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 and Billing Format	)	CC Docket No. 98-170

REPLY COMMENTS OF NEXTEL COMMUNICATIONS, INC.

Nextel Communications, Inc. ("Nextel"), by its attorneys, hereby submits these reply comments in response to the *Staff Study* regarding alternative universal service contribution methodologies.[1]

[1] Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies, *Public Notice*, CC Docket Nos. 96-45, *et al.*, FCC 03-31 (rel. February 26, 2003) ("*Public Notice*"); Wireline Competition Bureau Staff Study of Alternative Contribution Methodologies ("*Staff Study*").

I. INTRODUCTION

The comments filed in the universal service docket over the past year illustrate that universal service reform is no easy task. In the last round of comments alone, few industry segments were able to present a unified position on the best way to reform universal service fund ("USF") assessments.[2] Virtually every party commenting on the Wireline Competition Bureau's ("WCB") Staff Study claimed that it supported their respective positions.

Critically, however, no commenter refuted Nextel's demonstration of the flaw inherent in the *Staff Study*, namely that the assumptions underlying the analysis of each proposal fail to account for their economic welfare costs on telecommunications providers and consumers, which are proportional to differing elasticities of demand for the various services. While AT&T Corp. ("AT&T") and the United States Telecom Association ("USTA") claim that including an elasticity of demand component in USF assessment methodologies would be "inappropriate"[3] and "unworkable,"[4] neither explains why failing to take elasticity of demand into account improves the prospects of successful USF assessment reform or how ignoring demand elasticity advances economic welfare.

---

[2] While all of the IXCs agreed that some form of connection-based assessments should be adopted, they differed on exactly which form would be best. *See, e.g.,* AT&T Comments. at 19-40 (arguing in favor of a numbers-based assessment mechanism); Comments of WorldCom, Inc. d/b/a MCI, Inc. at 17-24 (arguing in favor of the CoSUS proposal). The Regional Bell Operating Companies did not uniformly back the SBC/BellSouth proposal, with Verizon urging the FCC to maintain revenue-based assessments. *See* Verizon Comments at 5-8 (arguing that the result of recent revisions to the existing contribution mechanism should be evaluated and pending proceedings resolved before deciding whether to adopt any entirely new mechanism). CMRS carriers largely argued against any form of connection-based assessments. *See*, *e.g.*, CTIA Comments at 2-7 (arguing that all variations of the connections-based proposals are inequitable, unfair and do not met the requirements of Section 254(d)); T-Mobile Comments at 6-11 (arguing that a connection-based methodology would constitute poor public policy).

[3] USTA Comments at 10.

[4] AT&T Comments at 33.

Consideration of economic welfare costs is not only appropriate, it is necessary for any USF assessment mechanism to comply with Section 254's "equitable and nondiscriminatory" requirement.[5] It also provides the basis for a more economically rational and efficient approach to selecting a USF assessment methodology which, in turn, prevents unnecessary consumer and producer welfare losses. Further, calculation of the relative funding burden for each industry, using elasticity-weighted contribution factors, can be achieved easily. The data necessary to estimate the elasticity of demand can be obtained readily from carriers and industry associations, if the Commission does not already have it in its possession. Elasticity of demand for each service can therefore be estimated and updated with every edition of the Commission's industry analysis reports.

II. THE STAFF STUDY IS FLAWED – IT MUST TAKE INTO ACCOUNT ECONOMIC COSTS WHEN DETERMINING THE MOST DESIRABLE USF ASSESSMENT METHODOLOGY.

A. The Assumptions Underlying the Staff Study are Incomplete.

In its February 26 *Public Notice*, the Commission sought comment on the *Staff Study* relating to the alternative methodologies for calculating contributions to the federal universal service support mechanisms.[6] In particular, the Commission urged parties to comment both on the Staff Study's analysis of assessment levels and on the underlying assumptions used for its projections.

As Nextel stated in its initial comments on the *Staff Study* on April 18, there is a fundamental flaw in the underlying assumptions used for all of the current and proposed USF

[5] 47 U.S.C. § 254(b)(4) ("All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.").

[6] *Public Notice* at 1.

assessment methodologies, both revenue-based and connections-based.[7] The underlying assumptions fail to account for the ***economic welfare costs*** on telecommunications providers and consumers. No commenter could refute this fact or that as a matter of basic promotion of economic efficiency, these welfare costs must be included as part of the overall USF assessment "equation."

It is obvious that regulatory taxes, fees and assessments ("TFAs") raise the cost of providing communications service. Not all telecommunications carriers operate under the same conditions. CMRS carriers, for instance, operate in a highly competitive environment, with typically four or more facilities-based carriers offering service in any given market. Traditional local landline carriers, on the other hand, operate in a vastly different environment, with oftentimes no competitive alternatives in most segments of their market.

These differences are a significant factor that the Commission cannot ignore in its deliberations about how and at what level USF costs should be assessed if the Commission is to achieve a result that promotes economic welfare. Any assessment methodology that requires ***all*** service providers to contribute ***on the same basis*** and ***at the same level*** is not equitable because it increases welfare costs to consumers and telecommunications providers alike.[8] It also would be economically *inefficient* because it would cause telecommunications providers with relatively high elasticities of demand (*e.g.*, CMRS and interexchange service) to lose the profits they need to reinvest and compete as consumers reduce their use of the service in reaction to the overall increase in the price of service.

---

[7] Nextel Reply Comments on Second FNPRM at 12.

[8] This is illustrated in Edward E. Zajac's book, "Fairness and Efficiency: An Introduction to Public Utility Pricing," where a distinction is drawn between "horizontal equity" ("equal" tax treatment for those in "equal" positions) and "vertical equity" (equitable distribution of tax among unequals). *See* EDWARD E. ZAJAC, FAIRNESS AND EFFICIENCY: AN INTRODUCTION TO PUBLIC UTILITY PRICING, at 53 (1978).

The *Staff Study* fails wholly to consider this critical point. While general taxation represents the least distortive method of collecting funds, the Commission currently is foreclosed by Section 254 from adopting this approach. Recognizing this, Nextel has presented an alternative that represents the most economically rational approach available at this time. Nextel's approach complies with Section 254(d)'s "equitable and non-discriminatory" requirement, because it recognizes the unique characteristics of each industry segment and adjusts the USF funding burden accordingly. This approach creates no funding shortfall and no funding stability problem. It is puzzling that AT&T and USTA have such problems grappling with the notion of enhancing economic welfare.

B. AT&T Deliberately Misunderstands the Elasticity of Demand Argument, and the Reason to Apply Elasticity Measures to Staff Study Data.

Nextel commented on the *Staff Study* and identified the under-inclusiveness of the study's underlying assumptions, namely that they fail to consider the demonstrably different elasticities of demand for the various telecommunications services. AT&T appears to deliberately misunderstand why Nextel is promoting elasticity of demand: to enhance economic efficiency as a whole. AT&T ignores that the Commission can relatively easily incorporate elasticity of demand into any USF contribution methodology. Indeed, as explained in Section III below, Nextel's approach is a workable solution that can be adapted easily to account for market changes and adjustments.[9] Moreover, Nextel did not suggest that USF can only be assessed on "strict" Ramsey pricing principles alone.[10] Rather, Nextel believes that price elasticity must be factored into the equation for any USF methodology to be equitable and nondiscriminatory.

---

9 *See infra* Section III.

10 AT&T Comments at 33. Ramsey prices are inversely related to market demand elasticities (the sensitivity of consumers' purchases to changes in price). Under Ramsey pricing, a service with a more inelastic demand (*i.e.*, where consumers react less to a change in price) should be assessed higher taxes,

Well-established economic thought shows a more economically efficient outcome is achieved when elasticity of demand is considered; it induces a relatively smaller reduction in service consumption than if the same TFA were applied to a service that had demand which was more price-sensitive. According to noted economists such as Alfred Kahn, this approach minimizes the welfare loss.[11] Indeed, when taxes, fees and assessments are increased for elastic services, such as wireless and interexchange service, consumer welfare is reduced. According to a former Commission Chief Economist, the effect of charges such as USF assessments "is to raise wireless providers' costs, which ultimately translates into higher prices. These higher prices suppress demand and lower consumer welfare."[12]

Thus, AT&T is plainly wrong when it asserts that the Commission will acquit its responsibilities if it merely determines whether "the contribution mechanism, in its actual implementation, assess[es] contribution on the same basis to all contributors providing the same service."[13] Any dictionary will tell you that ***equitable does not mean equal.*** For any assessment mechanism to comply with the Act's "equitable and nondiscriminatory" requirement, it must take into account the relevant differences among telecommunications carriers. The differences include, among others, the competitiveness of the market and the elasticity of demand for different telecommunications services.

---

fees and assessments ("TFA") relative to other services. Contrary to AT&T's contention, Nextel did not urge the adoption of a strict Ramsey pricing mechanism. Such a mechanism would require the Commission to estimate the marginal costs of each service as well as the average level of taxation. The elasticity weighted factors Nextel derived represent an approximation of Ramsey pricing – "the inverse elasticity rule" – and require only knowledge of the elasticities of demand for the different services. This approach is much simpler to implement and makes economic sense.

[11] *See, e.g.*, ALFRED E. KAHN, THE ECONOMICS OF REGULATION, vol. II, at 102 (1971).

[12] Michael L. Katz and John B. Hayes, *Unintended Consequences: Public Policy and Wireless Competition*, at 29 (October 1, 1998).

[13] AT&T Comments at 34.

Ironically, in the past AT&T has itself supported the use of a "demand elasticity" analysis. On September 22, 1993, for instance, AT&T filed a motion with the Commission to be declared non-dominant under Part 61 of the rules. As part of its argument in support of the petition, AT&T argued that the high elasticity of demand for interexchange service made it impossible for AT&T to be a dominant carrier.[14] Thus, AT&T understood why these are helpful measures that can enhance public welfare.

USTA similarly misunderstands the point. According to USTA, the "adoption of a contribution mechanism pursuant to Section 254(d) has absolutely nothing to do with the concept of loading more costs on consumers who need a service and have fewer alternatives to that service (Ramsey pricing)."[15] This is simply wrong: Section 254 has everything to do with ensuring that USF contributions are equitably dispersed among industry segments and that one class of carrier is not unfairly forced to pay more into the fund than the others. The only way to ensure this is to consider the demand elasticity of what are currently distinct services.

Economic theory and practice show that different industry segments face different consumer demand for their services.[16] Certain providers, like CMRS carriers, operate in fiercely competitive markets, while others do not. Assessing USF costs on every provider on the same

---

[14] *See* Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, *Order*, 11 FCC Rcd 3271, ¶ 53 (1995) ("AT&T maintains that a high own-price elasticity of demand for long-distance services prevents AT&T from possessing or exercising market power. AT&T argues that churn data are a key indicator of the demand responsiveness of the market and the inability of any single carrier to exercise market power."). *See also* Implementation and Scope of the International Settlements Policy for Parallel International Communications Routes, *Order on Reconsideration*, 2 FCC Rcd 1118 , n. 23 (1987) ("AT&T stated that the growth and elasticity of demand for international voice services and the fact that traffic balances are almost universally outbound from the U.S., with the U.S. in the payor rather than the payee position, provides U.S. carriers with greater bargaining power in their relationships with foreign correspondents.").

[15] USTA Comments at 10.

[16] *See, e.g.*, Nextel Comments on Second FNPRM at 19; Nextel Reply Comments on Second FNPRM at 12-13.

basis cannot lead to a rational outcome because inelastic services, such as traditional local landline service, will experience little shift in consumer demand as compared to highly elastic services such as CMRS and interexchange services.[17] The welfare losses (or cost) to consumers and providers of over-assessing these highly elastic services will be great, because the price for service will increase more than it should, resulting in a lowering of demand for the service and concomitant consumer welfare loss.[18]

III. USF ASSESSMENTS THAT ACCOUNT FOR ELASTICITY OF DEMAND FOR SERVICE ARE WORKABLE AND READILY ACHIEVABLE.

A. AT&T's Assertion that Nextel's Proposal is "Unworkable" is Plain Wrong.

AT&T also asserts that Nextel's "elegant economic theory," is "wholly unworkable," because it would require the Commission to develop estimates of the elasticity of demand for each service provided over the PSTN, and then develop a means to be *responsive* to changes in those elasticities. Critically, AT&T fails to explain why factoring demand elasticity would be "unworkable." Its assertion is incorrect.

As Nextel's reply comments demonstrated, using elasticity-weighted contribution factors, the relative funding burden can be calculated readily. The fundamental benefit of this exercise is

---

[17] The "bundling of service" issues raised by both AT&T and USTA are diversions from this fundamental point, and are merely meant to distract the Commission from even taking the necessary first step to consider demand elasticity in the USF assessment methodology. So too are the concerns about cross-elasticity. Nextel recognizes the importance of including cross-elasticities of demand, *i.e.,* the change in demand for one service due to a change in the price of another service,. into the Commission's USF methodology. Consideration of cross-elasticity can be done utilizing the concept of "super elasticity" which incorporate the self elasticity and cross-elasticities into one number which is then used instead of the elasticity. This simply should not be a deterrent to the Commission moving forward with an elasticity of demand analysis.

[18] *See, e.g.*, Jerry Hausman and Howard Shelanski, Economic *Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE LAW J. ON REG. 16 (Winter, 1999) ("the lower the elasticity of demand for a service, generally the less the harm to total economic welfare from raising the price of that service."); Jerry Hausman, *Taxation through Telecommunications Regulation*, in J. Poterba (ed.), TAX POLICY AND THE ECONOMY, 12, at 29-48 (1998).

that it results in an economically more rational approach that reduces unnecessary consumer and producer welfare losses.[19]

Implementing this program change will not require a major overhaul of either the existing revenue-based USF assessment approach or any of the connection-based plans proposed. Presumably, the Commission has the data necessary to estimate the elasticity of demand for each industry segment and can review it on an regular basis to respond to any demonstrated industry convergence or change. Further, any information the Commission lacks can be obtained easily from carriers and their trade associations. Elasticity of demand could, for example, be estimated and adjusted with every edition of the industry analysis reports.[20]

B. Differences Plainly Remain in the Elasticity of Demand for Different Telecommunications Services.

USTA asserts that differences in the elasticity of demand for traditional wireline and competitive wireless services no longer exist. According to USTA, "[w]ireline service is not inelastic. More and more wireline customers are substituting wireless for wireline service. Almost one in five Americans use their cell phone as their primary telephone. Significantly more Americans are expected to follow suit in the next five to ten years."[21]

USTA's data does not mean, however, that Americans are dropping their landline phone service. By USTA's own admission, Americans are maintaining their landline telephone service, even while using wireless as a convenient, add-on service. This data only confirms Nextel's basic point that relative to cellular service, demand for local landline service is highly

---

[19] *See* Nextel Reply Comments on Second FNPRM at 15-16.

[20] USTA and AT&T seem concerned that service convergence is not considered in Nextel's proposal. Nextel never suggested that the factors selected initially must stay in place forever. The Commission can periodically review market developments to determine appropriateness of demand elasticity factors, on a yearly or a biennial review process.

[21] USTA Comments at 8-9.

inelastic.[22] Limited substitution of service (as opposed to outright replacement of service) is no reason to reject an analysis of demand that enhances economic welfare.

In its December 4, 2002 *ex parte*, Nextel demonstrated that the elasticity of demand for wireless service is between 100 and 200 times greater than that for traditional local wireline service.[23] The basic monthly rate for flat-rate local service is simply not sensitive to price. Wireless consumers, as well as long distance consumers, on the other hand, tend to swap their service when prices increase or when better deals are offered by competitors. The Commission must consider these facts in crafting any new USF assessment methodology.

IV. CONCLUSION

Based on the foregoing, Nextel respectfully requests the Commission direct appropriate revisions to the *Staff Study*.

Respectfully submitted,
NEXTEL COMMUNICATIONS, INC.

/s/ Laura H. Phillips
Laura H. Phillips
Laura S. Gallagher
DRINKER BIDDLE & REATH LLP
1500 K Street, N.W., Suite 1100
Washington, D.C. 20005-1209
(202) 842-8800

Its Attorneys

Leonard J. Kennedy
Senior Vice President and General Counsel
Lawrence R. Krevor
Vice President – Government Affairs
James Paull, IV
Senior Manager – Government Affairs
NEXTEL COMMUNICATIONS, INC.
2001 Edmund Halley Drive
Reston, VA 2019

May 16, 2003

---

[22] Indeed, only about 3 percent of American users rely on their wireless phone as their only phone. That percentage has remained steady for the past couple of years. As one Yankee Group analyst recently noted "[w]e don't think people are giving up their landline phones, However, we think they are increasingly using their wireless phone and replacing minutes from their landline phone." *See* Judy Sarles, *Wireless Users Hanging Up Their Landline Phones*, SAN FRANCISCO BUSINESS TIMES, March 31, 2003.

[23] *See* Nextel December 2002 *Ex Parte* at Attachment (Impact of Universal Service Reform on the Wireless Industry) page 8 attached to Nextel's Comments (citing to Jerry Hausman, *Efficiency Effects on the U.S. Economy from Wireless Taxation*, NATIONAL TAX JOURNAL, Vol. 53, No. 3 Part 2 (September 2000); Yankee Group Report, "Competition Begins to Have an Impact on Wireless Pricing," April 18, 1997)).