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September 17, 2010

VIA ECFS

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Ex Parte Presentation, Universal Service Contribution Methodology, WC Docket No. 05-337, WC Docket No. 06-122 & GN Docket No. 09-51

I write to you on behalf of XO Communications, LLC ("XO"). The Commission has stated its intention to begin anew its ongoing effort to reform the federal Universal Service Fund ("USF") contribution methodology. The current system clearly is flawed, and XO applauds the Commission's commitment to fix it. However, in embarking on this effort, XO urges the FCC to reject outdated notions that numbers-based or connections-based approaches are the only available means to solve the USF funding dilemma, and instead to seek comment on the potential of remedying the situation simply by substantially expanding the base of contributors to the current revenues-based assessment system.

For the reasons set forth below, XO believes that expanding the base of federal USF contributors will permit the Commission to decrease the contribution factor to a reasonable level while more equitably spreading the burden of funding among competitors on a technology-neutral basis. There is no compelling rationale for the Commission to modify the current contribution scheme, and none of the alternative proposals ensure that providers of interstate telecommunications services make equitable and nondiscriminatory contributions to USF, as required by Section 254. Moreover, adoption of a numbers-based, connections-based or a hybrid methodology would require carriers to implement new tracking and billing mechanisms, and none would simplify the contributions system.

Numbers-Based Methodology. A numbers-based methodology is not forward-looking and does not resolve the concern about shrinkage of the base. Such an approach does not account for the myriad non-traditional uses of numbering resources made by service

providers today and in the future. For example, devices that provide machine-to-machine connections, such as Kindle and Nook e-readers, gaming consoles, and smart grid networks, often utilize numbering resources even though they provide no voice component. These devices provide ongoing services utilizing telecommunications networks but require no ongoing monthly fee or billing relationship with a telecommunications provider. Conversely, some voice over internet protocol ("VoIP") services mimic traditional telephony but route calls utilizing ENUM databases rather than via the public switched telephone network ("PSTN") using numbering resources,[1] which would potentially lead to inequitable exemptions for these providers under a numbers-based system.

In addition, companies continue to develop innovative new products and services that minimize the use of the PSTN (and, in turn, numbering resources). For example, Cisco is introducing new technologies that allow private PBXs to communicate with each other over the PSTN to establish *initial* connections and certifications, but then routinely route future communications between the devices over IP networks.[2] And services such as SayNow use telephone numbers to offer the ability for fans and celebrities to connect with one another for free via voice and text messaging. Each celebrity is given a telephone number, which fans can call to leave messages or which celebrities can use to leave messages for their fans.[3] The Commission should not adopt policies that would stifle these innovative services or encourage arbitrage opportunities. However, a numbers-based methodology for federal USF contributions could lead to gaming of the system as carriers modify services to unnecessarily avoid or hide the use of numbers. While no one can predict every future potential use of numbering resources, we do know that the state of the industry is not static and will constantly be moving forward.

Increasingly, numbering resources are being used for services other than telecommunications, while on the other hand, the provision of VoIP services similar to traditional telephony are reducing their use numbering resources. Therefore, there is little nexus between assignment of telephone numbers and usage of interstate telecommunications. Since use of numbers does not reflect usage of interstate telecommunications, a numbers-based

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1 See attached diagram depicting the evolution of voice services away from the PSTN.

2 *See* Jeffrey Burt, *Cisco IME Server to Expand Reach of UC Beyond Firewalls* at http://www.eweek.com/c/a/VOIP-and-Telephony/Cisco-IME-Server-to-Expand-Reach-of-UC-Beyond-Firewalls-385310/ (March 12, 2010) ("Each site will have an IME server, and when a person at one site makes a call to a person at another site, the IME takes the information and finds the best way to route the call over the Internet or private IP network. From that point on, calls between the two numbers will run over IP networks rather than over traditional phone lines, and callers will begin the call as they always have. The IME, which establishes the route, won't have to process the calls after that, and there won't be any changes needed on the end devices").

3 *See Phone Numbers Are Dead, They Just Don't Know It Yet* at http://techcrunch.com/2010/08/28/phone-numbers-dead/ (August 28, 2010); *see also* http://www.crunchbase.com/company/saynow.

approach risks placing a disproportionate responsibility for USF contribution upon relatively small users of interstate telecommunications. Prominent examples include government agencies, military bases, universities, and hospitals, who use thousands of numbers but who often have relatively low usage of interstate telecommunications per line. Granting exceptions for these *de minimis* users – in addition to other users also seeking exemptions – would complicate administration of the fund as well as shrink the base for contributions. By contrast, some users consume large volumes of interstate telecommunications over connections that have no associated telephone numbers (VoIP services with no telephone number assigned, for example) and thus avoid contributing to USF entirely under a numbers-based approach.

A numbers-based approach also sets up a serious jurisdictional conflict. Many lines with numbers assigned to them are used exclusively to purchase local exchange or other purely intrastate telecommunications services. Without some complex administrative scheme to cope with the problem, a numbers-based approach could unlawfully assess federal USF for purely intrastate services. Even where a line is not used exclusively for intrastate telecommunications, a flat-rate contribution mechanism cannot properly account for a customer's relative consumption of interstate versus intrastate telecommunications.

Connections-Based Methodology. A connections-based system suffers from many of the same pitfalls as a numbers-based system because of the complexities in identifying various speeds of circuits and services that carriers offer. Importantly, there is little correlation between connection speeds and usage of telecommunications services. The connection speed of a particular service merely identifies the amount of bandwidth that may be available for usage. Customers often purchase excess bandwidth for backup or future growth so the connection speed alone does not accurately reflect their use of particular circuits or services. Thus, assessing USF based on available bandwidth improperly taxes spare capacity and could lead to poor network management practices. In any event, the record developed thus far does not contain sufficient detail on how a connections-based contributions mechanism would work, except to highlight the fact that additional arduous tracking and reporting would be necessary.

Hybrid System. A hybrid system cures none of the deficiencies of a purely numbers-based or connections-based system. Rather than provide a simpler, more cost-effective means of assessing contributions from service providers, hybrid contribution mechanisms are more complex and expensive to administer than the current revenues-based contribution mechanism. A hybrid mechanism would create and require contributors to follow complex and essentially arbitrary distinctions between residential/wireless versus business customers, entities covered by Section 254 of the Act versus entities not covered by Section 254, North American Numbering Plan ("NANP") numbers versus NANP number equivalents, and number (or number-equivalent)-based services versus non-number based services.

A hybrid system would require expensive modifications – times two – to billing systems, accounting practices, and information technology resources to calculate and recover contributions based on two methodologies. For example, a numbers/revenues hybrid system would require carriers to maintain current revenue tracking systems while adopting new tracking mechanisms to ascertain whether a number is assigned to a residential or business customer, to report numbering usage for universal service fund purposes, and to calculate and recover contributions based upon the type of end user. Similarly, a hybrid numbers/connections contribution mechanism would require carriers, at a minimum, to develop the ability to track whether a number is assigned to a residential or business customer, to track and report numbering usage and the speed of the connection that provides service to a customer, and to modify billing, accounting practices, and information technology resources to calculate and recover contributions based upon the type of end user. Because of their complexity and ambiguity, hybrid proposals increase implementation, administrative and compliance burdens, create additional opportunities for arbitrage, and make compliance audits by regulatory authorities much more difficult and expensive. These detriments far outweigh any benefits they may offer and would make the contribution mechanism less stable and predictable than the current revenues based system.

Since numbers-based and/or connections-based assessment systems are beset with serious pitfalls, XO suggests that the Commission consider solving the USF funding problem by simply reforming the existing revenues-based assessment system. As NTCA accurately observed nearly two years ago, "[r]evenues reflect the balance consumers strike between competitive offerings, new and old technologies, and changes that occur over time. Contributions based on other measures, including numbers and connections, would reflect values at the time of adoption and require frequent periodic adjustments. The Commission should therefore continue to assess revenues for contributions to universal service."[4]

That is not to say, of course, that USF contribution reform is unnecessary. There can be no question that a USF contribution factor that has exceeded 15% in recent quarters is unacceptably high and unsustainable. However, XO believes that the contribution factor can be reduced substantially within the context of the existing revenues-based assessment system by fairly expanding the base of assessable revenues. As NTCA previously suggested, revenues

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4 *Reply Comments of NTCA*, WC Dkt. 05-337 *et seq*, p. 19 (Nov. 26, 2008) (*"NTCA Reply Comments"); see also, Comments of NTCA*, WC Dkt. 05-337 *et seq*, p. 29 (Dec. 22, 2008)(*"NTCA Comments")*(stating that they saw "no compelling reason to abandon the current revenues-based USF contribution system"). We, too, suggested that revenues remain the best basis for assessing USF contributions. *See, Letter of Genevieve Morelli to Marlene Dortch, Notice of Ex Parte Presentation,* GN Dkt. 09-51 *et seq, at p. 2* (Dec. 9, 2009)("[n]o party has shown why the current revenues-based system is broken beyond repair and would not work if the contribution base is broadened…."). *See also, Comments of Broadview Networks, Cavalier Telephone, Nuvox and XO Communications*, WC Dkt. 05-337 *et seq*, pp. 47-56 (Nov. 26, 2008).

should continue to be the basis for determining contributions "as long as the assessment does not produce an unreasonable result" and the "best way to keep the factor reasonable is by ... expanding the base of contributors to include all providers who benefit from interconnection to the PSTN, and including the assessment of all retail revenues associated with interstate telecommunications."[5] SouthernLINC Wireless recently echoed the same theme by stating that "modification of the current revenues-based contribution system" is far preferable to any hybrid numbers/connections-based system, and expressing support for "expansion of the contributions base."[6]

The problem with the current USF contribution system is not the revenues-based assessment *per se*; rather, it is that growth of assessable revenues has not kept pace with the increasing need for USF funding. For example, while the demand for USF funds increased from $5.97 billion in 2004 to a total projected demand of $8.4 billion in 2010 (a 39.7% increase), assessable interstate and international telecommunications revenue actually decreased from approximately $80 billion to a projected total of only approximately $69 billion during the same timeframe (a 16% decrease). Because the USF has grown while assessable revenues have remained stagnant, the contribution factor has necessarily increased substantially. Indeed, the contribution factor has increased from 8.76% in 2004, for example, to an average rate of nearly 14% for all of 2010 (a 57.5% increase).[7]

It is key to recognize that telecommunications-related revenue has actually continued to grow. Even a casual observer knows that wireless communications and Internet communications have experienced explosive growth over the past decade. It is only "assessable" revenue that has declined. As the telecommunications industry has evolved, it appears that service providers (and their customers) have steadily substituted new products that are treated as exempt from federal USF assessment in place of legacy interstate voice telephony offerings that remain fully assessable. For example, consumers have migrated to bundled voice telephony packages where interstate "long distance" minutes ostensibly are offered for substantially reduced prices. Similarly, consumers make much more extensive use of their wireless mobile telephones, and CMRS carriers are obligated to report only a minor portion of their revenues as assessable interstate telecommunications. Moreover, Commission decisions to classify all broadband Internet access as "information service" further exacerbate the problem by assigning a huge area of growth to a non-assessable category. Notably, this product substitution likely is

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5 *NTCA Reply Comments*, p. 18.

6 Letter of Todd Daubert to Marlene Dortch, *Notice of Ex Parte*, WC Dkt. 06-122 *et seq*, p. 1 (Aug. 20, 2010).

7 *See, Universal Service Monitoring Report for 2009*, CC Dkt. 98-202 (*"2009 USF Monitoring Report"*), Table 1.1 & *Federal Universal Service Mechanisms Quarterly Contribution Base for the Fourth Quarter 2010*, USAC (Sept. 1, 2010).

occurring at least in part due to the significant artificial cost advantage that non-assessable interstate services have over assessable interstate services -- *i.e.* a government imposed 14% surcharge on assessable services is a powerful incentive for consumers to replace them with less costly non-assessable services. As NTCA explained, "[s]addling traditional wireline and wireless voice service with the entire USF contribution burden ...accelerate[s] the migration away from these services to cheaper alternatives...."[8]

Importantly, relatively modest expansions in the assessable revenue contribution base can quickly result in a substantial reduction in the USF contribution factor. For example, expanding the assessable contribution revenue base by only around $35 billion could reduce the contribution factor by more than 1/3, and expanding the assessable contribution revenue base by $70 billion could cut the contribution factor in half. These figures are readily achievable when you consider the wealth of untapped telecommunications-related revenue available for assessment. While total end user telecommunications revenues in 2007, for example, were reported at $239 billion, only $80 billion was reported in federal USF-assessable categories that year.[9] Even more incredible, during the same year nearly $132 billion was reported to USAC as non-assessable "Non-Telecommunications," despite the fact that many (if not most) of the products included in that category have telecommunications transmission components embedded in them.[10]

There is ample precedent for the Commission to expand the list of assessable services so long as they include the provision of "telecommunications." In 1997, the FCC exercised its permissive authority in Section 254(d) to require "any other provider of interstate telecommunications" to contribute to USF "if the public interest so requires" and added two categories of non-telecommunications carriers to the list of required contributors. In adding private carriers and payphone aggregators to the list, the Commission emphasized that it was preserving competitive neutrality by ensuring that no technology gleaned a competitive advantage due to a USF exemption, broadening the contribution base to fairly spread the burden of USF funding between classes of providers that compete with one another in the marketplace, and carefully extending the obligation only to businesses that include telecommunications in the "core" of their business.[11] Much the same rationale was used by the FCC in 2006 to add interconnected VoIP providers to the list of mandatory contributors.[12] Indeed, as explained

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8 *NTCA Comments,* p. 28.

9 *See, 2009 USF Monitoring Report*, Tables 1.1 & 1.4.

10 *Id.,* Table 1.2.

11 *Universal Services First Report and Order*, Federal-State Joint Board on Universal Service, CC Dkt. 96-45, 12 FCC Rcd 8776 (1997).

12 *Second Contribution Methodology Order*, Federal-State Joint Board on Universal Service, CC Dkt. 96-45, 21 FCC Rcd 7518 (2006) (*"Interconnected VoIP Order"*).

further below, by treating interconnected VoIP providers as "other providers of telecommunications," the Commission essentially recognized the principle that providers of enhanced or information service could be obligated to make contributions under the USF program to the extent they include the provision of telecommunications.

Accordingly, XO suggests that the Commission explore anew the feasibility of expanding the USF revenues contribution base by assessing the telecommunications components of products that currently are treated as totally non-assessable. The following is an illustrative, non-exclusive list of services that the Commission should consider:

Broadband Service Providers. When the Commission elected to classify first cable modem and later all integrated wireline broadband Internet access as information services, it created a glaring omission from USF funding obligations. Telecommunications transmission that is fully assessable when offered on a stand-alone basis suddenly became fully exempt from USF contribution when integrated with Internet access functions. It is not happenstance that the total revenue reported to USAC as "Non-Telecommunications" swelled from $101 billion to nearly $132 billion in the first year after the wireline broadband information service classification became fully effective.[13] A telecommunications transmission component clearly is "core" to any integrated Internet access service offering, and the Commission should consider making at least a reasonable allocation of the revenue attributable to the telecommunications transmission input assessable.

XO agrees with NTCA's statement two years ago that "[if] broadband services are included in the definition of universal service, it is only logical that contributions be based on information services as well as telecommunications services. NTCA urges the Commission to expand the pool of USF contributors to include all cable, wireline, wireless, electric, and satellite broadband Internet access providers, all voice substitute services and all special access service providers. Section 254(d) specifically provides the Commission with permissive authority to require any provider of interstate 'telecommunications' to contribute to universal service. Requiring all broadband service providers and all voice substitute providers to contribute will provide sufficient universal service collections and create long-term stability in the USF contribution methodology."[14]

CMRS Voice Revenue. Currently, most revenue derived from CMRS voice telephony is exempt from federal USF contributions. CMRS providers are allowed to use either a 37.1% safe harbor to report their revenue into the federal USF fund even if their interstate traffic exceeds the safe harbor threshold. Moreover, CMRS providers are permitted to further

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[13] *See, 2009 USF Monitoring Report,* Table 1.2.

[14] *NTCA Comments,* pp. 26-27; *see also, Id.* at 28.

reduce their liability by producing a traffic study which supposedly establishes an even lower interstate usage. CMRS service is totally nomadic, and the truth is that the originating telephone number (and billing address) are meaningless in establishing the jurisdiction of any particular call, yet these criteria are routinely used in traffic studies. In addition, Section 332(c)(3) preempts state regulation of CMRS entry and rates, implying that all CMRS service is, at bottom, interstate. Accordingly, the Commission should consider declaring 100% of CMRS voice revenue as interstate telecommunications for purposes of federal USF assessment.

CMRS Data Revenue. The data services provided by CMRS carriers are growing exponentially. It is estimated that US wireless carriers derived approximately 30% of their total revenue from the provision of data services in 2009, and the total revenue from wireless data services was approximately $42 billion. Approximately 40% of wireless data revenue is attributable to text messaging services, while 60% is for non-messaging related usage.[15] Just as with wireline broadband Internet access, the telecommunications transmission component clearly is "core" to the service. Thus, at a minimum, the Commission should consider making at least a reasonable allocation of the revenue attributable to the telecommunications transmission input assessable.

Nomadic Interconnected VoIP Revenue. Interconnected VoIP providers are required to contribute to USF. However, they are permitted to apportion their revenue between the intrastate and interstate jurisdictions using either a 64.9% safe harbor even when actual interstate usage exceeds the 64.9% threshold. As is the case with CMRS voice traffic, interconnected VoIP providers are permitted to reduce their liability further by producing a traffic study. With respect to nomadic interconnected VoIP, however, those traffic statistics have little meaning. Similarly to CMRS traffic, the mobile nature of the devices makes the originating telephone numbers and billing addresses of customers relatively meaningless as identifiers of originating locations of traffic. Hence the Commission should consider declaring that 100% of revenue derived from nomadic (as opposed to fixed) interconnected VoIP services should be treated and reported as interstate traffic for USF purposes.

Non-Interconnected VoIP. Service providers that provide VoIP services that do not connect to the PSTN for *both* inbound *and* outbound calling currently are exempt from federal USF assessment. This has created an enormous loophole that has permitted some service providers to create services that connect to the PSTN, but only permit either outbound or inbound calling in order to claim a USF exemption. However, such non-interconnected VoIP services utilize telecommunications transmission in the same manner as do interconnected VoIP services, and they compete directly with the provision of voice services that connect to the PSTN in both directions. Thus, the Commission should revise the policy to require that all

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[15] *US Wireless Data Market Update – Q1 2009,* Chetan Sharma Technology & Consulting.

interconnected VoIP providers that connect to the PSTN to *either* place *or* receive calls must contribute to USF.

Other Information Services. The total revenue reported to USAC as "Non-Telecommunications" for 2007 was nearly $132 billion.[16] Although the "Non-Telecommunications" category includes revenue from many different areas, presumably a significant portion of that amount is attributable to the provision of a host of information services by companies that self-supply a telecommunications transmission input into the services. In addition to the potential assessment of a reasonable allocation of the revenues derived from broadband Internet access services discussed above, the Commission should require similar treatment for all information services where the service provider self-supplies the telecommunications transmission used to provide service (*i.e.,* where the information service provider does not purchase the underlying telecommunications service as an end user from a telecommunications carrier, and accordingly is charged USF by their underlying carrier).

The Commission has the legal authority to require all providers of interstate telecommunications to contribute to the federal USF if the public interest so requires.[17] Although the telecommunications transmission component of enhanced or information services is ostensibly embedded, it is unequivocally present, as the Commission clearly stated in the *Wireline Broadband Order.*[18] The definition of "enhanced services" includes "services, *offered over common carrier transmission facilities used in interstate communications*, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information."[19] Information services means "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information *via telecommunications*, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service."[20] Accordingly, there can be little doubt that those providers that offer enhanced services or information services integrate telecommunications into their products which are in turn offered to their customers. As such, even if that telecommunications is provided only on an integrated basis, it is nonetheless provided.

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16 *2009 USF Monitoring Report,* Table 1.2.

17 47 U.S.C. § 254(d).

18 *Wireline Broadband Order* ¶ 104.

19 47 C.F.R. § 64.702(a) (emphasis added).

20 47 U.S.C. § 153(20).

Consistent with Section 254(d) of the Act, some of the resulting revenues may be reasonably and justifiably allocated to this telecommunications component.

The Commission has, on several occasions, recognized, either explicitly or implicitly, its authority to collect USF contributions from revenues earned by information service providers. In its *Wireline Broadband Order*, the Commission adopted a regime whereby facilities-based wireline broadband Internet access providers could declare themselves enhanced service providers rather than telecommunications carriers. However, at the same time, the Commission required "that facilities-based providers of wireline broadband Internet access services must continue to contribute to existing universal service support mechanisms based on the current level of reported revenue for the transmission component of their wireline broadband Internet access services for a 270-day period after the effective date of this Order or until we adopt new contribution rules in the Universal Service Contribution Methodology proceeding."[21] Notably, the Commission took this action "as a matter of policy, to preserve existing levels of universal service funding, and prevent a precipitous drop in fund levels while we consider reform of the system of universal service in the Universal Service Contribution Methodology proceeding."[22] The Commission recognized its options, if "unable to complete new contribution rules within the 270-day period of time," included taking "whatever action is necessary to preserve existing funding levels, including extending the 270-day period discussed above or expanding the contribution base."[23]

Authority for the Commission to extend universal service contributions to revenues for telecommunications that make up a component of the information services described above can also be gleaned from the *Interconnected VoIP Order,* 21 FCC Rcd 7518, *supra*. There, the Commission extended contribution obligations to providers of "interconnected VoIP" service on two bases of authority, the permissive authority of Section 254(d) and ancillary authority under Title I.[24] Notably, the Commission determined that interconnected VoIP service was telecommunications but did not resolve whether the service was information service or telecommunications service.[25] In effect, the Commission concluded that it did not matter, and that even if interconnected VoIP was an information service, it would be subject to universal service contributions.[26]

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21 *Report and Order and NPRM*, CC Dkt. 02-33 *et seq*, ¶ 113 (Sept. 23, 2005)(*"Wireline Broadband Order"*).

22 *Id.*

23 *Id.*

24 *Id.* at 7538-7542.

25 *Id.* at 7537.

26 *Id.* at 7538-7542.

Applying the Commission's prior approaches to the services identified above, it is clear that the Commission has authority to extend the USF contribution obligations to the providers of such services. Broadband Internet access service providers rely heavily on integrated but distinct transmission capabilities, whether provided on a facilities or resale basis, to allow their subscribers to reach the websites of their choosing, where the subscribers can then interact with or modify the content of web pages, among other information services provided. Between the customer's premises and the websites, the service provided is clearly telecommunications: namely transmission of information of the subscriber's choosing without change in the content or protocol of the information. The manipulation of the information or the change in protocol occurs elsewhere, at the database, at the web-site or host, and so on. Accordingly, it is entirely consistent with the treatment for general purposes of the service, taken as a whole, as an information service, to treat, for universal service purposes, the transmission component as assessable. Moreover, it is in the public interest as all of the foregoing services, directly or indirectly, rely on the PSTN and, separately, the Commission has determined the need to maintain current funding levels. Certainly it is in the public interest to maintain those levels in a fair and even handed manner that allows the contribution factor to decline once again to reasonable levels. Consequently, there can be little doubt that the Commission has the authority to make assessable the revenues from a substantial component of both wireline and wireless Internet access and data services.

Thus, with respect to the upcoming rulemaking proceeding regarding USF reform, XO respectfully suggests that the Commission reject earlier proposals to change the contribution methodology and instead seek comment on the wisdom and feasibility of substantially increasing the universe of interstate revenues that are assessable for federal USF purposes. The goal would be to expand the assessable base sufficiently to drive the contribution factor down to a reasonable level while spreading the burden of funding federal USF on a more technology-neutral basis than exists today. This, of course, assumes that the USF will be capped at current levels, which XO believes is critical to making any contribution reform plan work. The Commission should seek comment on what revenues could be added, the legal and policy bases for including them, and the potential methods for achieving reasonable allocations when telecommunications and enhanced services are integrated. XO looks forward to participating in the process.

Respectfully submitted,

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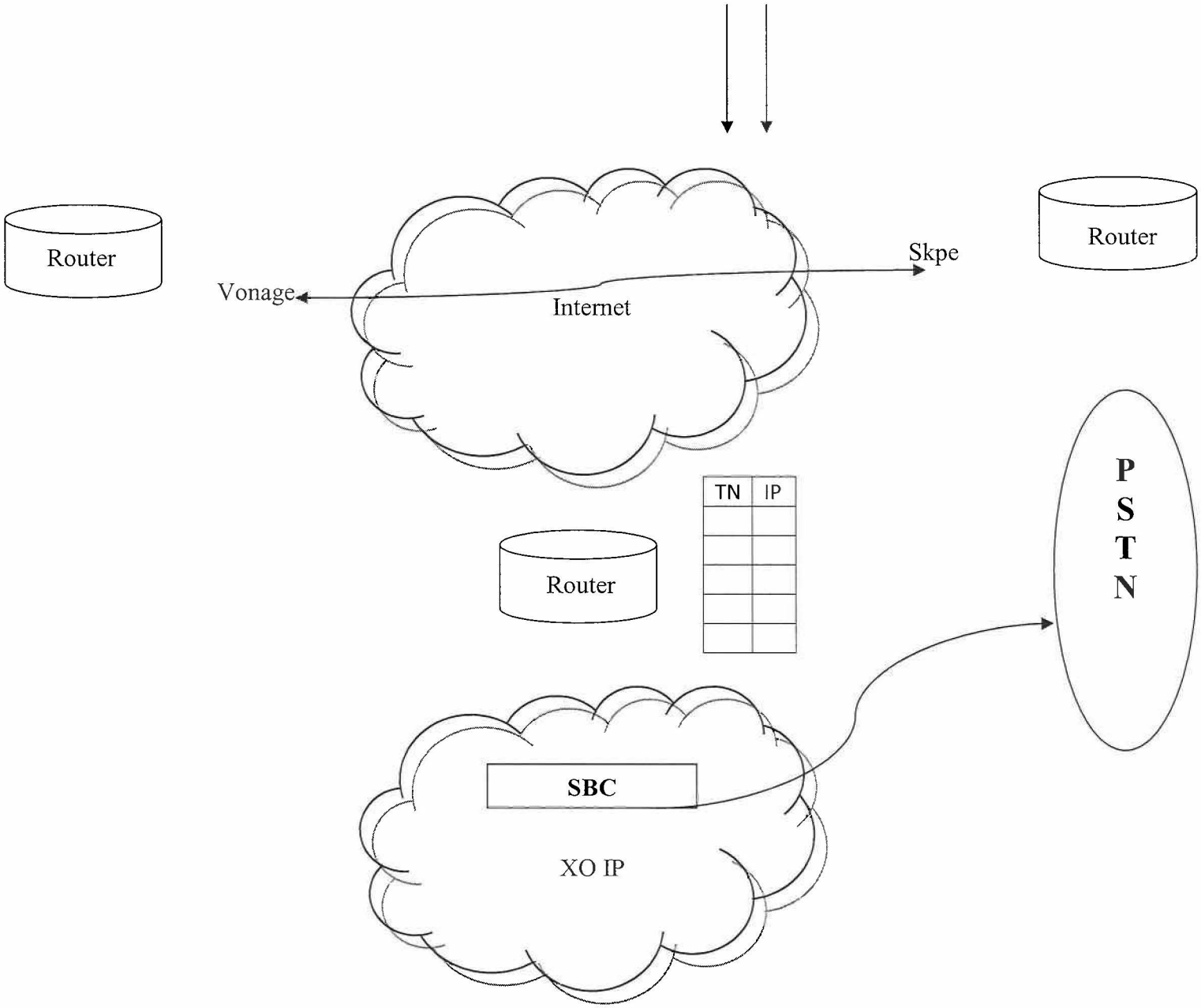
The Future Use of Telephone Numbers?
Evolving Away From the PSTN