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EX PARTE – Via Electronic Filing

Ms. Marlene Dortch
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, DC 20554

Re: CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200,
95-116, 98-170, and NSD File No. L-00-72

Dear Ms. Dortch:

The Coalition for Sustainable Universal Service (“CoSUS”) hereby submits the attached memorandum setting forth the reasons the CoSUS proposal is consistent with Sections 254(d) and 2(b) of the Communications Act of 1934.

In accordance with the Commission’s rules, a copy of this letter is being filed electronically in the above-captioned dockets.

Sincerely,

/s/

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Applicability of Sections 254(d) and 2(b) To the CoSUS Proposal

A number of commenters have argued that Sections 254(d) and 2(b) of the Communications Act of 1934, as amended, bar the Commission from adopting the universal service contribution reform proposal offered by the Coalition for Sustainable Universal Service (“CoSUS”). This memorandum demonstrates that the better interpretation of the law is that the Commission may adopt the CoSUS proposal, consistent with statutory requirements.

I. Section 254(d).

Section 254(d) states in full:

“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. The Commission may exempt a carrier or class of carriers from this requirement 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. Any other provider of interstate telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires.”

In the comments, two legal issues under Section 254(d) have been presented with respect to the CoSUS proposal:

1. Is the CoSUS proposal equitable and nondiscriminatory?
2. Does the CoSUS proposal violate Section 254(d) because some carriers are not required to contribute?

We address each of these issues below and demonstrate that neither precludes adoption of the CoSUS proposal. In addition, as discussed in detail in CoSUS' comments and reply comments, but not in this memo, the CoSUS proposal provides a much more “specific, predictable and sufficient” basis for universal service support than the current mechanism, and would end the funding “death spiral” that has already begun.

A. Is the CoSUS Proposal Equitable and Nondiscriminatory?

Yes. Section 254(d) clearly requires that the basis for universal service contribution be “equitable and nondiscriminatory.” However, neither the statute nor the legislative history provides any additional guidance as to the meaning of the statutory phrase “equitable and nondiscriminatory.” The plain meaning of “equitable and nondiscriminatory” must, however, include a requirement that the universal service contribution mechanism be competitively neutral. Indeed, when the Commission adopted competitive neutrality as a principle for determining universal service support, it noted that “competitive neutrality is consistent with . . . the explicit requirement of equitable and nondiscriminatory contributions.” *Universal Service*

First Report & Order, 12 FCC Rcd. 8776, 8801 (1997). Moreover, when it adopted the initial version of the current contribution mechanism, the Commission noted that it "agree[d] with the Joint Board's recommendation that we must assess contributions in a manner that . . . is competitively neutral and is easy to administer." *Id.* at 9207 (¶ 843).

As CoSUS has set forth in its previous comments, reply comments and ex partes, its proposal is the most competitively neutral of all the proposals. The CoSUS proposal assesses competitors providing similar, potentially substitutable services, such as residential wireline and wireless services, the same amount per connection. It cures competitive inequities created by reporting lags and differences in carrier uncollectible rates by proposing a collect-and-remit mechanism. It eliminates the distortion and discrimination that currently favors wireless services over wireline services. It also eliminates the need for the partial international exemption, and hence the competitive distortion caused by that exemption.

By contrast, as it has evolved, and as it now functions in the current market environment, the current revenue-based mechanism contains significant competitive inequities. Those inequities are due to reporting lags, the wireless safe harbor and the partial international exemption, and competitive imbalances between carriers that sell bundles and those that do not based on the carrier's ability to assign revenue to sources other than interstate telecommunications. In short, the current revenue-based mechanism is no longer "equitable and nondiscriminatory" and thus now violates Section 254(d)'s requirements.

As a second contrast to the CoSUS proposal, the SBC/BellSouth proposal is structured blatantly to favor operationally those carriers, such as the RBOCs, that predominantly provide their own end user connections in addition to long distance and Internet access service. This points up a second aspect of competitive neutrality: a mechanism cannot be competitively neutral, and therefore cannot be equitable and nondiscriminatory, if it would impose costs (particularly recurring costs) on only a portion of carriers seeking to provide competing services to the same customer. The SBC/BellSouth proposal would require carriers and ISPs (including those providing dial-up service) that do not provide connections to end users to obtain from the connection providers detailed information about the number and types of those connections (e.g. centrex, switched business lines, symmetric or asymmetric service, capacity of greater than 64 kpbs, DS-1 or DS-3), as well as information as to whether the customer was a Lifeline subscriber. Carriers' recent experience in implementing the Presubscribed Interexchange Carrier Charges (PICCs) suggests that ILECs and other carriers providing end user connections would be unwilling to provide the necessary information to unaffiliated presubscribed long distance carriers and ISPs free of charge, especially because this information would have to be provided by each and every connection provider, from the largest to the very smallest. In addition, the ISPs and presubscribed IXCs would incur additional costs of verifying and auditing the information provided by the unaffiliated connection provider, and of separately billing for the recovery of USF assessments. Because the SBC/BellSouth proposal imposes these additional costs on IXCs and ISPs that are unaffiliated with the provider of a specific customer's connection, but these costs are not incurred by carriers that provide both the connection and interexchange or Internet access service, the SBC/BellSouth proposal would not be competitively neutral in operation. Therefore it is neither equitable nor nondiscriminatory.

With the CoSUS proposal as the only proposal in the record to date that is competitively neutral, the question arises as to whether the requirement that contributions be made on an "equitable and nondiscriminatory basis" imposes any other limitation that would preclude adoption of the CoSUS proposal. There is none. In *Texas Office of Public Utility Counsel v. FCC*, 183 F. 3d 393, 434 (5th Cir. 1999), the court noted that Section 254(d)'s requirement that contributions be made on an equitable and nondiscriminatory basis "also refers to the fairness in the allocation of contribution duties." The court did not further explain what it meant by this language. However, the court's holding turned, at least in part, on the court's finding that the Commission had imposed "prohibitive" costs on COMSAT in a "discriminatory" manner. *Id.* This supports CoSUS' view that in order to be "equitable and nondiscriminatory," a contribution mechanism must be competitively neutral. Thus, *TOPUC I* does not enunciate a standard for "equitable and nondiscriminatory" contribution that precludes adoption of the CoSUS proposal.

Moreover, any evaluation of the "fairness in the allocation of contribution duties" can be made only in the context of the other statutory requirements. The court gave no explanation of any limiting or objective standards for evaluating "fairness," and standardless notions of "fairness" cannot override the requirement that the contribution mechanism be competitively neutral. In addition, evaluation of what is a "fair" contribution mechanism should consider the difficulties and transaction costs that would be incurred in implementing alternative proposals. All transactions and administrative costs ultimately are borne by consumers, whether through surcharges or service rates. It therefore would harm consumers, and be fundamentally irrational, to rearrange contributions in ways that generate substantial administrative and transaction costs simply to redistribute contributions in the first instance among different carrier groups. That is particularly so since the CoSUS proposal includes a "collect and remit" approach, which confirms the obvious fact that end users ultimately pay for contributions.

In addition, neither Section 254(d) nor administrative law requires that "fairness" be determined by comparison to the current distribution of contribution assessments among carriers. Nor is there a requirement that an "equitable" mechanism be equated with a revenues-based mechanism. This is especially true because the current distribution of USF payments results from a mechanism that, in today's environment, is highly flawed, and not competitively neutral. It would be irrational to define "fairness" based on a mechanism that was itself not "equitable and nondiscriminatory," and it would put the statute at war with itself to read "equitable" to override "nondiscriminatory."

Finally, some parties appear to be arguing that: (1) the statute requires that contributions be assessed in a manner that is related to "interstate activity," and (2) "interstate activity" must be measured in terms of revenues or minutes. Nothing in the statute, however, requires that contributions to universal service be based on interstate revenues or minutes. In a world in which jurisdictional revenues and minutes are becoming increasingly difficult to measure, and, consequently, an increasingly unreliable standard, the statute grants the Commission the discretion to select an assessment methodology that is not based on jurisdictional minutes or revenues – as long as that method is equitable and non-discriminatory. While the statute does provide for the assessment of contributions on carriers providing interstate telecommunications, defining interstate activity in terms of revenues has led to the mechanism in place today, which, as discussed above, is no longer equitable and non-discriminatory. The better reading of the

statute, therefore, is that it permits the Commission to adopt an approach under which interstate activity is measured by connections. As discussed above, the CoSUS connection-based mechanism best fulfills the requirements of Section 254(d).

The bottom line is that there is nothing in the Act that places the CoSUS proposal's distribution of carrier payments outside the zone of reasonableness. Indeed, it is the only proposal in the record to date that is competitively neutral, and that therefore meets the objective components of the Act's requirement that contributions be made on an "equitable and nondiscriminatory basis." Accordingly, the record evidence shows that the CoSUS proposal is the most equitable and nondiscriminatory proposal that has been advanced, and that the requirement in Section 254(d) that contributions be made on an "equitable and nondiscriminatory" basis does not preclude adoption of the CoSUS proposal. In addition, the CoSUS proposal will result in a "sufficient" fund, supported by "specific" and "predictable mechanisms."

B. Does the CoSUS proposal violate Section 254(d) because some carriers are not required to contribute?

No. As CoSUS has pointed out in its comments, the vast majority of telecommunications carriers, including historical long distance carriers such as AT&T, WorldCom and Sprint and next generation network providers such as Level 3, provide end user connections to a public network that would be subject to contribution assessments under the CoSUS proposal. AT&T, WorldCom, and Sprint, for example, provide private line and special access connections to a public network to their business customers, and provide switched connections to a public network to business and residential users. Nonetheless, there are likely some telecommunications carriers that provide interstate telecommunications, including standalone dial-around carriers and standalone long distance resellers, that would not be required to make a contribution under the CoSUS formula. Some commenters argue that this result violates Section 254(d)'s direction that "every carrier that provides interstate telecommunications services shall contribute" In addition, some commenters assert that the CoSUS proposal violates Section 254(d) by failing to assess contributions based on the interstate service provided by long distance carriers to customers to whom they do not provide the end user connection.

The argument that Section 254(d) is violated whenever a contribution mechanism results in a telecommunications carrier that provides interstate service making no contribution to the universal service fund "confuses 'plain meaning' with literalism." *Bell Atlantic v. FCC*, 131 F.3d 1044, 1045 (D.C. Cir. 1997). Words in a statute must be construed in light of their context, *see, e.g., Tyler v. Chin*, 121 S. Ct. 2478, 2482 (2001), and interpreted so as not to render other statutory terms superfluous, *Circuit City v. Adams*, 121 S. Ct. 1302, 108 (2001). The first sentence of Section 254(d) cannot be read literally to require that every carrier contribute because the second sentence makes clear that carriers need not contribute if their contributions would be de minimis, i.e., "[w]here the administrative cost of collecting contribution 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.*" H. Rpt. 104-458 at 131 (emphasis added). Clearly, Congress envisioned that some carriers providing interstate telecommunications would not contribute to the federal USF.

Some literalists might then argue, however, that even if Section 254 as a whole admits the possibility that some carriers will not contribute because of the de minimis exemption, the first sentence of Section 254(d) mandates that the Commission's contribution formula call for a contribution from every carrier if there were no de minimis exemption to apply. Under this interpretation, the first sentence of Section 254(d) would be read to require that the contribution formula result in every carrier providing interstate telecommunications being assigned a positive amount of contribution assessment, payment of which could then be subject to the de minimis exemption in the second sentence of section 254(d).

This literalist interpretation, however, is inconsistent with the Commission's implementation of Section 254(d) to date. Under the current contribution rules, a Commission-prescribed formula (percentage of end user interstate and international telecommunications revenues) is applied to all telecommunications carriers providing interstate service, and all carriers pay the resulting amount, except if their contribution would be de minimis. However, in the case of a carrier's carrier, the carrier itself is not required to contribute, even though it provides interstate telecommunications services, because all its services are provided to carriers rather than end users.

Indeed, this literalist interpretation amounts to reading the statute to require that the Commission use a gross revenues assessment for universal service contribution formula. No other formula, whether based on end user retail revenues, profits, or connections, can assure that every telecommunications carrier would always be subject to an assessment obligation prior to application of the de minimis exemption. There is, however, nothing in the statute or its legislative history that indicates that Congress intended to limit the Commission to assessing contributions based on gross revenues.

This literalist interpretation of the first sentence of Section 254(d) to require that the FCC's contribution formula result in some payment obligation prior to application of the de minimis exemption is also meaningless formalism in light of the de minimis exemption in the second sentence of Section 254(d). Unless the first sentence were read to require that the Commission's equitable and nondiscriminatory formula yield non-de minimis contributions for every carrier (which would contradict the second sentence of Section 254(d)), this literalist interpretation would attempt to draw a legal line between a formula that yielded an assessment of zero for some carriers and a formula that yielded a positive number that the Commission could then reduce to zero. This is not a meaningful difference, and there is no reason to assume that this is what Congress intended in enacting the first sentence of Section 254(d).

What the legislative history shows is that Congress, in adopting the first sentence of Section 254(d), wanted to make clear that the Commission could not exempt new entrants from contribution requirements in order to spur competition. So the drafters stated that "all telecommunications carriers, including competitive access providers," must contribute. S. Rep. 104-23, 104th Cong. 1st Sess. 27 (1995). Congress explained that that requirement "includes carriers that concentrate their marketing of services or network capacity to particular market segments, such as high volume business users." *Id.* But nothing in the statute or its legislative history evinces an intent by Congress to preclude the Commission from using connections to a

public network as the basis for contributions, or to require the creation of formalistic minimum assessments that could then be exempted under de minimis authority. And as CoSUS demonstrated both in its comments and above, that is the approach that best advances the goals of establishing “specific, predictable and sufficient mechanisms” funded on “an equitable and nondiscriminatory basis.”

In contrast to the literalist reading, the CoSUS proposal harmonizes each of the provisions in Section 254(d). It calls for contributions “on an equitable and nondiscriminatory basis” and establishes “specific, predictable and sufficient mechanisms” to support universal service. It requires “every telecommunications carrier that provides interstate telecommunications services” to contribute, unless its required equitable and nondiscriminatory contribution would be less than the Commission's de minimis threshold. It thus satisfies each requirement of the statutory text.

This harmonious interpretation of Section 254(d) reads the first sentence of section 254(d), in requiring “every telecommunications carrier” to “contribute, on an equitable and nondiscriminatory basis,” to prescribe a process, not a payment result. Under this interpretation, the first sentence of Section 254(d) requires each “carrier that provides interstate telecommunications services” to contribute the amount called for by formula established by the Commission’s rules. That formula -- in the case of the CoSUS proposal, its connection-based formula -- must be applied to every carrier, and it must provide for “equitable and nondiscriminatory” contributions that will create “specific, predictable, and sufficient mechanisms” to support universal service. In some circumstances – such as for carriers’ carriers that have no retail revenues under the current rules and for those few carriers that provide no connections under the CoSUS proposal – the equitable and nondiscriminatory formula called for in the Commission’s rules may result in no contribution assessment payment by a particular carrier. In other cases, the formula would result in a very small contribution being assessed. In that case, the second sentence of Section 254(d) comes into play, and the Commission can apply its de minimis authority to exempt that carrier from contribution. The Commission, under this interpretation, is allowed to treat carriers that would otherwise make very small contributions the same as carriers that would not be required to make contributions at all.

This harmonious interpretation ties together all the provisions of Section 254(d). Unlike the literalist interpretation, it recognizes that Congress granted the Commission substantial latitude in determining an appropriate contribution mechanism, as long as contributions were made on an equitable and nondiscriminatory basis. It reads the statute as a whole to lead to commonsense results.

In addition, Sections 254(b)(4) and (5), which set forth the basic principles governing universal service, support the CoSUS proposal. The first of those principles states that “All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.” The second states that “There should be specific, predictable, and sufficient Federal and state mechanisms to preserve and advance universal service.” Those principles show that it is of paramount importance for universal service contributions to be equitable and nondiscriminatory and result in the collection of revenue sufficient to support universal service. It is not of paramount importance that every

telecommunications carrier contribute, even if its contribution would be very small. No such principle is listed in Section 254(b) and the existence of the de minimis provision would preclude a reading of the statute that created such a principle.

Finally, it is important to note that nothing in Section 254(d) specifies which services or activities of a telecommunications carrier providing interstate service should be the basis for the equitable and nondiscriminatory contribution. It contains no direction, for example, that every interstate telecommunications service be subject to assessment. Indeed, if every interstate telecommunications service had to be subject to assessment, the Commission could never have exempted interstate access charges from contribution merely because those services are provided to carriers rather than to end users, as the current mechanism does. Thus, as long as the contribution mechanism is equitable and nondiscriminatory, there is no statutory requirement that long distance carriers contribute on the basis of the services they provide other than end user connections.

It is also important to note that the statute does not require the Commission to find that the long distance services offered by carriers that do not provide end user connections are themselves de minimis “activities” within the meaning of Section 254(d) in order for contributions by those carriers to be de minimis. Under the second sentence of Section 254(d) it is the “level of such carrier’s contribution” that must be de minimis. The Commission can assess those activities it chooses to assess, so long as the contribution mechanism is equitable and nondiscriminatory and results in a fund that is sufficient to sustain and advance universal service.

In sum, the argument that Section 254(d) requires every carrier to contribute to the fund “confuses ‘plain meaning’ with literalism.” *Bell Atlantic v. FCC*, 131 F.3d at 1045. As the D.C. Circuit has counseled, “The meaning of a statutory provision is its use in the context of the statute as a whole.” *Id.* That is particularly so where, as here, the Commission is “charged with understanding the relationship between two different provisions within the same statute.” *Id.* at 1047. In this case, as in *Bell Atlantic*, “at the level of literal language there exists a potential contradiction between the two provisions.” *Id.* at 1048. The Commission should not adopt a reading that puts the provisions at war with each other. It should instead adopt the CoSUS proposal.

II. Section 2(b).

Some commenters have argued that the CoSUS proposal is a de facto assessment on intrastate services or revenues, rather than an assessment on interstate revenues or services. This argument is both factually inaccurate and contrary to the D.C. Circuit’s decision in *NARUC v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984).

The D.C. Circuit in *NARUC* answered in the affirmative the question of whether the FCC can assess a flat rated charge that is not correlated with interstate usage on a connection capable of providing interstate service. In that case, petitioners had argued that Section 2(b) precluded the Commission from imposing flat-rate end user charges. As the Court noted, “Those charges, petitioners say, are in fact for intrastate, not interstate service. They must be paid to receive *any* telephone service; even subscribers who neither make nor receive interstate calls in the billing

period must pay.” *NARUC*, 737 F.2d at 1112. The Court squarely rejected these arguments, holding: “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 subscribers, of the portion of those costs that, in accordance with *Smith [v. Illinois Bell]* have been placed in the interstate jurisdiction.” *Id.*

The D.C. Circuit’s reasoning in *NARUC* applies equally to the CoSUS proposal. Nothing in Section 2(b) precludes the FCC from assessing, and permitting carriers to recover, universal service contributions based on connections capable of providing interstate service, regardless of whether the connection is actually used for interstate service.

The Fifth Circuit’s decision in *TOPUC I* does not require a contrary result. In *TOPUC I*, the Fifth Circuit held that Section 2(b) precluded the FCC from collecting contributions for its schools and libraries and rural healthcare support mechanisms from an assessment on intrastate telecommunications revenues, in addition to interstate telecommunications revenues. The assessment mechanism at issue in that case expressly assessed intrastate services, including vertical features and intrastate measured service or intrastate toll service. As the court observed, “There is no question that the amount of a carrier’s universal service contributions will increase with the inclusion of intrastate revenues.” *TOPUC I*, 183 F.3d at 447 n. 101. This led the court to be concerned that “allowing the FCC to assess contributions based on intrastate revenues could certainly affect carriers’ business decisions on how much intrastate service to provide or what kind it can afford to provide.” *Id.*

The CoSUS proposal is very different from the contribution mechanism that the Fifth Circuit found to violate Section 2(b). The CoSUS proposal does not vary federal USF contribution with the amount of intrastate revenue. An intrastate carrier could, for example, increase the price of local monthly subscription service, increase its measured service rates, increase intrastate toll rates, or increase vertical feature sales, all without increasing the amount of its universal service contribution.

The CoSUS proposal instead ties universal service contributions to the number of connections sold to end users that are capable of originating or terminating interstate or international telecommunications. Although this includes the lines used for local monthly service, the Commission and the courts have long recognized that these lines are capable of being used to send or receive interstate in addition to intrastate telecommunications. Even a user that does not have a presubscribed interexchange carrier can receive interstate calls over that line, as well as originate calls using dial around or calling card services. Thus, like the SLC, the CoSUS-proposed USF assessment is a charge on interstate, not intrastate, service.

III. Conclusion.

As demonstrated above, neither Section 254(d) nor Section 2(b) precludes adoption of the CoSUS proposal.