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

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


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## COMMENTS OF WORLDCOM, INC.

## I. INTRODUCTION AND SUMMARY

The events of the past year confirm that the Commission's continued reliance on a revenue-based universal service contribution mechanism presents a tremendous risk to the stability of universal service. As predicted, the contribution base continued to contract in 2002, and the projected demand for universal service funds expanded. The interim adjustments made by the FCC in its December 2002 *Order* do not address the fundamental flaws in the existing system. In particular, the interim rules: (1) continue to rely on interstate revenues, even in the face of a rapidly shrinking revenue base; (2) fail to adjust for the growing use of bundled or all-distance products; and (3) perpetuate the discriminatory effect of the wireless safe harbor. At best, the interim approach will buy the Commission a little time to implement an alternative mechanism that is sustainable. At worst, the contribution factor will continue to increase and it will exacerbate fund instability and customer confusion by causing large fluctuations in the contribution factor from quarter to quarter.

In order to put the universal service program back on a solid footing, the Commission should adopt the connections-based approach proposed by the Coalition for Sustainable Universal Service ("CoSUS"). The CoSUS approach fully complies with the statutory requirement that contributions be equitable and non-discriminatory and that the support mechanism be "specific, predictable and sufficient." The CoSUS proposal is also more efficient than alternative proposals. Because it can accommodate changing technological and marketing trends, the CoSUS proposal is competitively neutral and sustainable over time. The contribution mechanism also has the added benefits of being relatively simple to administer and difficult to avoid by carriers that otherwise may allocate revenues to a non-assessable category to reduce their contributions.

In contrast, SBC's and BellSouth's proposed alternative to "split the connection" suffers from substantial disadvantages. Among other shortcomings, it is likely to: (1) result in considerably more customer confusion and mis-billing; (2) dramatically increase the costs of implementing a change to the system; and (3) unfairly disadvantage one set of competitors (IXCs). The split-connection proposal is needlessly complicated and imposes unnecessary and duplicative transaction costs that will, in the end, be passed on to end-user customers. Because it offers no countervailing benefits, the Commission should reject the split-connection proposal.

In sum, a revenue-based system is inherently unstable and cannot improve the long-term viability of federal universal service support. To prevent the collapse of universal service, which has been central to U.S. telecommunications policy since its inception, it is imperative that the Commission act expeditiously to adopt the connections-based approach proposed by CoSUS, preferably by the end of this year so that a viable universal service collection mechanism can be implemented no later than January 2005. During this interim period, it is also necessary for the Commission to continue to consider the effect that its actions in other proceedings, such as the *Broadband Wireline Framework* proceeding, could have on the future sustainability of the universal service fund.

## II. DISCUSSION

### A. Any Revenue-Based Assessment Mechanism Is Flawed and Unsustainable.

As WorldCom and other carriers and users have shown, any revenue-based mechanism for the assessment of universal service contributions exhibits massive flaws and is inherently unstable. The Commission's recent interim tweaks to the assessment mechanism may buy the Commission a little time to adopt and implement a permanent mechanism, but the interim fixes do not address the underlying structural problem.

Consequently, in order to ensure the sustainability of its universal service programs, the Commission must act quickly to adopt an assessment mechanism that avoids reliance on revenues, such as the connections-based approach proposed by CoSUS.

In its recently released *Report and Order*, the Commission adopted two interim measures designed to maintain the near-term viability of universal service.[1] First, the Commission decided to base contribution assessments on projected collected end-user interstate and international telecommunications revenues, as opposed to historical gross-billed end-user revenues.[2] Second, the Commission raised the safe harbor for mobile wireless providers from 15% to 28.5% of telecommunications revenues.[3] At the urging of the wireless industry, the Commission also decided on reconsideration that a wireless carrier could alternately conduct a "traffic study" to estimate a company-specific interstate usage factor and use that factor in averaging its universal service expenses across all end users.[4]

Although the Commission indicated that these interim measures should improve the current contribution methodology, the Commission properly raised continuing concerns regarding the long-term viability of the universal service contribution system,

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1 *See Federal-State Joint Board on Universal Service*, Report and Order, 17 FCC Rcd 24952 (2002) ("*Report and Order*"). Unless otherwise indicated, all references are to materials filed in the docketed proceedings referenced in the *Report and Order*.

2 *Id.* ¶ 30. Use of the term "interstate" to describe the type of telecommunications revenues that are assessable for USF purposes should be read throughout these comments to include international revenues.

3 *Id.* ¶¶ 21-25, 51 n.131.

4 *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order and Order on Reconsideration ¶¶ 7-8 (rel. Jan. 30, 2003) (FCC 03-20) ("*Order on Reconsideration*").

and sought comment on whether to retain a revenue-based approach.[5] As explained below, the interim measures adopted by the Commission do not address the fundamental flaws inherent in any revenue-based methodology. The combination of a declining assessment base and increased funding demands will result in ever-higher contribution factors, unless the Commission moves away from a revenue-based approach. The recent changes to the revenue-based mechanism merely postpone the day of reckoning, as Chairman Powell recognized:

> Make no mistake, during this interim period, the migration of traditional telecommunications services to digital platforms will continue to occur – and at a gathering speed. The resulting bundles of innovative telecommunications and information services will continue to stress our current revenues-based contribution system if we do not act.[6]

1. *The Interim Approach Is a Stop-gap Measure that Does Not Address the Fundamental Flaws Inherent in a Revenue-based Methodology.*

The Communications Act of 1934, as amended (the "Act"), sets forth the statutory mechanism for funding federal universal service support. In particular, Section 254(d) requires that carriers "contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[7] The FCC has further required that any USF

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5 *Federal-State Joint Board on Universal Service*, Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, ¶¶ 67, 69 (2002) ("*Second Notice*").

6 *Report and Order*, Separate Statement of Chairman Michael K. Powell, at 1; *see also id.*, Separate Statement of Commissioner Kathleen Q. Abernathy, at 1 ("it seems increasingly clear that any methodology that assess contributions based solely on revenues . . . is fundamentally incompatible with the direction of the communications industry").

7 47 U.S.C. § 254(d).

mechanism be "competitively neutral."[8] As demonstrated below, the newly adopted interim methodology perpetuates a revenue-based funding mechanism that is increasingly unstable and discriminatory, and thus fails to meet the requirements of the Act.

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

As WorldCom has previously explained, and as other commenters have confirmed, there is little doubt that the universal service contribution factor, currently set at 7.2805%, will continue to increase as a result of a shrinking USF assessment base and a growing fund size.[9] Indeed, the current factor would be even higher but for the fact that for the past three quarters, unused funds intended for the Schools and Libraries support mechanism have been applied to stabilize the universal service contribution factor.[10]

These rising contribution factors are due primarily to two key trends. First, as discussed below, the total size of the federal universal service fund continues to increase.

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8 *See Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, ¶¶ 46-47 (1997) ("*1997 Universal Service Order*"), *aff'd in part, rev'd in part, remanded in part sub nom., Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) ("*TOPUC I*"). 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. 47 U.S.C. § 254(b).

9 *See* Comments of the Coalition for Sustainable Universal Service at 18-23 ("Coalition Comments"); *id.*, Attachment 4, Declaration of Daniel Kelley & David Nugent ¶ 11 ("Kelley/Nugent Declaration") (estimating a contribution factor of 10 to 13% by 2006 based on a model submitted by Verizon). All references to comments and reply comments herein are to comments and reply comments filed on April 22 and May 13, 2002, respectively, in response to the *Further NPRM* in this proceeding. *See Federal-State Joint Board on Universal Service*, 17 FCC Rcd 3752 (2002) ("*Further NPRM*").

10 *See Proposed First Quarter 2003 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (Dec. 9, 2002) (DA 02-3387); *Proposed Fourth Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (Sept. 10, 2002) (DA 02-2221); *Wireline Competition Bureau Announces No Change In Third Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (June 13, 2002) (DA 02-1409).

Second, at the same time, the universal service assessment base – that is, total end-user interstate and international telecommunications revenues – is steadily declining because of changes in the structure of the telecommunications sector.[11] Specifically, the annual contribution base has dropped from $79.49 billion in 2000 to $72.97 billion in 2002.[12] During the same time period, the average annual (unadjusted) contribution factor has risen from 5.698% to 8.089%.[13] Neither of these trends is likely to reverse, and WorldCom anticipates that the contribution factor will continue to climb.

One of the primary causes of the shrinking contribution base is the dramatic decline in wireline interstate and international minutes of usage, and, hence, declining

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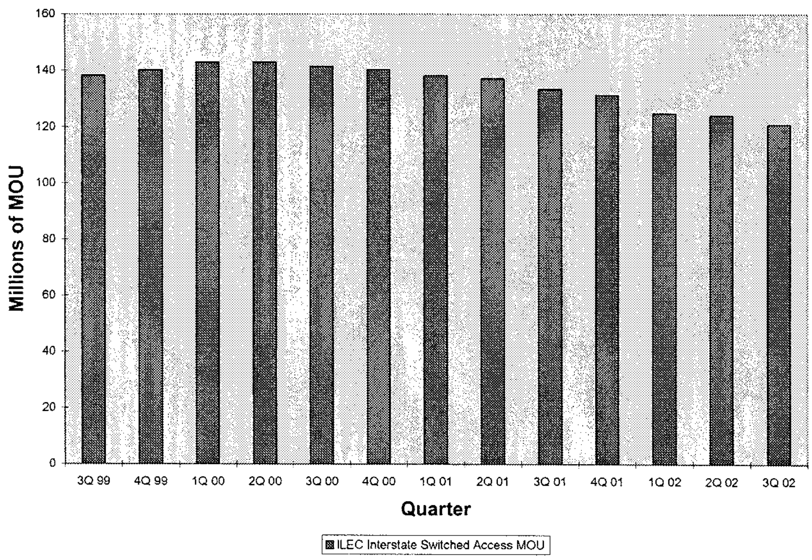
11 *See, e.g., Report and Order* ¶ 3 (growing use of bundled products and increased competition are contributing to a declining contribution base and rising contribution obligations).

12 *See Proposed Fourth Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (Sept. 10, 2002) (DA 02-2221); *Wireline Competition Bureau Announces No Change In Third Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (June 13, 2002) (DA 02-1409); *Proposed Second Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (March 8, 2002) (DA 02-562); *Proposed Fourth Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (Sept. 8, 2000) (DA 00-2065); *Proposed Third Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (June 9, 2000) (DA 00-1272); *Proposed Second Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (March 7, 2000) (DA 00-517); *Proposed First Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (Dec. 10, 1999) (DA 99-2780). The contribution base for First Quarter 2002 reported in the FCC's public notice ($20.246 billion) differs from the figure reported in the FCC's annual report on *Telecommunications Industry Revenues* ($19.801, or $20.001 adjusted for 1% uncollectibles) and thus appears suspect. *Compare Proposed First Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice (Dec. 7, 2001) (DA 01-2823), *with* FCC, *Telecommunications Industry Revenues 2000*, Table 14 (Jan. 2002), *available at:* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/telrev00.pdf> ("*Telecommunications Industry Revenues 2000*"). Accordingly, the above calculation uses the contribution base as reported in the annual report rather than the figure projected in the quarterly public notice.

13 *See supra* note 12.

long distance revenues.[14] Since the second quarter of 2000, incumbent LEC interstate switched access minutes of use ("MOUs"), the most significant measure of actual toll usage, have fallen continuously.[15]

**ILEC Interstate Switched Access MOUs**




*Sources*: *Trends 2002*; NECA, "December 2002 Supplemental Report of Access Minutes," *available at:* <http://www.necainfo.org/excel_files/MOURpt_122002.xls>.

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14 In 1999, interexchange carriers reported an average of $13.872 billion in end-user interstate and international telecommunications revenues per quarter. *See* FCC, *Telecommunications Industry Revenues 1999*, Table 8 (Sept. 2000), *available at:* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/telrev99.pdf> (potential universal service contribution base from interexchange carriers of $55.486 billion averaged over four quarters). 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. *See Telecommunications Industry Revenues 2000*, Table 14.

15 Kelley/Nugent Declaration ¶ 29 & Table 4. It is unlikely that CLEC-provided switched access MOUs offset this marked decline in wireline switched access minutes. *Id.* ¶ 29. FCC data show that, for as long as the FCC has been tracking interstate switched access MOUs, usage has never before declined for longer than a single quarter. FCC, *Trends in Telephone Service*, Table 11.3 (May 2002) ("*Trends 2002*"), *available at:* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend502.pdf>.

A substantial part of the decline in reported wireline long distance usage and revenues most likely reflects continued consumer substitution of email, instant messaging, Internet transactions (in lieu of toll-free calling), and – most of all – wireless long distance service for wireline long distance service.[16] As discussed in more detail below, substitution of a wireless carrier's long distance service for that of a wireline carrier reduces the USF contribution base because of the manner in which the wireless safe harbor operates.[17]

The need for such FCC action is all the more pressing against the backdrop of the *Broadband Wireline Framework* proceeding. In its *Second Notice*, the FCC deferred deciding whether and how connections that provide broadband Internet access would be assessed pending action in the *Broadband Wireline Framework* proceeding.[18] To date, digital subscriber line ("DSL") provided by the Bell Operating Companies ("BOCs") has

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16 *See* Sanford C. Bernstein & Co. LLC, "Global Telecom Services: Crossroads or Crisis?" at 11 (June 6, 2002) (predicting 50% rate of wireless substitution for long distance by 2006); *see also* J.P. Morgan, "Telecom Services: An Update on the Industry" at 19 (Oct. 2002) (anticipated relative price changes should add even more impetus for customers to switch from wireline to wireless between now and 2006); *id.* at 20-21 (wireless substitution for primary lines is expected to reach 9% by 2006, and substitution for additional lines could reach 40% by 2006); Peter DuJardin, "Local Telephone Giant Verizon Prevailed Last Week," *Daily Press*, at E1 (Nov. 17, 2002) (according to a report by the Yankee Group, traditional long distance revenues fell by 50% in 2001, with wireless usage accounting for half the decline; "Wireless usage will cause long-distance minutes to decline 10 percent a year over the next five years."); Shelley Emling, "The Bell Tolls for Long Distance," *Atlanta Journal & Constitution*, at 5F (June 28, 2002) ("according to Forrester Research, long-distance companies can expect to lose $3 billion in revenue by 2006 due to the ongoing shift to wireless. Local operators can expect to lose $8.8 billion.").

17 *See* discussion *infra* Section II.A.1.c; Kelley/Nugent Declaration ¶ 18.

18 *Second Notice* ¶ 76 (citing *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers*, 17 FCC Rcd 3019 (2002) ("*Broadband Wireline Framework Notice*")).

been classified as a telecommunications service. However, in the *Broadband Wireline Framework Notice*, the FCC reached a different conclusion by tentatively deciding that Internet access service, including DSL, is an "information service."[19] Under Section 254(d), only interstate telecommunications are assessable for universal service fund purposes. To the extent that DSL is classified as an information service, it no longer constitutes assessable telecommunications revenues for purposes of USF. The effects of such a decision would also have important implications for the future sustainability of USF.

In addition to a declining contribution base, recent Commission orders make it virtually certain that total universal service funding requirements will continue to increase, further driving up the contribution factor.[20] Moreover, the Commission is considering additional changes that could increase the federal universal service fund.[21] These rulemakings could all result in further increases in the amount of annual universal

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[19] *Broadband Wireline Framework Notice* ¶ 16. WorldCom strongly opposes any reclassification of DSL as anything other than a telecommunications service.

[20] *See, e.g.*, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 19613 (2001) (creating a new universal service support mechanism, Interstate Common Line Support ("ICLS")); USAC, "Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003," at 15 (Jan. 31, 2003) (projecting that funding for the ICLS mechanism will exceed $380 million in 2003); *Federal-State Joint Board on Universal Service*, 16 FCC Rcd 11244, ¶ 12 (2001) (adopting a modified five-year, high-cost loop support mechanism for rural carriers).

[21] *See, e.g.*, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking (rel. Feb. 25, 2003) (FCC 03-13) (seeking comment on whether the definition of supported services should be expanded to include other services); *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 2999 (2002) (reviewing the structure of the universal service support mechanism for non-rural carriers); *Rural Health Care Support Mechanism*, 17 FCC Rcd 806, ¶ 10 (2002) (seeking comments on ways to increase participation in the rural healthcare support mechanism).

service funding. This likelihood is confirmed by the President's Fiscal Year 2004 Budget, which projects that the federal universal service fund will exceed $7.1 billion annually by FY2008.[22]

b. The Interim Rules Do Not Address Bundling or All-Distance Products.

As the Commission has recognized, it is becoming increasingly difficult to identify interstate revenues as more and more end-user customers migrate to bundled packages of interstate and intrastate telecommunications and non-telecommunications products and services.[23] As bundles become more prevalent and as universal service contribution factors continue to rise, carriers have both an increased ability to characterize revenues in a way that minimizes their assessable contribution base, and an increased incentive to sell packages that avoid or reduce USF fees.[24]

As the record confirms, the provision of bundled local and long distance wireless and wireline services has grown significantly.[25] Virtually all of the major wireless providers now offer some form of a one-rate pricing plan that allows customers to purchase a bucket of minutes on a nationwide, or nearly nationwide, network without

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22 Office of Management & Budget, Executive Office of the President, "Budget of the United States Government," Fiscal Year 2004, Analytical Perspectives at 355 (2003) ("FY2004 Budget"), *available at*: <http://www.whitehouse.gov/omb/budget/fy2004/pdf/spec.pdf>. The budget predicts that universal service outlays will exceed $6.9 billion in FY2007, and $7.1 billion in FY2008. *Id.*

23 *Report and Order* ¶ 3.

24 *See id.*; *see also* Coalition Comments at 23-24. Carriers, of course, have other incentives to offer bundled products, such as decreased churn. *See* Michelle L. Hankins, "Carriers Struggle to Control Churn," *Billing World & OSS Today* (Jan. 2003).

25 *Further NPRM* ¶ 12.

incurring roaming or long distance charges.[26] Analysts report that a significant portion of customers now make most of their long distance calls using wireless services.[27] By year end 2000, approximately 20 million wireless customers subscribed to calling plans that allow them to make long distance calls without additional charges, and it has been estimated that this number will grow to 90 million by 2005.[28] Similarly, wireline carriers are increasingly bundling long distance with local and other services to compete for larger business and mass market customers.[29]

Under the Commission's bundling "safe harbors," a carrier is permitted to allocate 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.[30] However, there are often multiple stand-alone rates that

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26 *Id.*; *see also Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, 17 FCC Rcd 12985, at 34 (2002) (many wireless calling plans include free nationwide long distance).

27 *Further NPRM* ¶ 11.

28 *Id.* ¶ 12; Andrew Backover, "AT&T Loss Reflects Long-Distance Shift; Consumers Turn to Calling Cards, Wireless," *USA Today*, at 3B (Jan. 30, 2001).

29 This phenomenon has accelerated as the BOCs have gained Section 271 relief. *See* Press Release, "Verizon Now Third Largest Long-Distance Company" (Jan. 7, 2003), *available at:* <http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=78494> (offering packages of various combinations of services that usually start with a bundle of local and long distance calling services); *see also* Press Release, "Qwest Announces Competitive Long-Distance Plans for Customers in Eight States" (Jan. 7, 2003), *available at:* <http://www.qwest.com/about/media/pressroom/1,1720,1165_archive,00.html> (discussing Qwest's bundling plans after grant of Section 271 authority for eight states); The Neighborhood, built by MCI (2002), *available at:* <http://www.theneighborhood.com/res_local_service/jsps/default.jsp> (discussing MCI's The Neighborhood plan, which offers unlimited long distance and unlimited local calling for a single monthly rate).

30 *See Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 16 FCC Rcd 7418, ¶ 50 & n.152 (2001).

could serve as potentially appropriate points of reference for the bundled service, and determining which of these offerings is the most appropriate analogue necessarily involves a fair amount of carrier discretion. Consequently, carriers, together with their end-user customers, have both the incentive and the ability to characterize revenues in a way that minimizes the USF contribution.

As the practice of bundling accelerates, and as carriers characterize smaller portions of their bundled services as "interstate and international telecommunications," the decline in the universal service assessment base will also 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 to interstate and international telecommunications. The interim mechanism does not address the downward pressure on the contribution base caused by the prevalence of bundled offerings.

c. Adjustment of the Wireless Safe Harbor Has Not Rectified the Discrimination in Favor of Wireless Carriers.

The safe harbor has for some years unfairly shifted the burden of funding the universal service system from wireless to wireline carriers.[31] In its *Report and Order*, the Commission increased the interim safe harbor for wireless carriers from 15% to 28.5%.[32] In other words, the Commission concluded that wireless carriers unable to identify their interstate telecommunications revenues would be permitted to assume that 28.5% of their revenues are interstate and apply a USF surcharge on that interstate portion of the bill.

[31] Coalition Comments at 31-34.

[32] *Report and Order* ¶¶ 21-25, 51 n.131.

Moreover, as noted, the Commission's *Order on Reconsideration* permits wireless carriers to conduct "traffic studies" to estimate their percentage of interstate revenues.[33] While the increased safe harbor is a step in the right direction, the current contribution mechanism continues to unfairly favor wireless carriers because: (1) the safe harbor continues to understate wireless interstate revenues; and (2) the Commission's *Order on Reconsideration* decreases the likelihood that wireless carriers will be subject to the new, increased safe harbor because many wireless carriers will instead rely on a company-specific "traffic study" to claim an interstate percentage that is lower than the safe harbor.

In raising the wireless safe harbor to 28.5%, the Commission relied on a CTIA survey in which "[f]ive unnamed large national mobile wireless providers reported interstate minutes of use that range from 19.6 percent to 28.5 percent, while one niche provider, TracFone, reported interstate usage of 10 percent."[34] Most participants in the CTIA survey utilized minutes of use as a proxy for revenues.[35] Based on these meager survey results, the Commission decided to set the safe harbor "at the high end of the range of estimates . . . [in order to] provide mobile wireless providers an incentive to report their actual interstate telecommunications revenues if they are able to do so."[36]

Yet, as the record in this proceeding demonstrates, it is likely that 28.5% does not represent the high end of the range of wireless interstate revenues. As noted above, the Commission has acknowledged that the increasing availability of all-distance plans has

33 *Order on Reconsideration* ¶¶ 7-8.

34 *Report and Order* ¶ 22.

35 *Id.*

36 *Id.*

compounded the difficulty of identifying interstate revenues generated by wireless customers. In the face of such difficulties in the past, the Commission relied on data gathered from wireline carriers as a reasonable proxy for wireless interstate revenues because those data are readily available, publicly reported, and auditable.[37] Using USAC revenue data (which captures both the usage- and non-usage-based end-user telecommunications charges), the percentage of interstate revenues for wireline carriers is approximately 40%,[38] as summarized below:

**(end-user revenues, in 000s)**[39]

| | Total Revenues | Interstate +Int'l. | % Interstate + Int'l. |
|---|---|---|---|
| ILEC | 82,646 | 15,307 | |
| CLEC | 8,261 | 2,283 | |
| Toll Carriers | 74,878 | 51,095 | |
| Total Wireline | 165,785 | 68,685 | **41.43%** |

Consequently, the new safe harbor of 28.5% continues to understate wireless interstate revenues significantly. This results in a mechanism that discriminates in favor

37 As long as the USF contribution is based on interstate revenues, it is more appropriate to use the percentage of interstate wireline revenues, rather than interstate wireline traffic, as a proxy for interstate wireless revenues. Using traffic instead of revenues would, among other things, ignore the contribution wireline carriers make on subscriber line charge revenues, and would thus not be competitively neutral. *See* "Alternative Connections-Based USF Contribution Methodology," attached to *Ex Parte* Letter from Jamie M. Tan, SBC, to Marlene Dortch, FCC (Nov. 5, 2002) (suggesting that the wireless safe harbor should produce "USF contributions equivalent to those assessed on switched wireline services").

38 *See Ex Parte* from John Nakahata, CoSUS, to William Maher, FCC, at 3 (Nov. 19, 2002).

39 *See Universal Service Monitoring Report*, Table 1.9 (Full Year 2001), at 1-35, filed in CC Docket No. 98-202 (Oct. 9, 2002) (interstate and international data taken from "Universal Service Contribution Base" column).

of wireless carriers and against the wireline carriers with whom they compete in the provision of long distance services. Moreover, this systemic discrimination will only worsen if, as is likely, wireless interstate traffic continues to grow as a percentage of total wireless traffic, and, as experts have predicted, wireless traffic increasingly substitutes for wireline traffic.[40]

The new wireless safe harbor, in combination with the FCC's requirement that USF surcharges on wireline bills may not exceed the contribution factor multiplied by interstate usage on each customer bill, results in an additional discriminatory effect. Wireless carriers that take advantage of the safe harbor are not required to calculate USF fees for each individual customer, whereas wireline carriers must calculate USF fees for individual customers.[41] The FCC's recent *Order on Reconsideration* further extends the competitive advantage to wireless providers that contribute based on a company-specific traffic study, rather than using the safe harbor.[42] Thus, all wireless carriers may calculate a company-specific interstate usage factor and then use that factor as a line-item amount that effectively averages their USF fees across all end users. Wireline carriers, by contrast, must undertake the more arduous and costly task of computing their USF fees based on each individual customer's interstate usage in a given month. In addition, high-volume interstate users may be more inclined to select a wireless carrier over a wireline carrier to make long distance calls, since they will incur an averaged USF charge rather

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40 *See supra* note 16.

41 *See Report and Order* ¶ 51 n.131.

42 *Order on Reconsideration* ¶ 8.

than one specific to their higher usage. This disparity would disappear under the connections-based approach proposed by CoSUS.

2. *Use of Projected Revenues May Reduce the Predictability of the Fund.*

In addition to perpetuating the shortcomings inherent in a revenue-based assessment methodology, the interim mechanism creates new problems of its own. For example, the requirement that a carrier provide projected as well as historical revenues on the Form 499-Q is more expensive and administratively burdensome to implement than the prior system. Moreover, the mechanism may well result in considerable swings in the contribution factor, thus reducing the predictability of the universal service fund. These problems would be minimized or vanish altogether under the connections-based approach proposed by CoSUS.

Although the Commission discounts the burdens of projecting revenues,[43] the complexity of forecasting revenues for purposes of USF is considerable. Carriers may under- or over-forecast, simply because they are not used to projecting interstate revenues for purposes of USF. It may well take carriers several years to develop methodologies that accurately forecast quarterly interstate revenues for purposes of USF, thus contributing to volatile contribution factors.

Because inaccurate forecasts are inevitable, the contribution factor is likely to be considerably more volatile under the interim approach than under the previous historical

43 *See Second Notice* ¶ 33. The FCC also attempts to alleviate any concerns about submitting confidential company-specific revenue projections by noting that contributors may seek confidential treatment of those projections. *See id.* Even so, there is a risk that company-specific data may be released to third parties (either inadvertently or through the FOIA process). This is yet another reason that a connections-based mechanism is preferable to the interim approach.

revenues mechanism. This volatility will manifest itself in all quarters, but is likely to yield significant swings in the third quarter, because that is the quarter during which carriers true up their payments to USAC – paying additional funds for under-forecasting for the previous year and receiving refunds for amounts overpaid during the previous year.

### B. The CoSUS Proposal Is Equitable, Non-Discriminatory, and the Most Efficient Connections-Based Solution.

In the *Second Notice*, the Commission sought comment on a connections-based USF methodology that largely tracks the approach proposed last year by CoSUS.[44] As the record in this proceeding demonstrates, the CoSUS proposal meets all statutory requirements, and will provide the best means of ensuring the continued preservation and advancement of universal service. In stark contrast to any revenue-based system, the CoSUS proposal is consistent with the statutory requirement that contributions be equitable, non-discriminatory, and competitively neutral, and the Commission's determination that the support mechanism be "specific, predictable and sufficient."[45] Moreover, the connections-based contribution mechanism proposed by CoSUS is more efficient than alternative proposals; it is adaptable to changes in the marketplace and thus is sustainable over time; and it is relatively simple to administer. Consumers will also benefit under the CoSUS proposal because a connections-based approach will better

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44 The FCC proposed a handful of modifications to the CoSUS proposal, which are discussed in more detail below.

45 47 U.S.C. § 254(b)(4), (5); *1997 Universal Service Order* ¶¶ 46-49 (adopting the additional principle that federal support mechanisms should be competitively neutral, neither unfairly advantaging nor disadvantaging particular service providers or technologies).

ensure sufficient universal service funding without imposing inequitable burdens on any particular class of end user.

1. *A Connections-based Framework for USF Is Sustainable.*

In contrast with the interim projected revenue-based contribution system, a connections-based contribution mechanism will be sustainable. Connections, unlike revenues, are growing overall, and a connections-based assessment cannot be easily avoided by allocating interstate telecommunications a smaller portion of revenues for a bundle of services. A connections-based assessment is therefore sustainable, and meets the statutory directive that the universal service mechanism be "specific, predictable and sufficient."[46]

While end-user interstate and international telecommunications revenues are shrinking,[47] 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 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.[48] From December 1999 to June 2002, total mobile wireless subscribers grew from 79.7 million to 128.9 million, an increase of

46 47 U.S.C. § 254(d).

47 *See* discussion *supra* Section II.A.1.a.

48 FCC, *Local Telephone Competition: Status as of June 30, 2002*, Table 1 (Dec. 2002), *available at* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom1202.pdf>. Total switched access lines declined slightly during the first six months of 2002, to 189.1 million. *Id.* Given the substantial increases in wireless and special access lines during the same timeframe, it is likely that this decline results from substitution among different types of connections, rather than any shift in the overall growth trend for connections.

almost 62%.[49] Special access lines also increased dramatically, growing from 35.9 million at the end of 1998 to nearly 86 million at the end of 2001.[50]

Because the number of interstate connections is growing, rather than shrinking, the amount of the per connection USF assessment rates will increase only if the rate of growth for the fund exceeds the rate of growth for connections. If, as the Administration's Fiscal Year 2004 Budget predicts, universal service funding increases from $5.1 billion in FY2002 to $7.1 billion in FY2008,[51] connections-based assessments will not increase if the total number of connections also grows by approximately 6% on average per year, well below recent growth rates. Consequently, the connections-based mechanism results in a much more stable assessment base than a revenue-based system.

As described above, another critical flaw of a revenue-based contribution mechanism is that it creates incentives for carriers and customers to minimize their universal service contributions, for example, by allocating more revenue within a bundled offering to services other than interstate telecommunications, or by shifting to providers, such as wireless or "pure play" international carriers, that are subject to a favorable "safe harbor" or exemption.

In contrast, an interstate connections-based assessment is much more difficult to avoid. All telecommunications require the end user to have a connection to a network.

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49 *Id.*, Table 11.

50 FCC, *1998 Statistics of Common Carriers*, Table 2.5, *available at*: <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/SOCC/98SOCC.PDF>; FCC, *2001/2002 Statistics of Common Carriers*, Table 2.4 ("*2001/2002 SOCC*"), *available at* <http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/SOCC/01socc.pdf>. The FCC has not yet released statistics for special access lines as of December 31, 2002.

51 FY2004 Budget at 355.

That connection can be wireless or wireline, circuit-switched, packet-switched, or dedicated, but there still must be a connection to a network. Further, 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.[52] Accordingly, a connections-based mechanism cannot be easily avoided, and it is adaptable to changes in industry structure and technology.

### 2. *The Coalition's Proposed Connections-based Assessments Are Non-discriminatory.*

One of the principal advantages of the Coalition's proposed connections-based approach is that it operates in a neutral fashion and avoids the distortions produced by a revenue-based mechanism. A connections-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. In addition, since an end-user customer could not evade the universal service surcharge by changing its carrier, no carrier would be placed at a competitive disadvantage under a connections-based approach.

The Coalition proposal would also address the discriminatory impact of the current revenue-based approach, which results in consumers being assessed higher USF fees if they use wireline than if they use wireless carriers. Under the Coalition proposal,

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[52] *See* 47 C.F.R. § 36.154(a) (treating a special access or private line as interstate if interstate traffic constitutes more than 10% of the total traffic on the line). An intrastate private line similarly would not be assessable under the current mechanism.

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 PCS-based connection and interstate long distance service to the same customer. Residential wireless substitution for long distance service would no longer result in a lower USF contribution.

3. *A Connections-based Contribution Mechanism Is More Efficient Than Alternative Proposals and Minimizes Deadweight Economic Loss.*

There can be no disputing that a connections-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 original 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 traffic-sensitive basis.[53] 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.

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 the BOCs, 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*

53 Comments of the Ad Hoc Telecommunications Users Committee at 7.

*additional* efficiency loss of $1.25 billion.[54] In 2000, long distance carriers paid approximately $3.2 billion in contributions that they then collected from their subscribers.[55] 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 local service charges. They estimated that a $1 increase in local service charges will cause an additional efficiency loss of only $0.0006.[56] As a result, assessing the USF charge on local service would result in an additional efficiency loss of $600,000 for every $1 billion in USF subsidies – a negligible loss in comparison to the estimated loss ($1.25 billion per $1 billion in subsidies) for collecting universal service through long distance rates. There is no question that assessing universal service contributions based on end-user connections to the public network will be more economically efficient.

4. *Based on Available Information, the CoSUS Proposal Results in Lower USF Fees for Residential Customers, On Average, Than Other Proposed Alternatives.*

In the *Second Notice*, the Commission asked commenters to submit data and analysis on the assessment levels under each alternative universal service mechanism. In

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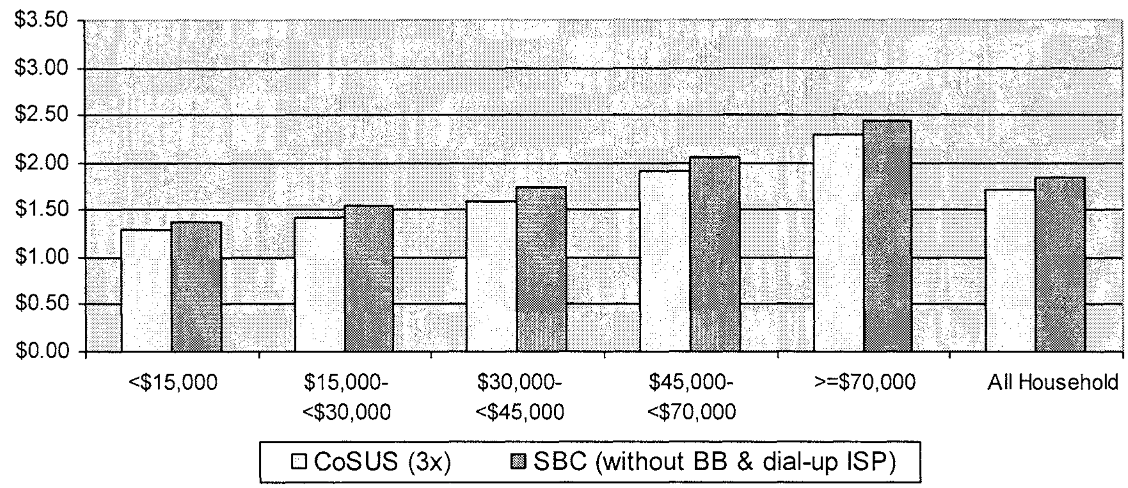
54 Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. REG. 19, 43 (1999) ("*Hausman/Shelanski*"). The average efficiency loss, as opposed to the marginal efficiency loss, was approximately $650 million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

55 According to FCC statistics, toll carriers had a potential universal service contribution assessment base of $56.586 billion in 2000, or approximately 70% of the total assessment base. *Telecommunications Industry Revenue 2000,* Table 8. The USF contribution factor averaged 5.698% during 2000. Thus, the long distance carriers paid approximately $3.2 billion in universal service contributions in 2000.

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

particular, it asked whether "the typical residential customer [would] pay more, less, or approximately the same amount" of USF fees as the customer would today.[57] As the Coalition has demonstrated, at every income level, the average residential USF assessment will be less under the Coalition's proposal than under the prior historical revenues mechanism.[58] Indeed, in the lowest income group (households with income below $15,000 per year), the average household will likewise pay $0.40 *less* for its primary residential line.[59] The following chart compares the relative effects of the CoSUS and SBC/BellSouth proposed mechanisms on residential households by income level:

**Projected USF Fees by Household Income Range**




57 *Second Notice* ¶ 73.

58 *See* Coalition Comments, Attachment 2, Declaration of Martha Behrend ¶ 4(a) ("Behrend Declaration"). CoSUS modified its original proposal to cap the ratio of business to residential consumer USF fees at 3:1, which would result in roughly a $1.10 fee per residential consumer (as compared to $1.00 under the original proposal). Although the Behrend Declaration is based on the original CoSUS proposal, its analysis coincidentally includes a $0.10 mark-up, which effectively equals the approximately $1.10 fee called for under the modified CoSUS proposal.

59 *Id.* ¶¶ 4(b), 11(b). In addition, under the Coalition proposal, USF fees for Lifeline customers would be wholly eliminated.

As the chart demonstrates, for residential households, the CoSUS proposal results in a lower USF fee on average across all income levels.[60]

5. *The CoSUS Proposal is Lawful.*

In the *Second Notice*, the Commission sought comment on arguments that Sections 254(d) and 2(b) of the Act bar the Commission from adopting the universal service contribution reform proposal offered by CoSUS.[61] As demonstrated below, when read as a whole, Section 254(d) confirms that "every" telecommunications carrier must be subject to the "equitable and non-discriminatory" and "specific, predictable and sufficient" *formula* that the Commission develops for universal service contribution. It does not require that every carrier contribute. This interpretation is not only consistent with the legislative history, but it also harmonizes the first sentence of Section 254(d) with the second sentence, which grants the Commission the authority to exempt carriers whose contributions would be *de minimis*. In addition, as the Coalition has explained, any argument that the CoSUS proposal improperly assesses intrastate services or revenues in violation of Section 2(b) 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).

a. The CoSUS Proposal Fully Meets the Requirements of Section 254.

The first sentence of Section 254(d) requires that "[e]very telecommunications carrier that provides interstate telecommunications shall contribute, on an equitable and

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60 At this point, WorldCom lacks sufficient data to model the effects of either the interim mechanism or the numbers-based proposal. In addition, the details of the numbers-based approach have not yet been developed in the record. As a result, WorldCom is currently unable to either support or oppose such a mechanism.

61 *See Second Notice* ¶¶ 71, 96.

nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service," while the second sentence allows the Commission to "exempt a carrier or class of carriers from this requirement . . . [if] the level of such carrier's contribution . . . would be de minimis."[62] Based on the first sentence of the statute, some commenters have argued 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. That argument, however, "confuses 'plain meaning' with literalism."[63] Words in a statute must be construed in light of their context,[64] and interpreted so as not to render other statutory terms superfluous.[65] 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.*, "where 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*."[66] Clearly, Congress envisioned that some carriers providing interstate telecommunications would not contribute to the federal universal service fund.

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62 47 U.S.C. § 254(d).

63 *Bell Atlantic v. FCC,* 131 F.3d 1044, 1045 (D.C. Cir. 1997).

64 *See, e.g., Tyler v. Cain,* 121 S. Ct. 2478, 2482 (2001).

65 *Circuit City v. Adams,* 121 S. Ct. 1302, 1308 (2001).

66 1996 Act Conference Report, H. R. Rep. No. 104-458, at 131 (1996) ("1996 Act Conf. Report") (emphasis added).

Regardless, some commenters have argued 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. 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 contribution assessment, payment of which could then be subject to the *de minimis* exemption in the second sentence of Section 254(d).

This interpretation, however, is inconsistent with the Commission's implementation of Section 254(d) to date. Under the current contribution rules, a Commission-prescribed formula (based on the ratio of USF funding requirements to total projected collected end-user interstate revenues) applies to all telecommunications carriers providing interstate service, and all carriers pay the resulting amount, unless their contribution is *de minimis*.[67] However, the current rules do not require a carrier's carrier to contribute, even though it provides interstate telecommunications services, because its services are provided to carriers rather than end users. As a result, the Commission's past implementation confirms that Section 254(d) cannot be read to require that "every carrier" contribute unless exempt under the *de minimis* exception.

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67 According to the literalist interpretation, it is of course permissible for a carrier that would otherwise have to contribute under the first sentence of Section 254(d) to be exempted from paying under the second sentence's *de minimis* exception.

Moreover, to the extent that the statute is ambiguous, Section 254(d) should be read in the context of its legislative history. Section 254(d) was enacted at a time when universal service was funded through implicit subsidies. Congress, in adopting the first sentence of Section 254(d), wanted to make clear that the Commission could not exempt new entrants from the Act's contribution requirements in order to spur competition. So the drafters stated that "all telecommunications carriers, including competitive access providers," must contribute.[68] This requirement "includes carriers that concentrate their marketing of services or network capacity to particular market segments, such as high volume business users."[69]

The legislative history further confirms that Congress vested in the Commission the authority to prescribe a contribution formula that would apply to "every carrier," even though that formula might not result in a contribution from "every carrier." In particular, the Conference Report explained that Congress envisioned that there would be a "formula for contributions selected by the Commission."[70] 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.[71] Congress also adopted the last sentence of Section 254(d), which allows the Commission to require other providers of telecommunications that are not

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68 1996 Act Senate Report, S. Rep. No. 104-23, at 27 (1995) ("1996 Act Senate Report").

69 *Id.*

70 1996 Act Conf. Report at 131.

71 *Id.*

telecommunications carriers to be subject to the Commission's contribution formula.[72] 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.

In light of the legislative history and the Commission's past implementation, the better reading of Section 254(d) is that the first sentence of Section 254(d) prescribes 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 the formula established by the Commission's rules. That formula – in the case of the CoSUS proposal, a connections-based formula – must be applied to every carrier, and it must provide for "equitable and non-discriminatory" 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 non-discriminatory 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

[72] 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.").

into play, and the Commission can apply its *de minimis* authority to exempt that carrier from contribution.

b. Interstate Connections-based Assessments Do Not Violate Section 2(b).

Some commenters in the past have also argued that the CoSUS proposal is a *de facto* assessment on intrastate services or revenues, rather than an assessment on interstate revenues or services.[73] This argument is both factually inaccurate and contrary to the D.C. Circuit's decision in *NARUC* v. *FCC*.[74]

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."[75] 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

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73 *See, e.g., Second Notice* ¶ 96 (noting claims that a connections-based approach would constitute an illegal assessment on intrastate revenues under Section 2(b)).

74 737 F.2d 1095 (D.C. Cir. 1984) ("*NARUC*").

75 *Id.* at 1113.

telephone subscribers, of the portion of those costs that, in accordance with *Smith [v. Illinois Bell]* have been placed in the interstate jurisdiction."[76]

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 court 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 (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."[77] 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."[78]

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[76] *Id.* at 1113-1114.

[77] *TOPUC I,* 183 F.3d at 447 n. 101.

[78] *Id.*

The CoSUS proposal is very different from the contribution mechanism that the Fifth Circuit found to violate Section 2(b). Significantly, under the CoSUS proposal, the federal USF contribution does not vary with the amount of intrastate revenue. Instead, under the CoSUS proposal, the Commission assesses universal service contributions based on the number of connections provided 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, as well as intrastate, telecommunications. Even a user that does not have a presubscribed interexchange carrier can receive interstate calls over that line, and can originate calls using dial around or calling card services. Thus, like the subscriber line charge, the CoSUS-proposed USF assessment is a charge on interstate, not intrastate, service.

### C. The FCC's Variations on the CoSUS Proposal Are Unnecessary and, in Some Cases, Problematic.

In the *Second Notice*, the Commission sought comment on a connections-based USF methodology that largely tracked – with some modifications – the connections-based approach proposed last year by CoSUS.[79] In particular, the Commission sought comment on: (1) a minimum contribution obligation; (2) a restructured set of four tiers and multipliers governing connections-based assessments; and (3) a one-year, one-step transition plan. As explained below, WorldCom does not believe that these modifications are necessary. Moreover, in some cases, no rationale is provided for the proposed changes, and it is consequently difficult to conclude that they are reasonable.

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[79] *See Second Notice* ¶ 78.

1. *If the FCC Decides to Adopt a Minimum Contribution, It Should Ensure that It is Applied Equitably.*

In its *Second Notice*, the Commission sought comment on whether imposition of a minimum contribution obligation was required to ensure that a connections-based contribution methodology would be consistent with Section 254(d)'s requirement that "[e]very telecommunications carrier that provides interstate telecommunications services" contribute to USF.[80] As explained above, Section 254(d) of the Act does not preclude the Commission from adopting an equitable and non-discriminatory contribution formula that applies to all telecommunications carriers, even if that formula would result in some carriers making no contribution. The Act therefore does not compel the Commission to adopt an "alternative minimum contribution."

If the Commission concludes that a minimum contribution based on interstate revenues is in the public interest, however, it should ensure that any minimum contribution adheres to certain guiding principles. Foremost, to avoid running afoul of the Act's requirement that a contribution mechanism be equitable and non-discriminatory, any minimum contribution must be offset against the carrier's connections-based assessment. In addition, the minimum contribution should be neither regressive nor progressive. That is, it should not result in a carrier that has lower interstate end-user telecommunications revenues paying a disproportionately higher contribution than a carrier that has higher interstate end-user revenues. Nor should it result in a carrier with higher interstate end-user revenues paying disproportionately more

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[80] *See* 47 U.S.C. § 254(d); *Second Notice* ¶ 72.

than a carrier with lower interstate revenues.[81] To the extent that the Commission adheres to these principles, WorldCom does not object to imposition of an alternative minimum contribution.

2. *The CoSUS Tiers Are Reasonable and the Second Notice Fails to Provide a Rationale for Discarding Those Tiers in Favor of the FCC's Proposed Tiers.*

In the *Second Notice*, the FCC proposed a modified four-tier assessment scheme for multi-line business connections, in contrast to the three-tier assessment plan submitted by CoSUS. The Commission sought comment on its proposed scheme, and also invited commenters to project the Tier 1 rate under that methodology.[82] As discussed below, the record in this proceeding contains substantial data supporting the CoSUS tier levels and multipliers. In comparison, the *Second Notice* provides no data or facts supporting the FCC's proposal nor are the modified tiers necessary to ensure that residential customers are better off. Absent an explanation or countervailing benefit, the proposed tiers raise concerns about distortion of customers' purchasing decisions, and exacerbation of the already heavy burden on business users.

As CoSUS has demonstrated, the CoSUS plan, including the proposed capacity tiers, was carefully designed to ensure that residential customers on average would be better off, while minimizing the administrative burdens and complexity of a connections-based system and ensuring that the USF contribution charges do not distort customer

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[81] The proposed tier approach for minimum contributions would appear to be progressive, assessing a higher contribution on carriers with higher interstate end-user revenues than would be assessed on a carrier with lower interstate end-user revenues. *See Second Notice* ¶ 80.

[82] *Id.* ¶ 81.

choices.[83] Specifically, the Coalition proposed three capacity levels – Tier 1 for connections of less than 1.544 Mbps, Tier 2 for connections of 1.544 Mbps or greater but less than 45 Mbps, and Tier 3 for connections of 45 Mbps or greater. The charge for Tier 1 is the base rate; the Tier 2 charge is 5 times the Tier 1 rate; and the Tier 3 charge is 40 times the Tier 1 rate. These three tiers conform to the DS-0, DS-1, and DS-3 industry conventions, and are 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.[84] The 5:1 ratio also is consistent with the 5:1 ratio that the Commission has established between the PRI ISDN multi-line business PICC charges and switched multi-line business PICC charges, and also between the PRI ISDN multi-line business end-user common line charges ("EUCL") and switched multi-line business EUCL charges.[85] 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 incumbent LEC special access tariffs. By using this ratio, the "crossover" point is maintained, rather than distorted by the USF contribution assessment.

In contrast, the FCC's proposed four-tier system appears to exacerbate the already heavy burden placed on medium and large business end-user customers by shifting a substantial proportion of total USF fees to higher capacity connections.[86] Since

83 Coalition Comments at 56.

84 PRI ISDN facilities have a capacity of 1.544 Mbps.

85 47 C.F.R. §§ 69.152(1)(2); 69.153(d).

86 *See Second Notice* ¶ 82.

residential customers are already better off under the CoSUS plan with the CoSUS tiers (compared to the historical revenues mechanism), the adjustment to the tiers is unnecessary.[87] It is also likely to have significant downside in terms of burdening business customers and distorting purchasing decisions. To illustrate the magnitude of this shift, the following chart compares USF fees based on the proposed FCC and CoSUS tiers:

**USF Charges/Month ($)**

| Connections-based | Residential Connection | Multi-line Business Connection | DS-1 Connection | DS-3 Connection |
|---|---|---|---|---|
| CoSUS | 1.11 | 3.34 | 16.68 | 133.46 |
| CoSUS with FCC tiers | 0.85 | 2.54 | 40.71 | 569.93 |

A DS-1 connection under the FCC's tiers proposed in the *Second Notice*, for example, would be assessed a fee of $40.71 – almost 2½ times the fee assessed under the CoSUS proposal and 16 times the FCC's Tier 1 rate. It is likely that these greatly increased multipliers will distort customer decisions regarding the purchase of telecommunications services. Moreover, other than pointing to potential (unidentified) "inequitable burdens" on small business customers, the *Second Notice* provides no rationale for the proposed

[87] For the same reason, "freezing" the assessment rate for residential connections is also unnecessary. *See id.* ¶ 77 (suggesting that the charge for residential connections could be adjusted on an annual basis, while the charge for multi-line business connections could be adjusted quarterly). Such an approach would place all the risk of any significant increase in fund demands on multi-line business, special access, and private line customers, which could result in extremely inequitable end-user recovery burdens. In order to avoid these concerns, the Commission should adopt the more equitable approach proposed by CoSUS, in which the risk of future fund increases is borne proportionally by all classes of end users.

tier multipliers of 16 (Tier 2), 224 (Tier 3), and 336 (Tier 4).[88] Without an explanation for the FCC's proposed tiers, it is difficult to assess whether the proposed tiers actually achieve any benefit. In the absence of a defined rationale, the proposed tiers merely raise significant concerns about the distortion of business customers' behavior.

### 3. *WorldCom Prefers a Shorter Transition Period for Residential and Wireless Customers.*

The Commission sought comment on the propriety of a one-year transition period, during which time providers would have to modify their billing systems and the Administrator would compile date necessary to finalize the calculation of initial assessment rates.[89] As CoSUS has explained, it is possible to accelerate the transition to a connections-based framework by having a two-step process, with assessments on residential and wireless customers converted to a connections mechanism a few months after adoption of an order, followed by switched business, special access and private lines within twelve months of the order.[90] This remains WorldCom's preference, because it would begin to cure the problems of the current system as quickly as possible. However, the FCC's proposal gives carriers twelve months to develop the necessary systems before a connections-based assessment would be implemented, and WorldCom does not have significant objections to this timeframe.

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[88] *See id.* ¶ 82.

[89] *Id.* ¶¶ 77-78.

[90] *See generally* Coalition Comments, Attachment 1.

### D. The Proposal to Split the Connections-Based Contribution Between Connection and Transport Providers Is Discriminatory and Unworkable.

The *Second Notice* seeks comment on the benefits and drawbacks of a proposal similar to that proposed by SBC and BellSouth,[91] to split contribution obligations for each switched end-user connection between interstate access and transport providers.[92] As explained below, this proposal would prove both inefficient and discriminatory.

Under the SBC/BellSouth proposal, a residential consumer with only one telephone line would be billed by two different service providers for universal service recovery charges. Only if that consumer takes a local residential connection and interstate long distance from the same provider is it possible that the customer might receive a single bill covering all USF fees. As a result, except in the bundled local/long distance scenario, two carriers will separately incur costs for: (1) gathering the data necessary to compute the connection assessment due from that customer; (2) billing that customer a USF fee; and (3) collecting that fee.

Moreover, unlike the LEC who has immediate access to customer service records for local service, long distance carriers do not, in the ordinary course of business, have

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[91] Unlike the SBC/BellSouth proposal, the proposal set forth in the *Second Notice* does not directly assess ISPs. *See Second Notice* ¶ 87. As WorldCom has explained, it strongly disagrees with SBC's characterization of ISPs as providers of telecommunications. *See* WorldCom Reply Comments at 9. Internet service providers, like other end users, use telecommunications services. ISPs use telecommunications services to provide information services; ISPs do not provide telecommunications or telecommunications services. *See* Joint Comments of WorldCom, Inc., the Competitive Telecommunications Association and the Association for Local Telecommunications Services, CC Docket No. 02-33, at 60 (May 3, 2002). In any case, this issue is currently the subject of a separate proceeding.

[92] *Second Notice* ¶¶ 86-92.

access to certain customer-specific information necessary to implement the SBC/BellSouth proposal. Among other problems, long distance providers typically do not know whether a customer is a Lifeline subscriber, and they may not receive timely information about whether a customer has switched to another local or long distance carrier or has had dial tone disconnected.[93] Also, interstate transport providers must obtain from the connection provider information about the number and capacity of connections provided to a given customer. The connection provider is the sole source of such data for the vast majority of customer lines.[94] As a result, long distance carriers would have to acquire this information – likely at substantial expense – from the connection provider, usually the incumbent LEC.[95] Long distance carriers also would have to constantly update this information, especially because so many customers frequently switch long distance providers. Indeed, churn presents a much more significant administrative problem in the long distance market than in the local market.[96] The SBC/BellSouth proposal thus results in substantially greater administrative transaction costs than the CoSUS proposal. It also creates an artificial competitive

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93 Sometimes the long distance provider does not know the identity of the customer's local exchange carrier for purposes of submitting or requesting customer information. This problem is particularly acute where the connection provider is a new entrant, because many new entrants do not notify the IXC that a customer has switched local providers. *See* Petition for Rulemaking at 3, CG Docket No. 02-386, *Petition for Rulemaking to Implement Mandatory Minimum Customer Account Record Exchange Obligations on All Local and Interexchange Carriers* (Nov. 22, 2002) ("CARE Petition").

94 *See* Reply of the Coalition for Sustainable Universal Service, Attachment 2, Declaration of Alan Lentz & Mark Milota ¶ 6 ("Lentz/Milota Declaration").

95 *See id.*

96 Coalition Comments at 80.

advantage in favor of carriers that can provide the connection and the transport as a bundled package.

The SBC/BellSouth proposal suffers from problems similar to those experienced when the FCC adopted the Presubscribed Interexchange Carrier Charge ("PICC") in 1997.[97] To implement the PICC, incumbent LECs charged IXCs substantial amounts for accurate line count information, and these costs were recurring as periodic full database updates were needed.[98] Despite the high cost, moreover, the data received from incumbent LECs was often inaccurate, resulting in IXCs frequently mis-billing customers.[99] The resulting transaction costs were substantial in that they led to consumers paying PICC recovery fees that were 40% greater than the incumbent LEC PICC charges.[100]

Moreover, the PICC experience actually *understates* the extent to which the SBC/BellSouth proposal would be burdensome and unwieldy. PICCs were implemented only by the 13 price cap LECs – the nation's largest incumbent LECs with the most

97 *See generally Access Charge Reform,* 12 FCC Rcd 15982 (1997).

98 Lentz/Milota Declaration ¶ 10.

99 *Id.* ¶ 6.

100 Because of these problems, a mere three years after the PICC was put in place, the Commission reversed course, increased residential and single-line business subscriber line charges, eliminated the residential and single-line business PICC and set the multi-line business PICC on a downward path. *See Access Charge Reform*, 15 FCC Rcd 12962 (2000), *aff'd in part and rev'd in part on other grounds*, *Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied sub nom. National Ass'n of State Util. Consumer Advocates v. FCC*, 535 U.S. 986 (2002). 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. *Id.* ¶ 81.

sophisticated billing and information technology capabilities. The SBC/BellSouth proposal would require over 1300 other, much smaller, incumbent LECs to develop the capability to provide line-type data to IXCs each month.[101] These carriers already have difficulty providing IXCs with certain billing information;[102] requiring them to also provide customer information for universal service purposes would increase that burden. That would surely prove to be even more costly and more error-prone than was the case with respect to the price cap LEC PICCs.

The SBC/BellSouth proposal also suffers from numerous other drawbacks. For example, it does not account for very low- or zero-volume users that an IXC would not normally bill on a monthly basis.[103] In those cases, the long distance provider must either generate a monthly bill – thereby incurring an additional billing expense attributable solely to universal service assessments – or it must wait to bill that customer in a multi-month bill, creating customer confusion and the appearance of high line charges. In addition, the SBC/BellSouth proposal would likely drive more customers to non-presubscribed services in an attempt to avoid the USF charge associated with the transport provider.[104] To the extent that the providers of non-presubscribed services qualify for *de minimis* treatment under Section 254 or for other reasons do not contribute

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[101] *See* Lentz/Milota Declaration ¶ 5.

[102] *See* CARE Petition at 2-7.

[103] It does not make sense for an IXC to bill a zero usage customer because the cost of sending the bill would exceed the USF fee that would be collected under the SBC/BellSouth proposal (approximately 50 cents).

[104] WorldCom has noticed an increase in the number of customers moving towards non-presubscribed services. This trend will likely accelerate if customers can avoid a USF charge by terminating service with an IXC and instead use a non-presubscribed service, which they would be encouraged to do under SBC/BellSouth's proposal.

to USF, the SBC/BellSouth proposal would unfairly disadvantage carriers offering presubscribed services.

By requiring multiple providers to compute the appropriate contribution obligation for each end user, the SBC/BellSouth proposal would impose unnecessary and duplicative transaction costs on carriers, needlessly raise customer bills, and confuse customers by requiring them to decipher multiple bills for universal service recovery charges. The SBC/BellSouth proposal also discriminates in favor of LECs that provide bundled local and long distance service and suffers from various other infirmities.

The *Second Notice* also seeks comment on two alternatives to the SBC/BellSouth proposal, both of which "would assess wireline switched access and transport providers partly on a connection basis, and partly on a revenue basis."[105] These alternatives would combine the worst of both worlds: the long-term unsustainability of any revenue-based system with the inefficiency and inequity of any system that splits assessments between interstate transport and local service providers. The Commission should therefore unequivocally reject the SBC/BellSouth proposal.

105 *Second Notice* ¶ 92.

## III. CONCLUSION

WorldCom urges the Commission to act expeditiously to adopt the connections-based approach proposed by CoSUS, preferably by the end of this year so that a viable universal service collection mechanism can be implemented no later than January 2005.

Respectfully submitted,

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