,888	\$ 31,332	\$ 72	\$ 69,724			\$ 8,837	\$ 475
Published USF Contribution Factor for 2nd Quarter, 2002	7.28%	7.28%	7.28%	7.28%	7.28%	7.28%			7.28%	7.28%
Total Annual Assessment - CURRENT (millions)	\$ 673	\$ 596	\$ 1,521	\$ 2,281	\$ 5	\$ 5,076			\$ 643	\$ 35
Lines or Subscribers (millions)	126.894	56.269	126.894	56.269	1.614	184.777			118,398	35,220
Average USF Assessment per Line per Month - CURRENT	\$ 0.44	\$ 0.88	\$ 1.00	\$ 3.38	\$ 0.27	\$ 2.29			\$ 0.45	\$ 0.08
Customer Groups:										
Switched Wireline Residential (per Line per Month)	Current USF Contribution Per Month									
Wireless Subscribers (per Handset per Month)	1.44									
Average Consumer -- Switched Residential Wireline & All Non-Paging CMRS (per Line/Handset per Month)	\$ 0.45									

Lines / Subscribers/ Revenues Data are from the Coalition's Analyses and other Publicly Available Sources:

Millions (2001)	Residential		Business		Sub-Total	Public	Household	Source
	Residential	Business	Residential	Business	Sub-Total	Public	Household	Source
Wireline - Access Lines	126.894		56.269		183.163	1.614	106,500	Residential Lines - Verizon estimates; Multiline Business - Projected using 1999-2000 Price Cap LEC Growth Rate of 1.4% CAGR; Payphones - Prorated using 1999-2000 Price Cap LEC Growth Rate of -4.4% CAGR
Wireless Subscribers					118,398			2001 Total Subscribers from CTIA Survey.
Local Wireline End User Retail Revenue	\$ 9,239	\$ 53,000%	\$ 8,193	\$ 47,000%	\$ 17,432			Total revenues are from Tables 12 to 14, Carrier Telecommunications Revenues with Estimated Breakdown by Type of Service, Telecommunications Industry Revenue Reports for 2001, FCC IAD, "Telecommunications Industry Revenues 2000" (rel. January 2002).
Toll Wireline End User Retail Revenue	\$ 20,888	\$ 40,000%	\$ 31,332	\$ 60,000%	\$ 52,220			Residential / business toll revenue splits are from Gartner Group, "Public Telecommunications Services North America Market Share and Forecast, 2000 Market Statistics," Table 4-4: Local residential / business split are based on relative SLC/PICC revenues.
Wireless End User Retail Revenue					\$ 8,837			Total 2001 Revenues are from FCC IAD, "Telecommunications Industry Revenues 2000".
Pagers Subscribers					35,220			Yankee Group Report Vol 3, No. 1 - January 2002