

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

In the Matter of

Federal-State Joint Board on Universal Service

CC Docket No. 96-45

1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms

CC Docket No. 98-171

Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990

CC Docket No. 90-571

Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size

CC Docket No. 92-237
NSD File No. L-00-72

Number Resource Optimization

CC Docket No. 99-200

Telephone Number Portability

CC Docket No. 95-116

Truth-in-Billing Format

CC Docket No. 98-170

Comments of TracFone Wireless, Inc.

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SUMMARY

TracFone Wireless, Inc. (TracFone) supports the Commission's recent changes to the universal service contribution methodology. Before considering radical alterations to this revised contribution methodology, the Commission should examine whether it has a broken system for assessing universal service. The recent rule changes may completely address concerns regarding the adequacy of the Universal Service Fund. Even if the Commission finds that its new rules do not ensure the ongoing needs of the Universal Service Fund, TracFone urges the Commission to consider additional changes to the revenue-based contribution methodology, such as eliminating the wireless safe harbor and ensuring that broadband Internet access services, particularly Internet-based telephony services, contribute to the Universal Service Fund. Attached to TracFone's comments is a report prepared by Economists Incorporated which demonstrates that interstate telecommunications service revenues are not in a long-term downward spiral as some have alleged, and that inclusion of all providers of interstate telecommunications in universal service funding will result in there being more than sufficient funding for the universal service programs for the foreseeable future.

The three connection-based contribution methodologies proposed by the Commission are at odds with the requirements of the Communications Act. In addition, these proposals would not serve the public interest because they would be especially disadvantageous to lower income and lower volume consumers, and to the carriers like TracFone who serve those consumers. In addition, the three proposed connection-based methodologies would harm competition by increasing the contributions paid by carriers that serve low-volume customers and decreasing the contributions paid by the largest interexchange carriers. The large increases to TracFone's contributions place it at a particular competitive disadvantage because it does not impose universal service

contributions as a separate line item on every customer's bill. TracFone does not bill its customers on a monthly basis so if TracFone's universal service contributions increase significantly, then its rates will have to be increased. In light of all the flaws associated with a connection-based universal service contribution methodology, TracFone strongly opposes the suggestion that the Commission would extend a connection-based methodology to Telecommunications Relay Service, Numbering Administration, Local Number Portability, and wireline regulatory fee programs.

If the Commission disregards TracFone's arguments regarding the inappropriateness of a connection-based contribution methodology, then the Commission should recognize that prepaid wireless providers like TracFone would be uniquely harmed by such a methodology. In recognition of these unique circumstances, the Commission should establish a different contribution level for prepaid wireless carriers, such as \$0.18 per month for each activated handset that has interstate calling in that month.

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Truth-in-Billing Format

CC Docket No. 98-170

COMMENTS OF TRACFONE WIRELESS, INC.

TracFone Wireless, Inc. (TracFone), by counsel, hereby submits its comments in response to the Second Further Notice of Proposed Rulemaking released by the Commission on December 13, 2002, regarding the above-captioned proceeding.¹

¹ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 *et al.*, (Report and Order and Second Further Notice of Proposed Rulemaking), FCC 02-329, released Dec. 13,

I. INTRODUCTION

TracFone is a prepaid wireless provider. TracFone makes available to consumers, including lower income and lower volume consumers, commercial mobile radio services (CMRS). Such consumers have traditionally been underserved in the wireless telecommunications service market.² TracFone supports the continuation of a revenue-based universal service contribution methodology as being the most nondiscriminatory and most equitable manner to fund universal service. It opposes a connection-based methodology that would increase TracFone's contributions more than tenfold and would force TracFone to increase rates charged to customers, including those many consumers of its service who make few or no interstate calls. Because of the significant potential impact on TracFone's business model and customers, TracFone has participated extensively in this universal service contribution methodology proceeding. TracFone filed comments and reply comments in response to the *First Further Notice* in this proceeding.³ In addition, TracFone met on a number of occasions with Commission staff members and filed sub-

2002 (*Report and Order and Second Further Notice*), reconsidered in part, (*Order and Order on Reconsideration*), FCC 03-20, released Jan. 30, 2003.

² In these Comments, we use the terms "CMRS providers" and "mobile wireless providers" to refer to CMRS providers that offer mobile telephone services, but not other CMRS offerings such as paging services.

³ See TracFone Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002 (*TracFone Comments*); TracFone Reply Comments in CC Docket No. 96-45 *et al.*, filed May 13, 2002 (*TracFone Reply Comments*); see also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 *et al.*, (*Further Notice of Proposed Rulemaking and Report and Order*), FCC 02-43, released Feb. 26, 2002 (*First Further Notice*).

stantive *ex parte* presentations.⁴ These earlier filings provide extensive detail regarding TracFone's prepaid mobile wireless service.

Certain aspects of TracFone's prepaid mobile wireless service are especially relevant in the context of the Commission's consideration of changes to the universal service contribution methodology in this proceeding. TracFone's customers spend significantly less than the average mobile wireless customer. The average monthly revenue per user in the industry is approximately \$45.46⁵ while TracFone's average revenue per user is currently \$17.75 – about 61 percent below the industry average. In addition, approximately 13 percent of TracFone's customers have annual incomes of less than \$15,000 and approximately 25 percent of TracFone's customers have annual incomes under \$25,000.⁶ About 12 percent of TracFone's customers are over age 65. Also,

⁴ Letter from M. Brecher, Counsel for TracFone Wireless, Inc., to M. Dortch, Federal Communications Commission, filed Sept. 26, 2002 (*TracFone September 26 Ex Parte*); Letter from M. Brecher, Counsel for TracFone Wireless, Inc., to M. Dortch, Federal Communications Commission, filed Oct. 4, 2002 (*TracFone October 4 Ex Parte*); Letter from M. Brecher, Counsel for TracFone Wireless, Inc., to M. Dortch, Federal Communications Commission, filed Oct. 25, 2002 (*TracFone October 25 Ex Parte*); Letter from M. Brecher, Counsel for TracFone Wireless, Inc., to M. Dortch, Federal Communications Commission, filed Nov. 1, (*TracFone November 1 Ex Parte*); Letter from M. Brecher, Counsel for TracFone Wireless, Inc., to M. Dortch, Federal Communications Commission, filed Dec. 5, 2002 (*TracFone December 5 Ex Parte*).

⁵ This number was derived by using CTIA information for six-month revenues as of June 2002 divided by estimated subscribers and then divided by six. See <<<http://www.wow-com.com/industry/stats/surveys/>>>.

⁶ For 2001, the U.S. Census Bureau considers the poverty threshold for a family of four (with two children) to be \$17,960. See <<<http://www.census.gov/hhes/poverty/threshld/thresh01.html>>>. A standard measurement of low-income status is 150 percent of the poverty level. See *Public Notice, Federal-State Joint Board on Universal Service Seeks Comment on Review of Lifeline and Link-Up Service For All Low-Income Consumers*, CC Docket No. 96-45, FCC 01J-2, at 3 n.16, released Oct. 12, 2001. Thus, a family of four with an income of \$26,940 would be considered low-income. TracFone does not have enough information to determine the percentage

TracFone's customers make very few interstate calls. TracFone customers average between 4 and 5 minutes of interstate calling per month. Currently, approximately 10 percent of TracFone's revenues are associated with interstate calling.

Another key factor relating to TracFone's service is that TracFone generally does not bill its customers on a periodic basis. Instead customers purchase prepaid calling cards either from retail outlets or from TracFone's website as they are needed. Therefore, TracFone cannot add a separate universal service line item to its bill to recover its universal service contribution. For TracFone customers, the number of available prepaid minutes are tracked in each customer's handset, rather than a centralized database. TracFone's handset-based technology does not allow it to deduct a universal service contribution from a customer account. This means that any significant change to TracFone's universal service contribution would necessitate that TracFone raise its per-minute rates. In contrast, those "traditional" CMRS providers who bill for services in arrears will be able to "hide" these changes by excluding universal service charges from advertised rates and passing those increases on to their customers as a separate line item charge (*e.g.*, "Federal Universal Service Fee") which does not appear to be part of those providers' service rates.

TracFone strongly supports the concept of universal service for all Americans. It does so not only by contributing to the Universal Service Fund, but also by making CMRS services available to those consumers who often find more traditional CMRS offerings either too costly or unavailable. Many of TracFone's customers cannot meet credit requirements or security deposit

of its customers that would meet this low-income test, but it believes a substantial number of its customers have incomes below that level and would be considered low income.

demands of traditional CMRS carriers. TracFone service also is available to customers who are unwilling or unable to enter into long-term service contracts with substantial early termination charges required by many traditional CMRS providers. In addition, many TracFone customers cannot meet the minimum monthly charges to obtain even the lowest levels of service offered by traditional CMRS providers. Consistent with the universal service principle of ensuring that consumers in rural, insular, and high cost areas have access to telecommunications services that are offered at rates reasonably comparable to those charged in urban areas, TracFone offers service in over 99 percent of the nation's zip codes at the same rate nationwide. In rural areas this means that it sometimes charges rates to customers that are lower than the wholesale rates that TracFone pays to its underlying facilities-based carriers. For these reasons, TracFone thinks of itself as a universal service provider. Without prepaid service offerings, these consumers would not have mobile wireless services available to them. If companies like TracFone are forced to significantly increase prices because of a radical change in the universal service contribution methodology, service to these lower income and lower volume consumers will be reduced and the goal of universal service will be undermined.

II. BEFORE MAKING RADICAL CHANGES TO THE CONTRIBUTION METHODOLOGY, THE COMMISSION SHOULD FIRST ASSESS THE SUFFICIENCY OF RECENT CHANGES AND CONSIDER ADDITIONAL REVISIONS TO THE REVENUE-BASED METHODOLOGY

The *Report and Order*, which was released in the same document as the *Second Further Notice*, made important changes to the existing revenue-based contribution methodology. Those changes will not be implemented until February and April 2003. Specifically, the Commission raised the wireless safe harbor, changed assessments from past end-user billed revenues to projected collected revenues, and limited carrier recovery of a universal service line item to the ac-

tual contribution factor set by the Commission without any mark up.⁷ TracFone believes that these important changes are likely to address and alleviate the concerns that have been raised throughout this proceeding by certain proponents of alternative funding methodologies. Those commenters have asserted that the Universal Service Fund may not be adequately funded in the future because of alleged declines in interstate revenues, and that ever-increasing contribution factors will impose significant hardships on consumers, particularly residential customers. Rather than undertaking a radical reform of the revenue-based contribution methodology at this time, TracFone urges the Commission to allow these recently-adopted changes to take effect and then assess whether they address existing problems with the current methodology or whether additional modifications might be made to the revenue-based methodology before undertaking a radical change and moving to a connection-based methodology of doubtful lawfulness that will inevitably lead to protracted litigation and uncertainty.⁸

⁷ *Report and Order*, at paras 1-2.

⁸ Although the *Second Further Notice* implies that there may be widespread support for some type of connection-based contribution methodology, the record in this proceeding shows the existence of significant opposition to every connection-based methodology that has been discussed. A variety of commenters in addition to TracFone support the continuation of a revenue-based contribution methodology both on legal and on policy grounds. *See Second Further Notice*, at para. 4. Arch Wireless Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; California Public Utilities Commission Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; Concerned Paging Carriers Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; Consumers Union *et al.* Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; NASUCA Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; Time Warner Telecom *et al.* Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; Verizon Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; VoiceStream Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002; CTIA Reply Comments in CC Docket No. 96-45 *et al.*, filed May 14, 2002.

A. The Recent Changes to the Revenue-Based Contribution Methodology Should Be Given a Chance To Have an Impact on the Sufficiency of the Universal Service Fund

The *Report and Order's* changes to the revenue-based methodology address many of the inadequacies that have been associated with the current methodology. Specifically, the Commission has identified two reasons for concern that a revenue-based contribution methodology might not be viable in the long term. These are alleged declines in interstate revenues and an increase in bundled offerings.

Notwithstanding the assertions of certain proponents of abandonment of a revenue-based contribution methodology, there is no evidence of an overall decline in interstate revenues.⁹ There has been a decline in the interstate revenues of certain providers (primarily major wireline interexchange carriers) as interstate traffic has migrated from those providers to alternative providers, including, *e.g.*, CMRS providers and providers of Internet-based services.¹⁰ Before the Commission abandons the current methodology for assessing universal service contributions, it should take such steps as are necessary and appropriate to ensure that all entities to which interstate traffic and revenues have migrated are subject to universal service contributions based on those revenues.

Curiously, it has been suggested in the *Report and Order* and *Second Further Notice* that increased competition in long distance has led to lower rates and revenues. Therefore, the overall

⁹ Attached to these comments at Appendix A is a report prepared by Henry B. McFarland of Economists Incorporated and entitled "The Sufficiency of Interstate Revenues to Fund Universal Service" (EI Report). The EI Report describes data which contradict the assertion that interstate revenues are subject to a long-term declining trend. EI Report, at 1-3.

¹⁰ *Report and Order*, at para. 3.

assessable revenue base is decreasing.¹¹ There is no factual basis for concluding that competition has caused revenues to decline. Moreover, such an assertion is counterintuitive and disregards several decades of Commission competition policy. The Commission has long recognized that increased competition leads to lower prices, which in turn stimulates demand for services. Rather than decreasing revenues, the overall revenues typically increase with greater competition.¹² As explained in the EI Report, whether or not declining prices lead to a reduction in revenues depends on how much increased consumption results from the lower rates. This in turn depends on the elasticities of demand for the product or service. As noted in that report, the elasticity of demand for interexchange telephone service has been estimated at between .63 and .72. At such elasticity levels, price reductions will generally produce only modest revenue declines.¹³ In addition, there is evidence suggesting that a decrease in wireline interstate minutes, rather than a decrease in rates led to a decline in interstate revenues.¹⁴

While it may be true that the revenues of certain competitors have declined, it does not follow that competition has led to a decline in overall revenues. If interstate revenues are merely migrating from wireline long distance services to wireless or Internet-based services, the Com-

¹¹ *Report and Order*, at para. 3.

¹² See, e.g., *Telephone Number Portability*, CC Docket No. 95-116, (*Fourth Memorandum Opinion and Order on Reconsideration*), 14 FCC Rcd 16,459, at n. 47 (1999) (“Indeed, competition should foster lower local telephone prices and, consequently, stimulate demand for telecommunications services and increase economic growth.”); *International Settlement Rates*, IB Docket No. 96-261, (*Report and Order*), 12 FCC Rcd 19,806, at para. 149 (explaining that a decrease in international settlement rates should lower international calling prices and significantly stimulate traffic flows, which will result in increased revenues for carriers).

¹³ EI Report, at 4-5.

¹⁴ EI Report, at 5.

mission must ensure that all providers of interstate telecommunications services using these alternative technologies are required to contribute in an equitable and nondiscriminatory manner based on their interstate revenues. Raising the wireless safe harbor to a level that more closely approximates current interstate revenues of CMRS providers is a good start.¹⁵ Elimination of any arbitrarily set safe harbor in favor of actual interstate CMRS revenues would be a further improvement.¹⁶ Basing CMRS Universal Service Fund assessments on actual interstate revenues should be fully implemented before any further consideration is given to a connection-based contribution system and before any conclusions are reached about whether or not interstate revenues are in decline.

The migration of interstate minutes to mobile wireless networks has been addressed in the *Report and Order*. As TracFone has noted and as the Commission has acknowledged, the 15 percent safe harbor for mobile wireless carriers established by the Commission on an interim basis in 1998 no longer reflects a reasonable estimate of interstate revenues for mobile wireless carriers, and that mobile wireless carriers have reasonable methods for identifying and properly allocating interstate revenues. Indeed, TracFone submitted an *ex parte* filing quantifying a significant increase in contributions to the Universal Service Fund that would result from an increase to

¹⁵ The EI Report shows that recent declines in the universal service contribution base is largely due to the use of the 15 percent safe harbor to determine mobile wireless interstate revenues. Using estimates based on the new wireless safe harbor, the EI Report concludes that the decline in the universal service contribution base between 2001 and 2003 would have been only about 1 percent rather than 9 percent. EI Report, at 6-7.

¹⁶ The undercounting of revenue may become more serious with the continued growth of the mobile wireless industry. EI Report, at 7.

the wireless safe harbor.¹⁷ In the *Report and Order*, the Commission wisely raised the wireless safe harbor to 28.5 percent. Based upon the data that TracFone previously provided to the Commission and the attached EI Report, it is anticipated that the safe harbor increase will substantially raise the amount of universal service contributions paid by mobile wireless carriers and stabilize the Universal Service Fund.¹⁸

As discussed below, the Commission is currently considering the issue of whether Internet-based telephony services should contribute to the Universal Service Fund as well as whether providers of broadband Internet access via telecommunications should be required to contribute. These are important potential sources of universal service funding. Inclusion of all providers of telecommunications, including IP telephony services as well as broadband Internet access services, in the category of Universal Service Fund contributors has the potential to significantly expand the base of contributions and may obviate any need for abandonment of the revenue-based contribution methodology in favor of alternative methods that are of such questionable lawfulness. At a minimum, the Commission should allow these changes to go into effect and then assess whether the additional contributions to the fund are adequate to address current alleged shortfalls.

Second, the Commission describes the so-called “bundling” problem. As carriers begin to combine packages of local and long distance services, and possibly information services, as well

¹⁷ See *TracFone October 25 Ex Parte*. If the safe harbor were raised to only 25 percent, TracFone estimated an additional \$698 million in contributions to the fund in 2003, without any increase in the 7.2805 percent contribution factor.

¹⁸ EI Report, at 8-10. When the contribution base is adjusted to include the new wireless safe harbor, the EI Report estimates a contribution factor of 7.2 percent for the second quarter of 2003. *Id.*, at 9-10.

as customer premises equipment, it allegedly becomes more difficult to isolate interstate telecommunications service revenues that are subject to universal service contribution requirements. It has been suggested that bundling leads to increased opportunities for certain providers to mischaracterize revenues that should be counted for contribution purposes in order to minimize their Universal Service Fund contribution obligations.¹⁹ Again, TracFone believes that to the extent these concerns are valid, they can be addressed in the context of the current revenue-based contribution methodology. This proceeding thus far is a perfect example. In 1998, faced with stated concerns that mobile wireless carriers were not then able to separate the interstate from the intrastate portions of their bundled offerings, the Commission adopted an interim safe harbor for CMRS carriers to address difficulties in allocating interstate revenues.²⁰ During the course of this contribution methodology proceeding, it became clear that the fifteen percent interim safe harbor was no longer an appropriate estimate of mobile wireless interstate revenues and that wireless carriers are capable of submitting more accurate estimates of interstate revenues. Thus, the Commission raised the wireless safe harbor from 15 percent to 28.5 percent.

Although there has been discussion that a similar problem could develop as other types of bundled offerings become more prevalent, such discussion is extremely speculative at best. The record in this proceeding does not quantify the extent to which bundled offerings are achieving success in the marketplace. To the extent they exist, it has not been shown that these bundled offerings are having a significant negative impact on universal service contributions. The Commis-

¹⁹ *Report and Order*, at para. 3.

²⁰ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, (*Memorandum Opinion and Order and Further Notice of Proposed Rulemaking*), 13 FCC Rcd 21,252, at paras.10-13 (1998).

sion may have adequate safe harbors in place to address universal service contributions for wireline bundles. As the Commission acknowledged in the *Report and Order*, the Commission's rules already include safe harbors for reporting telecommunications revenues when telecommunications services are bundled with customer premises equipment or information services.²¹ Carriers may elect to report revenues from bundled telecommunications and equipment/enhanced service offerings based on the unbundled service offering prices, with no discount from the bundled offering being allocated to telecommunications services. Alternatively carriers may elect to treat all bundled revenues as telecommunications service revenue for purposes of determining their universal service obligations.²² There is no evidence that carriers are underreporting interstate revenues either relying on a safe harbor methodology or using a different methodology.

The suggestion that providers of bundled offerings might somehow misallocate revenues to non-interstate service portions of their bundles is unsupported and is contradicted by actual marketplace behavior. For example in the CMRS context, handsets and services are typically sold in bundled packages. The price of the handsets are advertised and sold below cost (sometimes they are even given away), but the costs are recovered over time in the service rates. Since handsets are not interstate telecommunications services, there are no universal service contribution obligations associated with the sale of the handset at a subsidized price. Under the logic suggested in the *Second Further Notice*, CMRS providers would do the opposite: they would charge inflated prices for the handsets which are bundled with interstate service so as to reduce their in-

²¹ *Report and Order*, at para. 12.

²² *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket Nos. 96-61 & 98-183, (*Report and Order*), 16 FCC Rcd 7418, at paras. 50-51 (2001).

terstate service revenues. Yet, that is not what has occurred or what is likely to occur in the future. It is marketplace realities that drive the pricing of wireless handsets and not the regulatory implications of universal service contributions. There is no reason why appropriate allocation methodologies and safe harbors cannot be developed and modified as necessary for current and future bundled offerings.

One additional aspect of the Commission's recently-adopted changes to the current contribution methodology should not be missed. The Commission's prohibition against carriers marking up universal service line item amounts above the relevant contribution factor should result in significant decreases in the amounts identified for universal service that are paid by consumers, particularly residential consumers. Thus, increases in the contribution factor (should they become necessary) are far less likely to lead to rate shock or customer concern. For example, a customer that currently pays a marked up 11 percent universal service fee on interstate charges would realize a 2 percent rate reduction in that fee even if the contribution factor were increased to 9 percent.²³

B. Additional Changes to the Revenue-Based Methodology Should Be Considered Before Considering a Connection-Based Methodology

Before the Commission undertakes a radical step of replacing a revenue-based contribution methodology in favor of a connection-based contribution methodology of questionable lawfulness, it should consider further refinements to the current system. First, the *Second Further Notice* itself sought additional comment on possible further changes to the wireless safe harbor. These further reforms should be carefully considered before any abandonment of a revenue-based

²³ *Report and Order*, at para. 46 & n. 124.

system is even contemplated. Second, although TracFone understands that the Commission intends to address the universal service obligations of providers of broadband Internet access in the context of a separate proceeding,²⁴ the Commission must recognize that those issues can have a significant impact on the long-term sustainability of a revenue-based system, and therefore must be addressed and resolved before the Commission considers a potentially unnecessary legally dubious change in contribution methodology. The Commission needs to resolve its treatment of broadband Internet access services, particularly providers of Voice over Internet Protocol (VoIP) technologies. As the Commission noted five years ago, so-called “phone-to-phone” IP telephony services possess many of same characteristics as telephony services delivered wholly over circuit switched networks.²⁵ Subjecting the latter to universal service funding obligations while exempting the former from those same obligations creates a pricing distortion which has no place in a competitive marketplace. Moreover, it results in depriving the Universal Service Fund and those who benefit from the fund of substantial and increasing contributions from those rapidly growing services.²⁶ If VoIP telecommunications service providers are required to contribute to the Uni-

²⁴ See *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers*, CC Docket No. 02-33, (*Notice of Proposed Rulemaking*), 17 FCC Rcd 3019, at paras. 65-83 (2002).

²⁵ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, (*Report to Congress*), 13 FCC Rcd 11,501 (1998).

²⁶ The Commission recognized both of these points in deciding to require both private service providers that offer interstate telecommunications to others for a fee and payphone aggregators to contribute to the Universal Service Fund. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, (*Report and Order*), 12 FCC Rcd 8776, para. 795 (1997) (*Universal Service Order*), as corrected by *Erratum*, FCC 97-157, released June 4, 1997, *aff'd in part, rev'd in part, remanded in part sub nom. Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999), *cert. denied*, 530 U.S. 1210, and *cert. denied*, 530 U.S. 1223, and *cert. granted*, 530 U.S. 1213, and *cert. dismissed*, 531 U.S. 975 (2000). The EI Report estimates over the past three

versal Service Fund (as are their circuit switched competitors), a significant amount of additional funding would be available.²⁷

The wireless safe harbor should be eliminated because it is no longer necessary. As explained by TracFone in previously-submitted *ex parte* comments, wireless carriers have the capability to identify interstate traffic and to allocate interstate revenues. Indeed, many CMRS providers' customer invoices routinely identify originating and terminating locations of calls, based upon cell site locations for calls that originate or terminate at wireless telephones. Although such identifications of location may not be 100 percent accurate (a small number of cell sites actually serve areas that cross state boundaries), it will provide a more precise estimate of interstate revenues than any safe harbor, which only discourages carriers with high interstate revenues from providing more accurate information and contributing their fair share of universal service contributions. Before the Commission radically alters the contribution methodology, it must consider that elimination of the safe harbor would address many of the concerns regarding the sustainability of the Universal Service Fund.

The Commission has also sought specific comment on how CMRS providers should determine their actual interstate end-user telecommunications revenues.²⁸ Minutes of use is an ap-

quarters revenues from cable modem and Internet telephone services have been growing faster than the Universal Service contribution base even though the overall revenues from these services are currently small compared to the size of the overall contribution base. EI Report, at 7-8.

²⁷ For example, for the first quarter of 2003, an additional \$276 million in revenues would be included in the contribution base if providers of VoIP telephony services are required to contribute to the Universal Service Fund. EI Report, at 8.

²⁸ *Second Further Notice*, at para. 68.

propriate proxy for determining interstate revenues. Interstate revenues would be calculated by taking the interstate minutes of use and dividing by the total minutes of use incurred by the customer during the relevant period (not the total minutes available in customers' packages) and then multiplying that ratio by the total collected revenues for the given time period. Because wireless carriers charge for incoming, as well as outgoing calls, incoming calls as well as outgoing calls should be included in traffic studies. The jurisdictional nature of the call should be determined at the start of the call and applied for the entire call.²⁹

TracFone has already suggested that the originating cell site and terminating area code or NPA be used to determine whether calls from mobile wireless customers to wireline telephones are interstate. This information is readily available to CMRS providers and often is included in customer invoices sent by those carriers. For calls that terminate on wireless handsets, TracFone has suggested that the location of the terminating cell site (if available) should be used to determine the jurisdictional nature of a call, or, alternatively, the location of the terminating wireless switch could be used if the cell site is unavailable.³⁰ In response to the request for comment on the inclusion of roaming minutes in traffic studies,³¹ TracFone's experience is that it receives from most of its underlying carriers enough information regarding customers who are roaming to

²⁹ Although this approach will not adjust interstate usage measurements in those occasional situations where a caller is changing jurisdictions during the course of the call, TracFone believes that such situations are rare and likely that the same percentage of calls will begin as interstate but change to intrastate during the course of the call as will begin as intrastate and change to interstate during the course of the call. Similarly, it is likely that the same number of calls will be picked up by a cell site across a border will be categorized as interstate and intrastate.

³⁰ *TracFone October 25 Ex Parte*.

³¹ *Second Further Notice*, at para. 68.

apply the same criteria that would be applied to non-roaming calls. Regarding the treatment of international minutes, universal service contributions should be assessed on revenues from international minutes because international revenues are assessed for other telecommunications providers, except when the percentage of interstate revenues is less than 12 percent of the combined interstate and international revenues.³² A mobile wireless carrier would have information if a customer makes an international call or makes a call while roaming internationally.³³

III. THE COMMISSION'S CONNECTION-BASED PROPOSALS ARE INCONSISTENT WITH THE REQUIREMENTS OF THE COMMUNICATIONS ACT AND WOULD NOT SERVE THE PUBLIC INTEREST

A. Each of the Three Proposed Connection-Based Methodologies Would Violate the Communications Act

Section 254(d) of the Communications Act requires that “[e]very 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.”³⁴ In comments and reply comments filed with respect to the *First Further Notice*, TracFone and other parties explained three aspects of the proposed connection-based methodology that would violate the requirements of the Communications Act. First, the connection-based methodology proposed in the *First Further Notice* would violate the requirement that *every* telecommunications carrier contribute to the fund because not every telecommunications carrier that provides interstate telecommunications service

³² 47 C.F.R. § 54.706(c).

³³ TracFone understands that at least some facilities-based carriers would also be capable of determining whether calls received by their customers are international calls.

³⁴ 47 U.S.C. § 254(d) (emphasis added).

and derives revenues therefrom provides subscribers with connections to the public switched network. Second, that proposed connection-based methodology would not be “equitable and nondiscriminatory,” *inter alia*, because it would have a disproportionately adverse impact on lower income and lower volume users of interstate services, as well as on those carriers whose services are directed toward those market segments. In addition, it would largely exempt or at least limit the contribution obligations of many of the largest providers of interstate telecommunications services for no reason other than that those providers do not directly connect their customers to networks. Third, that connection-based methodology would exceed the Commission’s jurisdiction because it would impose Federal universal service funding requirements on intrastate services.³⁵

The Commission’s latest connection-based proposals set forth in the *Second Further Notice* each address only one of the three statutory violations already discussed by commenters in this proceeding. Two of the proposals address the concern that every telecommunications carrier that provides interstate telecommunications must contribute to universal service. They do so by suggesting that those providers of interstate telecommunications services who do not provide network connections contribute nominal amounts based on their interstate revenues. The *Second Further Notice*, however, does not even attempt to explain why any of these proposals would not violate the equitable and nondiscriminatory requirement of Section 254(d). Also, only one of the three alternatives set forth in the *Second Further Notice* even purports to be responsive to the jurisdictional concern. It is ironic and internally inconsistent that in the *Report and Order* portion of the document, the Commission explains that it might be inequitable or discriminatory for mo-

³⁵ *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 446-48 (5th Cir. 1999).

bile wireless providers to contribute to universal service based on a safe harbor that does not correlate with their interstate revenues,³⁶ and then in the *Second Further Notice* portion of the same document it proposes connection-based methodologies that suffer from the infirmities that were just corrected. All three of the connection-based proposals in the *Second Further Notice* contain major statutory impediments and should not be adopted.

Under the first connection-based methodology proposal discussed in the *Second Further Notice*, a mandatory minimum revenue-based contribution obligation would be imposed on those carriers who do not themselves provide network connections. That proposal fails in several important ways to comply with the equitable and nondiscriminatory requirement of Section 254(d). Simply stated, it would not be equitable and nondiscriminatory for some carriers to pay flat connection-based contributions while other carriers pay a revenue-based contribution for the same interstate service. For example, a prepaid mobile wireless carrier like TracFone would pay a flat monthly fee (*e.g.*, \$1.00 per month) for each customer, irrespective of how much – or how little, if any – interstate service revenues were generated by that customer,³⁷ but a prepaid wireline long distance provider would contribute based only on interstate revenues received from its customers. If that prepaid wireline provider's customers made few or no interstate calls in a month, the universal service contribution would be far less than the \$1.00 per month for each customer that would be owed by the prepaid mobile wireless carrier whose customers made few or no interstate

³⁶ *Report and Order*, at para. 21.

³⁷ As discussed below, it appears that the exclusion of intrastate-only connections refers to connections where interstate calling is not possible.

calls in the same month. To the consumer, however, the long distance service is essentially the same.

Even more inequitable is the aspect of the proposal that would allow carriers that do not provide network connections for some customers to make revenue-based contributions only to the extent that those carriers do not also provide connections to different customers.³⁸ Large long distance providers such as WorldCom and AT&T would pay connection-based contributions only for their special access or local exchange subscribers. To the extent that these contributions exceed a certain threshold, the carriers would pay no revenue-based charges for interstate revenues that do not involve a connection such as presubscribed long distance service, collect calling, or calling card services, notwithstanding the fact that the overwhelming portion of those companies' interstate service revenues are derived from their non-connection-based services. A long-distance-only carrier that serves residential customers (and which therefore has no special access connections or competitive local exchange carrier operations), however, would pay a revenue-based charge for identical services to those provided by the largest carriers. The result would be that the larger, more diversified carriers would be able to offer lower long distance charges for exactly the same services because there would be no universal service charges added to the customers' bills.

This connection-based proposal also introduces a new inequity for TracFone and other telecommunications resellers by requiring for the first time that wholesale providers also contrib-

³⁸ *Second Further Notice*, at para. 78.

ute directly to the Universal Service Fund.³⁹ The *Second Further Notice* recognizes the problem it accurately describes as “double-counting” of revenues.⁴⁰ In other words, telecommunications wholesalers would charge resellers for universal service contributions that the wholesale provider owes. The costs of these contributions would be passed on to the end-user customers of the resellers but those end-user customers would also be charged a second universal service fee necessary to recover the costs of the contribution owed by the reseller. In the *Universal Service Order*, the Commission addressed this issue by assessing only end-user revenues. The Commission found that basing contributions on gross revenues would distort competition because it would disadvantage resellers. In addition, the Commission reasoned that although it was relieving wholesale carriers from the obligation to contribute directly to the universal service support mechanisms, “the end-user method does not exclude wholesale revenues from the contribution base of carriers that sell to end users because wholesale charges are built into retail rates.”⁴¹ This approach was not challenged in court, although numerous aspects of the *Universal Service Order* were appealed. The *Second Further Notice* offers no explanation as to why the minimum contribution requirement would be based on all interstate telecommunications revenues including wholesale revenues, rather than only on end-user telecommunications revenues, even though the Commission has acknowledged that imposition of universal service funding obligations on wholesale and

³⁹ Since the adoption of the *Universal Service Order*, universal service contributions have been based only on revenues derived from interstate services provided to end users.

⁴⁰ *Second Further Notice*, at para. 79.

⁴¹ *Universal Service Order*, at para. 846.

retail revenues would improperly increase the costs of service obtained from resellers and would therefore distort competition.⁴²

In addition, the connection-based methodology with mandatory minimum contribution obligation proposal would result in universal service contributions being based on intrastate services in violation of Section 2(b). Under that proposal, international-only and intrastate-only connections would be exempt.⁴³ It appears that a connection that is capable of being used to place an interstate call would be subject to a connection-based contribution requirement even if no interstate calls were made using that connection in any month. For TracFone's customers this would mean that a contribution would be due for each active customer, even though about 61 percent of its customers make no interstate calls in a given month. For those customers, a connection charge would require Federal Universal Service Fund contributions based solely on intrastate services in violation of Section 2(b) of the Communications Act.⁴⁴ With respect to whether or not Federal universal service charges are to be assessed on intrastate telecommunications services, there is no difference between a prepaid mobile wireless customer who makes no interstate calls in a month

⁴² Such a competition distorting mechanism hardly would conform with the Commission's determination that universal service funding mechanisms should be competitively neutral. In addition, this requirement that wholesale providers contribute to the Universal Service Fund raises questions regarding whether collection of universal service contributions from resellers would amount to an implicit subsidy in violation of Section 254(e). *See Texas Office of Public Utilities v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999), *on remand Federal-State Joint Board On Universal Service; Access Charge Reform*, CC Docket Nos. 96-45, 96-262 (*Sixteenth Order on Reconsideration in CC Docket No. 96-45, Eighth Report and Order in CC Docket 96-45 and Order in CC Docket 96-262*), 15 FCC Rcd 1679 (1999), *rev'd in relevant part in COMSAT Corp. v. FCC*, 250 F.3d 951 (5th Cir. 2001).

⁴³ *Second Further Notice*, at para. 76.

⁴⁴ 47 U.S.C. § 152(b). *See also Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 446-48 (5th Cir. 1999).

calls in a month and a customer of an intrastate-only line who cannot use that line to make any interstate calls.⁴⁵ In neither case is interstate service being provided to the customer.

The second connection-based proposal set forth in the *Second Further Notice* would split connection-based contributions between switched transport and access providers. That proposal would also violate the “equitable and nondiscriminatory” requirement of Section 254(d). Again, some long-distance providers (*e.g.*, dial around providers) would contribute to the Universal Service Fund based on revenues while others would pay a flat unit rate even though both carriers would be offering the same voice-grade interstate service. The only distinction between the two would be whether the customers are subscribers or casual (*i.e.*, non-presubscribed) users. Two consumers could make the exact same number of long distance calls to the exact same locations for the exact same durations, but pay vastly different universal service contributions. For example, a presubscribed customer who makes only one \$0.19 one-minute interstate call in one month would be subject to a one-unit (*e.g.*, \$0.50) contribution for long distance that would exceed the cost of the call,⁴⁶ while a casual user who places the same \$0.19 interstate call would contribute only a small percentage of the price of the call. The Commission has already recognized that such

⁴⁵ The proposal to assess Federal universal service charges on local connections that are not used for any interstate services is readily distinguishable from assessment of Federal Subscriber Line Charges on access lines that are not used for interstate calls. Federal access charges recover the costs of those portions of subscriber lines that are assigned to the interstate jurisdiction pursuant to the jurisdictional separations process. *Smith v. Illinois Bell Telephone Company*, 282 U.S. 133 (1930). In contrast, a Federal universal service charge on local connections would not be recovering costs that are jurisdictionally interstate.

⁴⁶ A rule that produces such an outcome might also be considered arbitrary and capricious. *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 434-35 (5th Cir. 1999).

a situation would be unfair under the current revenue-based contribution methodology.⁴⁷ One variation of this proposal would be to assess wireline switched access providers on a connection basis and wireline switched transport providers on an interstate revenue basis, while CMRS providers would be assessed purely on a connection basis.⁴⁸ This proposal is inequitable and discriminatory because it would result in much lower contributions from wireline switched transport providers that serve lower volume customers than from CMRS carriers, like TracFone, that also have a disproportionate number of lower volume customers.

As with the first proposal, the splitting of the connection-based contributions proposal also would exceed the Commission's jurisdiction by assessing carriers for those customers who make no interstate calls in a given month. The *Second Further Notice*, however, recognizes this problem only in the context of interstate interexchange carriers that currently do not bill subscribed customers that make no long distance calls in a given month.⁴⁹ As explained above, many TracFone customers make no interstate calls in a given month and connection-based contribution methodologies described in the *Second Further Notice* would result in an assessment based on intrastate service.

The third connection-based proposal set forth in the *Second Further Notice* – a telephone-number methodology proposal – also fails to meet the requirements of the Communications Act. The *Second Further Notice* seeks comment on whether using the Commission's exclusive authority over numbering resources addresses Section 2(b) concerns regarding a flat-fee connec-

⁴⁷ *Second Further Notice*, at n. 126.

⁴⁸ *Second Further Notice*, at para. 92 & n. 191.

⁴⁹ *Second Further Notice*, at para. 88.

tion-based contribution methodology. It does not! Section 251(e)(1) of the Communications Act grants the Commission “exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States.” Section 251(e)(1) does not grant the Commission exclusive jurisdiction over every aspect of a service that uses telephone numbers, nor does it confer jurisdiction to regulate all revenues derived from services that use telephone numbers. If, as is suggested in the *Second Further Notice*, the Commission’s Section 251(e)(1) authority over telephone numbers which are part of the North American Numbering Plan, somehow conferred on the Commission jurisdiction over all services that use those numbers and all revenues derived from such services, then it would follow that the Commission would have jurisdiction over all intrastate and local services which involve use of such telephone numbers. Obviously, such a jurisdictional land grab would fly in the face of Section 2(b) of the Act.

In addition, application of the Commission’s authority over numbering resources does not absolve the Commission of its duty to implement Section 254 of the Communications Act. “A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant, and so that one section will not destroy another unless the provision is the result of obvious mistake or error.”⁵⁰ Thus, establishment of a universal service contribution methodology based on the Commission’s jurisdiction over telephone numbers, would not relieve the Commission of its statutory duty to require *every* telecommunications carrier that provides interstate telecommunications service to contribute on an equitable and nondiscriminatory basis. A telephone number-based contribution methodology, however, would

⁵⁰ 2A NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION § 46:06 (6th ed. 2000) (footnotes omitted).

fail to meet the requirements of Section 254. The *Second Further Notice* appears to recognize that a telephone number-based contribution methodology would not comply with the Section 254 requirement that every telecommunications carrier contribute and seeks comment on whether to impose a minimum contribution obligation on all providers.⁵¹ As with the connection-based methodology with mandatory minimum obligations, such a proposal would lead to inequitable and discriminatory results. In short, the telephone number-based connection charge proposal suffers from all of the legal and public interest infirmities of the other connection-based proposals set forth in the *Second Further Notice* as well as the since-discredited CoSUS plan upon which comment was sought in the *First Further Notice*. All that the telephone number-based plan offers is an argument for getting around the jurisdictional limitations based on an expansive reading of the Commission's authority over telephone numbering – a reading which at best could be described as tenuous.

B. The Proposed Connection-Based Methodologies Would Not Serve the Public Interest and Should Not Be Considered for Other Funds Administered by the Commission

In addition to violating the Communications Act, each of the three proposed connection-based methodologies would also violate the Commission's established principle of competitive neutrality upon which to base its policies and rules regarding universal service support mechanisms.⁵² The Commission has explained that competitive neutrality means that universal service

⁵¹ *Second Further Notice*, at para. 96.

⁵² *Universal Service Order*, at paras. 46-55. Section 254(b)(7) permits the Commission to include among the principles specifically enumerated in Section 254(b) “[s]uch other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.”

support mechanisms and rules should neither unfairly advantage or disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.⁵³ Each of the Commission's connection-based proposals would disadvantage those providers such as TracFone that have a disproportionate number of lower income and lower volume customers. The universal service contribution obligations would increase substantially for those providers that have large numbers of lower volume customers even though contributions for providers of higher volume customers would decrease. Since higher volume customers generally lead to larger profits, the competitive pressures to attract these customers at the expense of low volume consumers is already great and would only increase. The Commission's proposals would only exacerbate the lack of competition among service providers to serve lower volume customers – hardly a public interest benefit. As described in preceding sections of these Comments, the connection-based proposals also would have the perverse effect of favoring certain wireline providers over wireless providers and would favor those companies who offer interstate service (and derive revenues therefrom) without providing network connections over those companies which offer the same or similar services that do provide network connections. Such favoritism flies in the face of the Commission's own requirement that universal service funding methodologies must be competitively neutral.

In prior filings, TracFone has explained why adoption of a connection-based methodology would be particularly disadvantageous to TracFone and to its customers as well as to other similarly situated carriers and their customers. Because TracFone cannot add a separate line item to a customer's bill and a connection-based methodology would involve a substantial increase in

⁵³ *Universal Service Order*, at para. 47.

TracFone contributions, TracFone would be forced either to increase its per-minute rates or to absorb its increased contribution requirements. Such price increases would make TracFone's services less competitive and, more importantly, would increase the price of CMRS services to consumers who have few, if any, alternatives. TracFone's traditional CMRS competitors, however, send monthly bills to customers and collect universal service contributions as a separate line item. Therefore, these traditional CMRS competitors can keep their advertised per-minute rates low while increasing the unadvertised government-mandated universal service charge. At the same time, it will appear as though TracFone is significantly increasing its rates.

The *Second Further Notice* suggests that a connection-based contribution methodology may be more economically efficient than a revenue-based methodology because revenue-based assessments create inefficient incentives for consumers to curtail their usage of interstate telecommunications networks.⁵⁴ The curious notion that consumers are likely to curtail their efficient use of telecommunications services in order to avoid usage-based universal service charges is unsupported and unsupportable. Using the Commission's logic, a sales tax that is a percentage of the purchase price creates inefficient incentives for consumers to purchase lower-priced goods, irrespective of the value of those goods and consumers' need for those goods, solely to avoid a greater sales tax. For example, consumers would have economic incentives to eat only at low-cost fast food restaurants because of the sales tax rather than the low-cost food. A connection-based charge would be like charging consumers the same sales tax whether they buy a \$1.50 hamburger at McDonalds or a \$35.00 steak at Mortons. Using the Commission's logic, states should adopt a flat sales tax for all purchases for the purpose of promoting "economic effi-

⁵⁴ *Second Further Notice*, at para. 70.

ciency.”⁵⁵ The *Second Further Notice* does not explain why such a plan is in the public interest or meets the equitable and nondiscriminatory requirement of Section 254(d).

Finally, the Commission also seeks comment on whether it should extend a connection-based methodology to the Telecommunications Relay Service (TRS), Numbering Administration, Local Number Portability, and wireline regulatory fees programs.⁵⁶ TracFone strongly opposes such an extension of a connection-based methodology. The Commission has offered no explanation or justification for altering the current revenue-based structure of these funds. There has been no discussion that any of these funds are facing shortfalls or the potential for inadequate funding in the future. For at least some of these funds, such a funding methodology would violate the Communications Act. For example, Section 225 of the Communications Act requires the Commission to establish regulations for the jurisdictional costs of TRS and that “costs caused by interstate telecommunications relay services shall be recovered from all subscribers for every interstate service and costs caused by intrastate telecommunications relay services shall be recovered from the intrastate jurisdiction.”⁵⁷ The jurisdictional concerns associated with connection-based methodologies have been outlined above. Another example is that a connection-based methodology would violate the competitive neutrality requirements of the Numbering Admini-

⁵⁵ The connection charge proposal also analogizes to a Federal income tax system in which every taxpayer would be assessed the same tax amount, irrespective of income, as opposed to the income tax system in which tax liability increases as income increases. Just as a single amount for all taxpayers tax system would be inappropriate for collection of income taxes, so to would a flat, connection charge system be an inappropriate means to support the Universal Service Fund.

⁵⁶ *Second Further Notice*, at para. 74.

⁵⁷ 47 U.S.C. § 225(d)(3)(B).

stration and Local Number Portability funds.⁵⁸ TracFone has already explained why the connection-based proposals are not competitively neutral. The overall impact of this proposed extension of a connection-based methodology would be to further exacerbate the inequities of requiring lower volume and lower income customers (and the carriers that serve them) to contribute a disproportionate share of the costs of these programs when compared to their use of the telecommunications network.

IV. IF THE COMMISSION ADOPTS A CONNECTION-BASED PROPOSAL, IT SHOULD RECOGNIZE THE UNIQUE CIRCUMSTANCES OF PREPAID WIRELESS CARRIERS

As explained above and in TracFone's earlier filings, in addition to violating the Communications Act and disserving the public interest, the connection-based contribution methodologies proposed would significantly harm both TracFone and its customers. If the Commission eventually decides to adopt a connection-based contribution methodology, then it should recognize that prepaid CMRS providers such as TracFone would be uniquely harmed by such a system and should be subject to special provisions based on their unique circumstances. The Commission has recognized that it should treat some providers differently based on special circumstances. For example, it has proposed a per-connection charge of \$.10 per month for one-way paging carriers and a per-connection \$.20 monthly charge for two-way paging carriers.⁵⁹ The

⁵⁸ Section 251 of the Communications Act requires that "[t]he cost of establishing telecommunications numbering administration arrangements and number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission." 47 U.S.C. § 251(e)(2).

⁵⁹ *Second Further Notice*, at para. 75. We note that although this proposal is much lower than the \$.25 per-pager monthly charge proposed in the *First Further Notice*, this proposal remains higher than connection-based charges suggested by paging carriers. *See, e.g.*, American Association of Paging Carriers Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002 (proposing a

Commission has also suggested that it might find it reasonable to adopt a different contribution level for seasonal and intermittent use telephone numbers.⁶⁰ It would be similarly appropriate to adopt a different contribution obligation for prepaid CMRS carriers. Without such a recognition, it is likely that TracFone would find itself in the untenable situation described in the *Report and Order* of paying a flat connection-based charge of \$1.00 or more for customers that in one month make few, if any, interstate calls.⁶¹

TracFone has suggested an \$0.18 per month charge on every prepaid CMRS handset used for making or receiving interstate calls during a month. Because providers of prepaid wireless services, like TracFone, cannot pass through any additional charge as a customer surcharge, recovery of the charge either would be included in the provider's rates or would be absorbed by the provider.⁶² TracFone explained that, like paging carriers, prepaid wireless providers derive relatively little revenue from interstate service – well below the levels enjoyed by traditional postpaid wireless carriers.⁶³ TracFone's percentage of interstate revenues is approximately 10 percent, while all of the other traffic studies submitted by CTIA indicated interstate revenues from 19.6

monthly connection charge of \$0.005 per traditional pager and \$0.20 per unit for advanced messaging services); Arch Wireless Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002 (proposing that the average monthly connection charge should not rise above the current \$0.07); Concerned Paging Carriers Comments in CC Docket No. 96-45 *et al.*, filed Apr. 22, 2002 (proposing to define a connection to exclude one-way paging); WebLink Wireless Reply Comments in CC Docket No. 96-45 *et al.*, filed May 13, 2002 (proposing that a monthly connection charge should be no higher than the current average of \$0.07).

⁶⁰ *Second Further Notice*, at para. 97.

⁶¹ *Report and Order*, at n. 126.

⁶² *TracFone September 26 Ex Parte*.

⁶³ *TracFone September 26 Ex Parte*.

percent to 28.5 percent.⁶⁴ Also the average revenue per user for TracFone customers is much less than for other CMRS carriers.

One key aspect of TracFone's suggested alternative for prepaid CMRS is that it would exempt from payment any connections that make or receive no interstate calls in a month. Actual interstate usage in a month is an essential condition precedent to assessment of a Universal Service Fund connection charge on prepaid wireless carriers since imposition of a universal service assessment based only on intrastate service would violate Section 2(b) of the Communications Act.

⁶⁴ Letter from M. Altschul, CTIA, to M. Dortch, Federal Communications Commission, filed Sept. 30, 2002.

V. CONCLUSION

For the reasons set forth above, TracFone supports the continuation of a revenue-based contribution methodology, with such additional changes and refinements described in these comments as needed to ensure continued sustainability of the Universal Service Fund and to ensure that the fund will continue to be supported by contributions from every provider of interstate service and that such contributions be equitable and nondiscriminatory. Also, for the reasons described in these comments, none of the alternative connection or telephone number-based proposals set forth in the *Second Further Notice* would comply with Section 254(d) of the Act or the Commission's competitive neutrality requirements. Accordingly, none of those proposals should be adopted.

Respectfully submitted,

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February 28, 2003

APPENDIX A

The Sufficiency of Interstate Revenues to Fund Universal Service

by

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Economists Incorporated

Analysis prepared for
TracFone Wireless Inc. by
Economists Inc.
February 28, 2003

The Sufficiency of Interstate Revenues to Fund Universal Service

Introduction

The Universal Service Fund provides financial support to ensure that all Americans have access to affordable telecommunications services. Universal service programs support services for low-income consumers and those living in high-cost areas. These programs also support services for eligible schools and libraries, and for rural health care providers. The Universal Service Fund is supported by fees that are based on certain interstate and international revenues of interstate telecommunications carriers. Concerns have been expressed that this method of funding will not be sufficient for future needs. In particular, it has been suggested that the revenues on which contributions to the fund are based, the contribution base, might decline significantly in the near future. A large decline in the contribution base would force the FCC either to reduce universal service funding or to greatly increase the contribution factor, the fee rate on revenues, which might in turn hasten the decline of the contribution base.

This report addresses whether there is a possibility of a large decline in the contribution base. It examines past changes in the base to see whether there is any evidence of a downward trend. The report then analyzes the effects of certain regulations on the size of the contribution base. In particular, it examines the effect of a recent change in reporting requirements for wireless carriers. It also examines the effect of excluding revenues from certain Internet services from the contribution base.

Recent Trends in the Universal Fund Contribution Base

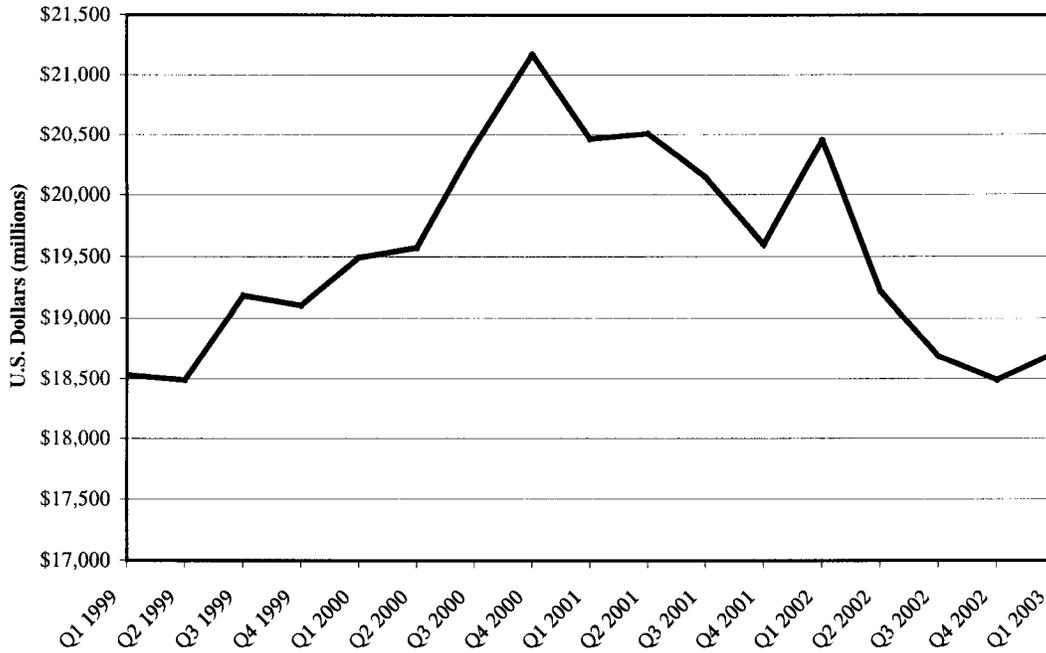
Fluctuations in the size of the contribution base are shown in Table 1 and Figure 1. These data show changes in the Universal Service Fund contribution base from the beginning of 1999 until the first quarter of 2003. The contribution base rose during 1999 and 2000 and then declined until the beginning of 2003, when it again increased. The level of the contribution base in the first quarter of 2003 was slightly higher than its level at the start of 1999. Thus, the data do not show a declining trend over the whole period. They do show a modest decline in the last two years, but not in the most recent quarter.

Table 1: Universal Service Fund Contribution Base, 1999 Q1 to 2003 Q1¹

Period When:		
Base Used	Revenue Earned	Contribution Base (millions)
Q1 1999	Jan-June 1998	\$18,531
Q2 1999	Jan-June 1998	\$18,490
Q3 1999	July-Dec 1998	\$19,183
Q4 1999	July-Dec 1998	\$19,102
Q1 2000	Jan-June 1999	\$19,492
Q2 2000	Jan-June 1999	\$19,572
Q3 2000	July-Dec 1999	\$20,403
Q4 2000	July-Dec 1999	\$21,172
Q1 2001	Jan-June 2000	\$20,463
Q2 2001	Jan-June 2000	\$20,507
Q3 2001	Q1 2001	\$20,141
Q4 2001	Q2 2001	\$19,597
Q1 2002	Q3 2001	\$20,450
Q2 2002	Q4 2001	\$19,219
Q3 2002	Q1 2002	\$18,684
Q4 2002	Q2 2002	\$18,488
Q1 2003	Q3 2002	\$18,705

¹ Data on the revenue base are from reports of the Universal Service Administrative Company. Until the third quarter of 2001, the revenue base was calculated on a 6 month basis. The revenue base from the earlier periods was divided by two to put it on a quarterly basis and thus make it comparable with data from later periods.

Figure 1: Revenue Base by Quarter



The shares of various industries in the contribution base are shown in Table 2. These shares exhibit some definite trends. The share of interexchange carriers in the contribution base has been steadily declining, and the shares of local exchange carriers and wireless telephone companies have been increasing. Particularly striking is the increase in the share coming from wireless telephony. From 1998 to 2001, that share almost tripled. In its February 2002 Notice, the Commission expressed concern that revenues of the interexchange carriers, who historically have been the source of most of the contribution base, were declining.² While the interexchange carrier revenues included in the contribution base have been declining, however, the included revenues of local exchange carriers and wireless telephone companies have been increasing.

² Federal Communications Commission, "Further Notice of Proposed Rulemaking and Report and Order," Released February 26, 2002, ¶ 7.

	1998	1999	2000	2001
Interexchange Carriers⁴	77.5%	76.0%	70.2%	65.3%
Local Exchange Carriers	17.3%	17.3%	20.2%	22.4%
Wireless Telephony	4.4%	6.0%	9.0%	11.6%
Other Wireless	0.7%	0.6%	0.6%	0.6%
Payphone Service Providers	0.1%	0.1%	0.1%	0.1%

Several reasons have been suggested for the decline in the contribution base from the end of 2000 until the end of 2002. One explanation that has been advanced is the growth in Voice Over Internet Protocol or Internet telephony, a technology that allows customers to make phone calls using the Internet Protocol rather than the services of “traditional” circuit switched telecommunications carriers. As will be discussed later in this report, however, Internet telephony currently has very few U.S. subscribers, about 2.5 million at the end of 2002.⁵ Thus, so far Internet telephony is unlikely to have had a significant effect on the contribution base.

Another suggested reason for the decline in the contribution base is that increasing competition has reduced rates, and the fall in rates has reduced revenue. This explanation seems unlikely. A decline in rates will cause usage to increase, and the effect of increased usage on revenue will counteract some of the effect of lower rates. Whether the net effect of a decline in rates is to increase or decrease revenue will depend on how much traffic increases in response to the fall in rates. The effect of rates on the volume of traffic is measured by the elasticity of demand, the ratio of the percentage change in units sold to the percentage change in the price. A fall in rates will increase revenue if the elasticity is greater than one and will reduce revenue if the elasticity is less than one.⁶ Estimates of the elasticity of demand for long-distance service range from .63 to .72.⁷ With an elasticity of

³ Data are from the October 2001 and 2002 Monitoring Reports from FCC Industry Analysis Division, Federal-State Joint Board Monitoring Reports. These data are not yet available for 2002.

⁴ These data also include the contribution base attributed to certain other toll service providers, such as toll resellers.

⁵ This estimate is from the National Telecommunications and Cable Association (NTCA).

⁶ By convention the elasticity of demand is expressed as a positive number although the actual value is negative because the changes in price and quantity will have the opposite sign.

⁷ The lower estimate is from W. E. Taylor and L. D. Taylor, “Post-Divestiture Long Distance Competition in the United States,” *American Economic Review*, May 1993, pp. 185-190. The higher estimate is from Joseph Gatto, J. Langin-Hooper, P. Robinson, and H. Tyan, “Interstate Switched Access Demand Analysis,” *Information Economics and Policy*, 1988, pp. 310-335.

demand in that range, a fall in rates will cause revenue to fall, but unless the rate decrease is very large, revenues will not fall by much. A 5% decline in rates will only cause revenue to fall by 1.8%.⁸ Moreover, interstate switched access minutes declined during this period, which suggests that the decline in revenue did not stem primarily from a decline in rates.⁹

A more important reason for the decline in the contribution base seems to have been the increase in the wireless share of the telecommunications industry coupled with the Commission's regulations for measuring wireless carriers' interstate traffic. The effect of those regulations, which the Commission changed at the end of 2002, was to undercount the interstate revenues of wireless carriers, thereby artificially reducing the size of the contribution base. As those carriers captured an increasing share of industry revenues, the effect of that undercount became steadily more severe. As will be shown in the next section, if the size of the contribution base is adjusted to take account of the undercounting of wireless interstate revenues, the decline in the base almost totally disappears.

Effects of Changes in the Wireless Safe Harbor Regulation

When the FCC established its regulations for reporting the contribution base, it was concerned that wireless carriers often would not be able to determine how much of their revenues were interstate. Thus, the FCC established a "safe-harbor." Any wireless carrier was allowed to assume that its interstate revenues were 15% of its total revenues.¹⁰ This safe-harbor provision was used by firms accounting for the bulk of wireless revenues.¹¹

As the wireless industry grew, however, many carriers had interstate revenues that exceeded 15% of their total. Thus, these carriers' use of the safe-harbor resulted in their under reporting interstate revenues. The Commission addressed this issue in its December 2002 Report and Order, which increased the safe-harbor limit to 28.5%. This change

⁸ Evaluated at an elasticity of .675, the midpoint of the range.

⁹ Data on minutes are from FCC Industry Analysis Division and National Exchange Carrier Association Common Carrier reports.

¹⁰ Wireless carriers referred to in this section are those providing wireless telephony, cellular, broadband personal communications services (PCS), and digital special mobile radio (SMR). Analog SMR and paging providers have safe harbor limits of 1% and 12% respectively, and those limits were not changed by the December 2002 Notice.

¹¹ "Report and Order and Second Further Notice of Proposed Rulemaking," Released December 13, 2002, ¶ 21.

becomes effective for the filing due in February 2003, which will be used to calculate the contribution base for the second quarter of 2003.¹²

The change in the safe-harbor regulation would have significantly increased the contribution base, had it been in effect in previous quarters. Table 3 shows estimates of how much higher the contribution base would have been in earlier quarters, had the new safe-harbor limits been in effect. The derivation of these estimates is described in the Appendix. As the size of the wireless industry has grown over time, the adjustment has also increased, from about 5% in the first quarter of 2001 to about 13% in the first quarter of 2003. Because the wireless industry is expected to continue to grow, the importance of the new regulation will likely also increase.¹³

Table 3: Adjusting the Contribution Base for the Effect of the Higher Safe-Harbor Limit, 2001 Q1 to 2003 Q1

	Contribution Base	Adjustment	Total Contribution Base with Adjustment	Adjustment Size Relative to Unadjusted Base
	(millions)			
1Q 2001	\$20,463	\$939	\$21,402	5%
2Q 2001	\$20,507	\$1,023	\$21,531	5%
3Q 2001	\$20,141	\$1,164	\$21,305	6%
4Q 2001	\$19,597	\$1,255	\$20,852	6%
1Q 2002	\$20,450	\$1,456	\$21,906	7%
2Q 2002	\$19,219	\$1,689	\$20,908	9%
3Q 2002	\$18,684	\$1,942	\$20,626	10%
4Q 2002	\$18,488	\$2,195	\$20,683	12%
1Q 2003	\$18,705	\$2,436	\$21,142	13%

The data in Table 3 also show that the recent decline in the contribution base is largely due to the safe-harbor regulation. From the first quarter of 2001 to the first quarter of 2003, the contribution base declined by about 9%. If the adjustment due to the change in safe-harbor regulations is included in the base, then the decline is only about 1%. Thus,

¹² The Commission made another significant change in the method of determining universal service contributions by changing their basis from historical revenues to projected revenues. This report does not examine the effect of this change, which was primarily motivated to maintain “competitive neutrality among contributors” rather than to change the overall size of the contribution base. “Report and Order and Second Further Notice of Proposed Rulemaking,” Released December 13, 2002, ¶ 1.

¹³ Analysts reports forecasting continued growth in wireless include Salomon Smith Barney, “Telecommunications—Wireless Services,” January 29, 2003; CIBC World Markets, “Telecommunications Services,” December 11, 2002; and Morgan Stanley, “Global Wireless Competitors,” February 1, 2003.

the major cause of the decline in the contribution base was the safe-harbor limit. The Commission's December 2002 Report and Order addressed that problem by increasing the limit. The new safe-harbor limit may still result in an undercount of wireless carriers' interstate revenues, because some carriers may have interstate revenues that are more than 28.5% of their total revenues. While the increase in the safe-harbor provision will reduce the significance of this problem, the undercounting of revenue may become more serious with the continued growth of the wireless industry. Under those circumstances, however, the Commission has the option of eliminating the safe-harbor provision and requiring wireless carriers to report actual interstate revenues.

Internet Services Revenues Excluded from the Contribution Base

The contribution base excludes revenues from certain Internet services: cable modem services and Internet telephony. Cable modem service is a form of broadband Internet access that involves transmission over the cable network. Revenues from an alternative form of broadband Internet access, digital subscriber line (DSL), are included in the revenue base. Both cable modem service and Internet telephony serve many fewer customers than traditional and wireless telephony. At the end of 2002, cable modem service had 11.3 million subscribers and Internet telephony had 2.5 million.¹⁴ In comparison, there were 119.9 million wireless subscribers at the end of 2001.¹⁵ Nonetheless, both cable modem service and Internet telephony have been rapidly growing, and their significance is likely to increase in the future.

The estimated revenues earned on cable modem and Internet telephony for the most recent three quarters are compared to the contribution base in Table 4. (The derivation of the estimates is described in the appendix.) Revenues from these Internet services have been growing faster than the contribution base. From the third quarter of 2002 to the first quarter of 2003, they increased from 7% to 8% of the base. Revenues from these services, however, remain small relative to the size of the contribution base, and their growth during that period was not accompanied by a decline in the base.

¹⁴ Statistics on subscribers are from the National Cable and Telecommunications Association, www.ncta.com/industry_overview/indStats.cfm?statID=13 and www.ncta.com/industry_overview/indStats.cfm?statID=15, downloaded February 20, 2003.

¹⁵ CTIA, "Wireless Industry Indices," Washington, D.C., August 2002, p. 24.

Table 4: Contribution Base and Estimated Revenues from Cable Modem Service and Internet Telephony and the Ratio of Those Revenues to the Contribution Base, Q3 2002 to Q1 2003¹⁶				
	Contribution Base	Cable Modem	Internet Telephony	Ratio
	(millions)			
Q3 2002	\$18,684	\$1,054	\$229	7%
Q4 2002	\$18,488	\$1,168	\$252	8%
Q1 2003	\$18,705	\$1,308	\$276	8%

Adequacy of the Contribution Base

The adequacy of the contribution base depends on the need for universal service funds. Because the need for these funds depends to a significant extent on policy decisions, it is difficult to forecast. Nonetheless, universal service funding requirements have been stable for some time, and there is no reason to expect them to increase dramatically in the future. Assuming that requirements maintain their current level, the contribution base with the new safe-harbor regulation should be adequate to meet those needs.

Universal service funding requirements are shown in Table 5. This table also shows the ratio of funding requirements to the contribution base. That ratio is not the same as the contribution margin. In recent quarters, the Commission has used unspent funds from the schools and libraries support mechanism to keep the contribution margin constant at about 7.28%. Funding requirements increased significantly in the third quarter of 2002, with the addition of the Interstate Common Line Support Mechanism to the funding requirements. Since that change, however, funding requirements have been generally stable, both in absolute terms and relative to the contribution base.

¹⁶ To ensure comparability, the estimates of Internet services revenue pertain to the quarters in which the contribution base revenues were earned, the first three quarters of 2002. Although Internet telephony is used for local as well as for long-distance calls, no attempt was made to separate out intrastate service revenues.

Table 5: Contribution Base and Universal Service Funding Requirements, 2001 Q1 to 2003 Q2¹⁷			
	Contribution Base	Funding Requirements	Ratio
	(millions)		
1Q 2001	\$20,463	\$1,354	6.6%
2Q 2001	\$20,507	\$1,397	6.8%
3Q 2001	\$20,141	\$1,375	6.8%
4Q 2001	\$19,597	\$1,380	7.0%
1Q 2002	\$20,450	\$1,378	6.7%
2Q 2002	\$19,219	\$1,385	7.2%
3Q 2002	\$18,684	\$1,505	8.1%
4Q 2002	\$18,488	\$1,586	8.6%
1Q 2003	\$18,705	\$1,501	8.0%
2Q 2003	NA	\$1,534	NA

If the level of the contribution base is adjusted for the change in the safe-harbor regulation, then its apparent stability relative to funding requirements is enhanced. Table 6 compares the adjusted contribution base to the funding requirements. This table includes a projection of the contribution base for the second quarter of 2003, the first quarter in which new regulations will take effect. In that quarter, funding requirements will be 7.2% of the contribution base, slightly below what the ratio would have been in the third quarter of 2002, when the requirements were increased to include common line support.

¹⁷ Funding requirements are from the Universal Service Administrative Company Quarterly Filings.

Table 6: Contribution Base Adjusted for the New Safe-Harbor Regulation and Universal Service Funding Requirements, 2001 Q1 to 2003 Q2¹⁸

	Adjusted Contribution Base	Funding Requirements	Ratio
	(millions)		
1Q 2001	\$21,402	\$1,354	6.3%
2Q 2001	\$21,531	\$1,397	6.5%
3Q 2001	\$21,305	\$1,375	6.5%
4Q 2001	\$20,852	\$1,380	6.6%
1Q 2002	\$21,906	\$1,378	6.3%
2Q 2002	\$20,908	\$1,385	6.6%
3Q 2002	\$20,626	\$1,505	7.3%
4Q 2002	\$20,683	\$1,586	7.7%
1Q 2003	\$21,142	\$1,501	7.1%
2Q 2003 ¹⁹	\$21,337	\$1,534	7.2%

It is possible that some future marketplace or regulatory developments could cause a substantial erosion of the contribution base. There is no reason to expect that such developments will occur over the next several years. If such developments were to occur, the Commission should be able to address those changes within the context of a revenue-based methodology. For example, Internet telephony could begin to grow extremely rapidly, causing a substantial decline in traffic and revenues for the carriers using circuit switched technology now making universal service contributions. If such an event did take place, the Commission could respond to it by including Internet telephony in the contribution base.

Conclusion

A revenue-based method of raising universal service contributions is likely to be adequate for the foreseeable future. An analysis of recent changes in the revenue contribution base does not suggest a long-term negative trend. There has been some decline recently, but that decline was due primarily to the safe-harbor provision for the wireless industry. This provision resulted in the undercounting of interstate revenues for wireless telephony, and the seriousness of the undercounting grew as the wireless industry grew. The Commission's recent adjustment of the safe-harbor provision will reduce the

¹⁸ Funding requirements are from the Universal Service Administrative Company Quarterly Filings.

¹⁹ For this quarter, all elements of the contribution base except wireless telephony were assumed to stay at the levels of the previous quarter. Wireless telephony revenue was projected in the manner described in the appendix.

extent of this undercounting. Under the amended safe-harbor provision, there will still be some undercounting of wireless interstate revenue, but if this undercounting becomes a serious problem, the Commission has the option of completely eliminating the safe-harbor provision. Basing wireless carriers' universal service contributions on their actual interstate revenues is likely to provide sufficient funding to sustain the Universal Service Fund for the foreseeable future. The level of funding requirements has been stable since a change in the regulations in mid-2002, and there is no reason to expect the contribution base to fall relative to those requirements.

Appendix: Estimation of Elements of Revenue Excluded from the Contribution Base

Revenues Excluded By the Safe-Harbor

Estimating the adjustment to the contribution base that would reflect the change in the safe-harbor regulations required several steps. First, not all firms used the safe-harbor provision in reporting their revenues, and the revenues from those firms should not be adjusted. According to the December 2002 Report and Order, firms using the safe harbor provision represented 78% of wireless end-user revenues.²⁰ Thus, the adjustment was only based on 78% of these revenues.

For firms that used the safe-harbor provision, the change in the regulation will increase the share of their revenues that are interstate and thus part of the contribution base. This share will be defined as the post-change ratio. The adjustment in the contribution base due to the change in regulations has been calculated using the following equation:

$$\text{Adjustment} = (\text{post-change ratio} - \text{old safe harbor ratio}) * .78 * \text{wireless end user revenues.}$$

Thus, calculating the adjustment requires estimating the post-change ratio. In determining the new safe-harbor level, the Commission relied on studies by several firms that provided the actual share of their revenues that were interstate. The Commission then set the new safe-harbor ratio equal to the highest ratio found by any of these firms, 28.5%. This ratio was selected to give firms an incentive to report actual revenues, rather than relying on the safe-harbor.²¹ These studies were also used as the basis for the estimated post-change ratio. Of the 6 firms providing data, five had ratios of interstate traffic significantly above the old safe-harbor ratio of 15%, thus they were taken as representative of firms using the safe-harbor provision.²² The average ratio of interstate to total revenue for these firms was 23.6%, so 23.6% was used as the estimated post-change ratio.

²⁰ "Report and Order and Second Further Notice of Proposed Rulemaking," Released December 13, 2002, ¶ 21.

²¹ "Report and Order and Second Further Notice of Proposed Rulemaking," Released December 13, 2002, ¶ 22.

²² Data for these firms is in an attachment to a letter from Michael F. Altschul of the Cellular Telecommunications and Internet Association to Ms Marlene H. Dortch, Secretary, Federal Communication Commission, September 30, 2002.

While wireless end user revenues were available for each quarter of 2001, they were not available for 2002 or 2003. Thus, those revenues were projected using growth rates found in Salomon Smith Barney, "Telecommunications—Wireless Services," January 29, 2003, p. 23.

Estimating Revenue for Internet Services

Revenue for Internet services was found by multiplying estimated subscribership from the National Cable and Telecommunications Association by estimated revenue per subscriber. The estimated average revenue per subscriber for cable modem services is \$42.32 a month, which is from a recent study reported in the trade press.²³ The estimated revenue per subscriber for Internet telephony is \$39.99 per month, which is the rate posted by Vonage, the leading provider of Internet telephony.²⁴

²³ Denise Pappalardo, "Broadband Prices Declining, Slightly," *Network World Fusion*, December 12, 2002.

²⁴ www.vonage.com, downloaded February 20, 2003. See also E.C. Baig, "Price is right for using the Net for phone calls," www.usatoday.com/tech/columnist/2002/05/01/baig.htm, April 30, 2002, downloaded February 20, 2003.

CERTIFICATE OF SERVICE

I, Michelle D. Diedrick, an Executive Assistant with the law firm of Greenberg Traurig, LLP, hereby certify that on February 28, 2003, a true and correct copy of the foregoing Comments of TracFone Wireless, Inc., was submitted to the following:

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* Sent via hand delivery.

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