Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Universal Service Contribution Methodology	)	WC Docket No. 06-122
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	

COMMENTS OF PEERLESS NETWORK, INC.

Dated: July 9, 2012

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I. INTRODUCTION AND SUMMARY

Peerless Network, Inc. ("Peerless") files these Comments on the Federal Communication Commission's ("FCC" or "Commission") Further Notice of Proposed Rulemaking in the Universal Service Fund ("USF") contribution reform proceeding.[1] The *FNPRM* requests comment on three primary proposals concerning how USF contributions should be assessed: 1) reform of the current revenues-based system; 2) assessing contributions on the basis of "connections;" and 3) assessing contributions on the basis of numbers.[2] With respect to the reform of the revenues-based system, the Commission also presents an alternative approach to the current system of basing collections on end user revenues to instead assess so-called "value-added" revenues.[3]

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[1] *In the Matter of Universal Service Contribution Methodology, A National Broadband Plan for Our Future,* WC Docket No. 06-122, GN Docket No. 09-51, Further Notice of Proposed Rulemaking, FCC 12-46 (rel. Apr. 30, 2012) ("*FNPRM*").

[2] *See FNPRM,* ¶ 98 *et seq*.

[3] *See FNPRM,* ¶, 149 et seq. (seeking comment on whether to modify the existing universal service contribution methodology to assess "value-added" revenues rather than "end-user" revenues).

Peerless Network Inc., through its operating subsidiaries (collectively, "Peerless Network"), has built one of the largest interconnection networks in the country, enabling wireless carriers, competitive and incumbent local exchange carriers, cable companies, enhanced service providers and enterprises to connect with one another regardless of how (SIP or TDM), where (centralized or decentralized) and with whom they need to interconnect. Peerless Network is connected to nearly every major domestic carrier, offering, call origination and termination services in over 100 LATAs and 30 MTAs. In this capacity, Peerless Network operates as a buyer and seller of both telecommunications and information services, and is fully aware of the issues associated with the current state of the USF system. As described in more detail below, Peerless believes that the existing USF system can be preserved and improved without creating major disruptions to the business that contribute to the USF system.

Peerless respectfully asserts that the expansion of the contribution base, under the existing revenues-based methodology, would solve most of the issues identified by the FCC with the existing USF contribution system, and meet the Commission's goals of efficiency, fairness and sustainability.[4] A value-added revenue assessment system is not necessary to increase the USF contribution base, and in practice would be administratively unwieldy, create market distortions, and would ultimately be counter-productive to the sustainability of the fund. Likewise, the proposed connections- and numbers-based systems would not produce the desired outcomes sought by the Commission. Finally, the FCC should ensure that carriers are not prohibited from passing through USF surcharges to customers.

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[4] *See FNPRM*, ¶¶ 23-25.

II. THE VALUE-ADDED SYSTEM WILL NOT WORK CORRECTLY

The Commission has solicited comment on switching from the current system to a "value added" system. Under this proposed method, each provider's revenues would be assessed based on the incremental "value" it adds to the service.[5] Switching to such a system is not, however, likely to work within the context of a special application assessment on telecommunications, as opposed to taxes of general applicability for which value-added approaches are often useful. A fundamental problem that plagues the current USF contribution system is the lack of clarity concerning which revenues are subject to assessment. The myriad of guidance documents and orders cannot keep up with the quick pace of the change of technology, which naturally leads to contributors drawing arbitrary lines in order to decide which service revenues should be reported and which should not. It would not be possible to construct a value-added system that is consistent with the Commission's authority under Section 254(d) of the Act[6] that would address this problem.

A. The Complexity of the Telecommunications Market Will Render a Value-Added System Unworkable

The complexity of the telecommunications marketplace today, where providers often bundle multiple products and inputs into end user telecommunications and non-telecommunications services, is an incredibly complex web of inter-related parts. Overlaying a value-added contribution methodology on this market will further complicate the reporting system, and will undoubtedly result in a significant increase in inter-carrier disputes as well as complaints and appeals to the FCC and USAC. Rather than simplifying the USF contribution

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[5] *See FNPRM* at ¶ 151.

[6] 47 U.S.C. § 254(d).

system, it will add additional layers of complexity and increase the Commission's costs of addressing disputes and appeals.

Further, the competitive pitfalls of a value-added system are numerous. Many carriers will see a value added methodology as an opportunity to game the system in order to shift costs onto their competitors. Because a wholesaler-reseller relationship can also be a competitor-to-competitor relationship, the ability to shift USF surcharges to competitors can create competitive inequities in the USF contribution burden, in violation of the Act. Assuming that current law regarding recovery of USF does not change,[7] wholesalers will have the opportunity to assess on their carrier customers -- who are also competitors -- both USF contributions and other add-on fees that are nominally intended to recoup administrative costs associated with USF. This approach would be nothing but an increase in revenue to wholesalers and incumbents at the expense of downstream competitors. Wholesale suppliers that provide service to carrier/competitors would be able to use a value-added system essentially to increase pricing on their competitors with below the line charges. In a competitive space, carriers could move to other suppliers, but when carriers are purchasing essential components from incumbent suppliers that are a sole source of last mile, special access, UNEs or other components, services that are now always considered wholesale[8] these monopolist providers will undoubtedly use USF charges and associated add-on fees to their competitive advantage.

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[7] *See* 47 C.F.R. § 54.712.

[8] *See 2012 Telecommunications Reporting Worksheet Instructions*, at 16, .

While a value-added taxation system may work for taxes of general applicability like sales and use taxes, for a limited application assessment like USF in as complex of a market as the telecommunications market is today, such a system would prove to be utterly unworkable. Typically in value-added system, everything coming in and out of a company would be subject to taxation, such as a state sales or use tax.[9] As described above, telecommunications components can be used for many things, including other telecommunications, VoIP or information services. These services face different regulatory regimes and different levels of USF contribution. Tracking whether an input was or was not subject to contribution and then whether the output was or was not subject to contribution will be incredibly difficult, and is likely to be difficult to track by carriers, and as a result, difficult to audit by USAC.

B. The Value-Added System Has Many Regulatory and Competitive Pitfalls

There is no reason to switch from the existing end user revenue-based system, in which carriers contribute based on end-user sales, by replacing it with a value-added system. The proposed value-added system is intended to improve the current contribution methodology because it would lessen the confusion associated with what is subject to USF, and thus would curb underreporting of the telecommunications components of services that contain both telecommunications and non-telecommunications services. The results of this confusion have occasionally been described pejoratively as "gaming" the system.[10] Much, if not all, of this supposed gaming is the result of confusion regarding the breadth of certain existing exemptions of the system, and can be ended simply by broadening the contribution base. Specifically, by

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[9] *See, e.g.*, the Michigan Single Business Tax, http://www.michigan.gov/taxes/0,1607,7-238-43533-154440--,00.html.

[10] *See FNPRM*, ¶ 23 ("Clearer, simpler rules that can be applied in new situations could deter gaming of the system and save consumers, companies, and the government money.").

including broadband[11] and other services in the USF contribution base, and clarifying the treatment of several services that are the subject of pending FCC appeals, the Commission can remove much of the line-drawing that is currently in the hands of the reporting entities. If broadband is re-introduced to the contribution base,[12] carriers that integrate wholesale telecommunications components in their combined telecommunications and broadband offerings will no longer be able to exempt this portion of their revenue from contribution while simultaneously having their sales be treated as exempt by their suppliers.[13] Because providers of broadband normally also provide telecommunications services, there is potentially a loss of contribution base when carriers use the exemption provided by the Wireline Broadband Order which also exempts the underlying component.[14] Adding broadband to the base and assessing the revenue at the end user level (where it is likely highest) solves this problem, without having to create a value-added system. Tracking and monitoring the "value-added" in such a system could be extremely burdensome for carriers, especially those that both buy and sell on a wholesale basis, or act as intermediate providers. Carriers purchase both telecommunications and non-

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[11] *See Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, et al.*, Report and Order and Notice of Proposed Rulemaking, CC Docket 02-33 et al., FCC 05-150(rel. Sept. 23, 2005) ("Wireline Broadband Order"); *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, et al.*, Declaratory Ruling and Notice of Proposed Rulemaking, GN Docket No. 00-185 et al., FCC 02-77 (rel. Mar. 15, 2002) ("Cable Broadband Order"). The Commission need not reverse its prior classification of these services, but instead can simply clarify that it can assess the telecommunications within these services.

[12] *See* Wireline Broadband Order and Cable Broadband Order (effectively removing broadband from the USF contribution base by classifying cable modem broadband and wireline broadband (DSL) as information services without retaining a USF contribution requirement).

[13] *See Universal Service Contribution Methodology, Request for Review of the Decision of the Universal Service Administrator and Emergency Petition for Stay by U.S. TelePacific Corp. d/b/a TelePacific Communications*, Order, WC Docket No. 06-122, DA 10-752, ¶¶13-16 (rel. Apr. 30, 2010) ("TelePacific Order")

[14] *See id.*

telecommunications and integrate them into their telecommunications and non-telecommunications offerings. Tracking and separating both inputs and determining their value-added elements to their telecommunications (while also separating out the telecommunications components used for information service) will be administratively burdensome and time consuming, and will assuredly result in further gaming of the system. The Commission should retain the existing revenues-based system, but should not burden it with a value-added assessment methodology.

III. CONNECTIONS- OR NUMBERS-BASED SYSTEMS WILL BE UNWORKABLE AND WILL NOT PRODUCE THE INTENDED RESULTS

A. A Connections-Based System Would Reduce Redundancy In the Network, And Skew Markets To the Detriment of Small Capacity Users

Because of the numerous different possibilities with a connections-based system, it is impossible to determine if a connections-based system will actually result in increased contribution base. The underlying assumption of the connections-based systems is that the growth in the use of numbers and connections[15] will continue at their current pace even if the USF contribution system is changed in a way that directly assesses fees based on those metrics.[16] If, however, the USF system is changed to a connections-based system, the price of connections will necessarily increase simply by adding an assessment to the facility, which, even by the most basic measures of economic behavior in turn will decrease customer demand. Customers with fixed amounts budgeted for connections will simply be unable to purchase more. Instead,

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[15] While this discussion talks primarily about a "connections-based" system, the same analyses, based on economic principles are equally applicable to a numbers-based system. Use of both are currently without a USF cost. Assessing a cost on them will create economic incentives to reduce USF contribution through a reduction in use.

[16] *See FNPRM*, ¶ 310 (requesting comment on the trend in numbers growth through 2015).

consumers will simply purchase fewer connections, perhaps through the use of compression technologies, sharing connections for multiple uses, as is already done for some services that dynamically switch between voice and data applications, or other means of maximizing the use of the connections that are purchased.

Assessing USF directly on connections will similarly create an incentive to find ways of minimizing contribution through reduced connections or numbers. Charging per connection will encourage carriers and consumers to minimize connection usage, which will reduce the use of multiple or redundant connections such as emergency back-up connections. The Commission should be advancing policies that improve network redundancy and diversity.[17] An assessment system based on connections will make the cost of redundancy more expensive, which will naturally discourage it. Discouraging redundancy and diversity in the network is not in the public interest.[18] Redundancy is but one example of a potential harm to the network through a direct assessment on connections. In general, connections growth would certainly slow, which

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[17] As noted by the FCC Public Safety Bureau's website, "Redundancy refers to the resiliency of communications systems that is achieved by alternative means or systems. Redundancy provides for multiple interchangeable components that can perform a common function as well as backup systems that perform a common function in the event of failure, mishap, or change in operational conditions. Redundancy is the provisioning of duplicative or repetitive components or systems to perform a common function. Redundancy of systems is a method of insurance against failure of primary system functionality. Redundancy may also be used in an a priori manner to preclude errors or failures from occurring in order to insure error free exchange of information." http://publicsafety.fcc.gov/pshs/clearinghouse/core-concepts/redundancy.htm.

[18] *See Independent Panel Reviewing the Impact of Hurricane Katrina on Communications Networks*, Report and Recommendations to the Federal Communications Commission, at 13 (July 12, 2006) (noting that one of the core problems identified following Hurricane Katrina was the lack of, and failure of, redundant pathways for communications traffic).

by decreasing connectivity, would be contrary the very aims of the USF system which is to encourage ubiquitous coverage of the network.[19]

If the Commission were to adopt a connections-based system, it would need to ensure that circuits are priced in tiers by volume. For example, a T-1 with 24 voice grade lines worth of capacity is not the same in terms of connectivity and function as 24 individual lines. The larger the capacity, the more likely it is sold for use that is capacity-intensive, but not necessarily high in cost. Without using pricing tiers, USF contribution fees could become a substantial portion of low capacity connection costs.[20]

B. A Numbers Based System Will Shift USF Contributions to Those That Use the Network The Least

A system based on numbers, or a hybrid of connections and numbers, is equally unworkable. First, numbers, by themselves, do not generate revenue, and are not distributed based on the revenue generation capacity of the service. As such, there are a number of uses of telephone numbers tied to important services that nonetheless have virtually no revenue. Some numbers, for example, are used primarily for technical reasons such as with telematics. Assessing USF contributions on non-telecommunications uses will result in fewer uses of telephone numbers, which in turn will result in reduced technological innovation in both the telecommunications and information services markets, which is not in the public interest.

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[19] 47 U.S.C. § 254(b)(2) ("Access to advanced telecommunications and information services should be provided in all regions of the Nation.").

[20] *See* Letter to Chairman Genachowski *et al*. from Ad Hoc Telecommunications Users Committee, Google, Inc., Skype Communications S.A.R.L., Sprint Nextel Corporation and Vonage Holdings Corp., WC Docket No. 10-90 et al., at 6-7 (filed Aug. 18, 2011) (advocating a tiered connection approach). While Peerless does not believe that a connections methodology should be implemented, to the extent the Commission implements such a system then the tiered connection approach would be the best means to undertake such an alternative.

Further, a contribution system based on numbers is highly likely to affect low-usage and residential customers disproportionately. Rather than assessing those entities that use the network the most, a numbers-based system will result in an inequitable and discriminatory contribution burdens, and is therefore more likely to be overturned on appeal. It will also link numbering policy with universal service policy, which may significantly hinder the Commission's ability in the future to modify policy in either of these areas (including NANP numbering reform and exhaust issues) without necessarily affecting the other, as well as the industry at large.

Finally, with respect to the question over the scope of the Commission's authority over the numbering system and a numbers-based assessment,[21] while the Commission holds plenary authority over the regulation of numbers under the U.S.-portion of the North American Numbering Plan,[22] it is entirely unclear whether that authority extends to USF assessments as well. Clearly, while Congress intended the FCC to ensure that numbering in the United States was ubiquitous and to "administer telecommunications numbering and to make such numbers available on an equitable basis,"[23] the Act does not state that the Commission has the authority to levy regulatory fees against those resources. While the Commission notes that its numbering authority was a basis for requiring VoIP providers to provide E911 services,[24] the Act specifically calls for the creation of a universal emergency telephone number.[25] It does not,

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[21] *See FNPRM*, ¶ 292.

[22] *See* 47 U.S.C. § 251(e).

[23] 47 U.S.C. § 251(e).

[24] *See FNPRM*, ¶ 291.

[25] 47 U.S.C. § 251(e)(3).

however, call for the use of numbers as a proxy for determining USF contributions. In fact, levying fees against numbers may violate the dictate in the Act requiring the Commission to administer numbers in a manner that results in equitable usage. Monetizing numbers in a manner that results in the use of those resources solely towards revenue generating services will not result in equitable distribution.

IV. THE EXISTING REVENUE SYSTEM CAN WORK WITH REFORMS THAT EXPAND THE CONTRIBUTION BASE AND COST CONTROL

The existing revenue system is the most equitable means of supporting USF. It charges retail carriers based on the telecommunications revenue they receive. Often, these charges are passed through to end users based on the amount of services they purchase. While the recent increases in the contribution factor are certainly problematic,[26] they are easily remedied within the existing system. Increases in the USF contribution rate over the past few years have been the result of: (i) the increase in demand for USF funding, and (ii) the removal of services from the contribution base. Neither of these factors requires resort to the value-added, connections, or numbers-based approaches discussed above.

First, increases in the demand for USF funding can be controlled. The Commission has recently substantially altered the legacy high-cost system to dramatically reduce not only growth, but also the size of this support. While the Connect America Fund ("CAF") is likely to be a significant draw on the overall fund, at least temporarily, the Commission's stated goal is to

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[26] *See FNPRM*, Statement of Commissioner McDowell ("the contribution factor, a type of tax paid by telephone consumers, has risen each year from approximately 5.5 percent in 1998 to almost 18 percent in the first quarter of this year.").

reduce the *long term* demands on the fund, which would certainly reduce the contribution rate.[27] Similarly the changes to the low income program, to reduce waste, fraud and abuse, and to improve the administration of the plan are already showing a reduction in demand.[28] While these savings are earmarked for the CAF initially, in the long run, if the CAF demand is expected to reduce over time (as is anticipated), the net result will be a reduction on USF funding demand, which in turn will reduce the contribution rate.

In conjunction with policies to decrease demand for funding, the Commission can reduce the contribution rate, especially in the near term, by broadening the contribution base, especially by including revenues derived from broadband Internet access services and other services. Broadening the contribution base should be done in a manner that is equitable and fair, and captures those services that use the network the most. By including broadband in the USF contribution system, the Commission would immediately cure the inequities currently inherent in the system, would ensure that contributions are levied on those services that use the network the most, and would ensure that those types of services that receive funding support through the CAF are the same types of services that support the fund in the first place.

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[27] *See Connect America Fund, et al.*, Report and Order and Further Notice of Proposed Rulemaking, WC Docket No. 10-90, et al., FCC 11-161, Statement of Chairman Genachowski (rel. Nov. 18, 2011) (noting the CAF transition is intended to curb the growth in the existing USF system).

[28] *See Lifeline and Link Up Reform and Modernization, et al.*, Report and Order and Further Notice of Proposed Rulemaking, WC Docket No. 11-42, et al. FCC 12-11 (rel. Feb. 6, 2012). Since the publication of this Order, the contribution factor has dropped from 17.9% to 15.7%.

Further, broadening the base in this way can reduce the gaming and line-drawing inherent in the system today. Currently, many "enterprise" services are based on broadband-capable transmission lines, which are often treated by carriers as exempt (or treated as non-exempt to their competitive disadvantage). Broadening the base to include broadband and broadband-capable access lines should eliminate the need to address services like MPLS or VPN separately, as well as any justification for treating them differently. There has been much confusion about the proper treatment of MPLS and VPN in light of the Wireline Broadband Order.[29] Much of this confusion stems from the fact that the Commission purports to assess VPN and MPLS, even though these services are often dependent upon a broadband line.[30] Meanwhile many of the functionalities that make MPLS network functionalities special are often enhanced service under long-standing precedent.[31] There is no need to change decades old precedent simply to broaden the contribution base when the solution should be readily apparent.

Finally, subjecting intrastate services to contribution potentially makes intrastate services subject to double taxation as states will continue to assess on these services. Such an assessment would be counter-productive, unfair, and inequitable in contravention of the Act.

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[29] *See Universal Service Contribution Methodology et al.*, Petition for Clarification, or in the Alternative, Application for Review of Masergy Communications, Inc., WC Docket No. 06-122 (Mar. 27, 2009) ("Massergy Appeal") (seeking review of the proper treatment of MPLS services). *See also Request for Review of Decision of the Universal Service Administrator by XO Communication Services, Inc.*, WC Docket No. 06-122 (filed Dec. 29, 2010) ("XO Appeal"). *See* Letter from Jennifer McKee, Acting Chief, Telecommunications Access Policy Division, Wireline Competition Bureau, to Michelle Tilton, Director of Financial Operations, Universal Service Administrative Company, at 1 (April 1, 2009) (implying that MPLS technology may be used at least some of the time in the context of providing information services).

[30] *See* XO Appeal, at 45.

[31] *See* Masergy Appeal, at 4, n.3.

V. CARRIERS SHOULD NOT BE PROHIBITED FROM RECOVERING USF FROM CUSTOMERS

The Commission seeks comment on ways to improve transparency related to the pass through of USF contribution charges to customers.[32] As an initial point, there is no public policy reason to prevent carriers from accurately describing their USF contributions and passing this contribution through to consumers.[33] If the Commission were to prohibit USF pass-through, the Commission should require a fresh look for all contracts to allow long term contracts to be adjusted so that carriers can recover the added cost through their rates.

If the Commission is concerned that customers do not understand the USF surcharges on their invoices, it could adopt a requirement for a more detailed description of the calculation of the charge.[34] But, a complete ban on recovery from customers would defeat reasonable business expectations and cause significant competitive distortions in the market. In fact, such a prohibition would likely result in other, less transparent forms of pass through to customers (such as raising rates generally, other types of line-items, etc.). As such, a general prohibition on passing through USF contribution assessments would not serve the public interest.

VI. CONCLUSION

For the reasons set forth above, Peerless Network urges the Commission to modify the existing revenues-based system, continue its policies of reducing USF funding demand, and expand the contribution base. The adoption of a value-added, connections, or numbers-based

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[32] *See FNPRM*, ¶ 389.

[33] *See FNPRM*, ¶ 396 (seeking comment on authority to impose constrains on contribution recovery from customers).

[34] *See FNPRM*, ¶¶ 389-95.

system will not simplify the system, will unfairly apportion USF costs on those that use the network the least, and will result in significant administrative burdens and carrier disputes.

Respectfully submitted,

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