

**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 LEVEL 3 COMMUNICATIONS, LLC**

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## **Summary of Comments of Level 3 Communications, LLC**

Level 3 Communications, LLC, (“Level 3”) hereby comments in response to the Commission’s Further Notice of Proposed Rulemaking with respect to reform of the universal service contribution mechanisms.<sup>1</sup> The universal service contribution mechanisms have long been recognized to be broken. Level 3 is encouraged that, in a break with the past, the FNPRM focuses expressly on enterprise and wholesale issues, in addition to mass market services.

Level 3 agrees with the FNPRM’s goals of efficiency, fairness and sustainability in a universal service contribution mechanism. However, as stated, these goals are underinclusive. In evaluating efficiency, for example, the Commission must also consider the extent to which a proposed contribution mechanism creates deadweight economic loss. With respect to fairness and sustainability, the Commission must also recognize the importance of speedy decision-making and guidance. This can best be achieved by adopting a private ruling system under which contributors that presented an issue to the FCC would have a ruling within 90 days or have their request deemed granted; in either case the contributor would be entitled to a safe harbor within the parameters of the request until the FCC stated a new rule.

The Commission should not adopt the FNPRM’s proposals broadly to subject to universal service contribution any information services for which the information service provider “provides the transmission,” along with parallel provisions on how to determine the revenue attributed to an interstate telecommunications component of an information service or of a bundle with non-telecommunications services. In the first instance, these proposals exceed the bounds of Section 254(d) because they would extend contribution obligations beyond providers of interstate telecommunications. Moreover, taken together, these proposals would reverse the “contamination rule” under which information services and telecommunications services were mutually exclusive with information services not subject to common carrier regulation or automatic universal service contribution, and replace it with a system in which information service providers would be subject to contribution on potentially any product (depending upon what it means to “provide transmission”) and in which information service providers could be forced to become common carriers in order to limit the extent of universal service assessments on value that they add beyond telecommunications.

In any event, the Commission has not assessed Internet backbone peering and transit services or CDNs to date, and should not begin doing so now even if it decides to reverse field and assess end user broadband Internet access. The Commission historically has avoided assessing the Internet “cloud,” including backbone services that interconnect end users’ Internet service providers (“ISPs”) and content. This has been appropriate and allowed the development of “cloud” services and new methods of distributing Internet content, such as CDNs, without

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<sup>1</sup> See *Universal Service Contribution Methodology; A National Broadband Plan for Our Future*, Further Notice of Proposed Rulemaking, FCC 12-46, WC Docket No. 06-122, GN Docket No. 09-51 (rel. April 30, 2012) (“FNPRM”). Level 3 also separately comments on the proposed changes with respect to contributions by providers of international services. See *Joint Comments of Undersea Cable Operators*, WC Docket No. 06-122, GN Docket No. 09-51 (filed July 9, 2012).

skewing those decisions through the application of universal service fees. In the first instance, peering and transit are the wholesale interconnection services that allow end user ISPs to exist. To the extent that the Commission assesses end user ISPs, it would already be collecting on the retail value of backbone connectivity. CDNs similarly are a means by which Internet content is exchanged and made available to broadband end users.

With respect to wholesale services, the Commission should not adopt a VAT, which is unworkable in practice. Nor should it adopt the additional certification procedures it proposes. Instead, the Commission should shift to a collect-and-remit system, and then exempt any provider when it has a valid resale certificate.

Level 3 also comments as follows on the various proposals for administrative reform:

- Forms 499 should be changed prior to the beginning of the reporting year, not during or after. Proposed changes should be provided in redline to increase transparency.
- Contribution factors should continue to be revised quarter. The USAC prior period adjustments should be spread over two quarters, rather than all taken in one.
- The Commission should eliminate its practice of assessing any shortfalls based on the two-highest factors, and any refunds on the two lowest factors.
- The Commission must provide a mechanism to correct clerical (e.g. “fat finger”) errors if it mandates “pay and dispute.”
- The Commission should not adopt an added fee for paper filing.
- The Commission should not and cannot ban USF recovery line items, because such a ban would be a prior restraint on speech. Nor should it, for enterprise customers, require additional explication on whom universal service pass-through fees are calculated.

Finally, the Commission should continue to explore a connections-based USF contribution mechanism, provided that such a mechanism does not disincent augmentation of high capacity services, or assess interconnection, backbone, CDNs and other wholesale inputs.

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**COMMENTS OF LEVEL 3 COMMUNICATIONS, LLC**

**I. INTRODUCTION**

Level 3 Communications, LLC, (“Level 3”) hereby comments in response to the Commission’s Further Notice of Proposed Rulemaking with respect to reform of the universal service contribution mechanisms.<sup>2</sup> The universal service contribution mechanisms have long been recognized to be broken. Level 3 has explored connections-based proposals as a member of the Coalitions for Sustainable Universal Service and numbers-based proposals as a member of the Intercarrier Compensation Forum and a participant in the Missoula Plan process. What is apparent is that all proposals present difficult issues and questions.

Level 3 is encouraged that the FNPRM focuses expressly on enterprise and wholesale issues, in addition to mass market services. Historically, the FCC’s contribution rules have been designed primarily for retail mass market services, and thus have been difficult to apply in the enterprise and wholesale contexts. This has been especially true with respect to IP networks and

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<sup>2</sup> See *Universal Service Contribution Methodology; A National Broadband Plan for Our Future*, Further Notice of Proposed Rulemaking, FCC 12-46, WC Docket No. 06-122, GN Docket No. 09-51 (rel. April 30, 2012) (“FNPRM”). Level 3 also separately comments on the proposed changes with respect to contributions by providers of international services. See *Joint Comments of Undersea Cable Operators*, WC Docket No. 06-122, GN Docket No. 09-51 (filed July 9, 2012).

services, for which the distinctions between assessable telecommunications and non-assessable information service have been increasingly blurred. Moreover, the current mechanisms applicable to wholesalers are extremely burdensome, and have been applied by USAC in a manner that creates large potential liabilities as a result of errors or difficulties with paperwork collection.

While it is certainly a concern that the universal service contribution base of interstate and international end user telecommunications revenues has been shrinking,<sup>3</sup> it would also be a mistake to let the quest for additional contribution dollars override other policy considerations. As discussed further below, many of the proposals presented in the FNPRM could potentially sweep in a wide, expansive range of Internet-based services, including cloud-based services, content delivery networks (“CDNs”) and Internet backbone interconnection. The Commission historically has avoided assessing the Internet “cloud,” including backbone services that interconnect end users’ Internet service providers (“ISPs”) and content. This has been appropriate and allows the development of “cloud” services and new methods of distributing Internet content, such as CDNs, without skewing those decisions through the application of universal service fees. The Commission should take care that it does not create a universal service contribution mechanism that sweeps so broadly that it suppresses the innovation in new services, particularly those offered for free or for little charge, that has been a hallmark of the Internet and one of the key outcomes that the Commission seeks to promote through its broadband deployment efforts.

One of the other flaws with the current contribution system is that the Commission has not had a viable mechanism for rapid guidance to the industry. This means that competitive

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<sup>3</sup> See FNPRM ¶ 20.

distortions have been left to develop for years, with providers subject to the risk of substantial back liabilities mounting during the years it takes for issues to work their way through USAC audits and appeals. Even when providers have sought a direct declaratory ruling, prompt guidance has been rare. This has meant that regulatory risk tolerance has become an item of competition between providers: providers that take a “conservative” position with respect to USF revenue reporting, and thus assessment, are disadvantaged between those that take aggressive positions with respect to the application of the rules. This creates a dynamic that undermines both the fairness and sustainability of the current contribution mechanisms.

To address this—and to create a mechanism that will help smooth the operation of whatever contribution mechanism the Commission ultimately seeks—it should create a system of private rulings that allow providers that present questions as to contribution obligations to the Commission and to obtain a rapid decision—or deemed decision—that serves as a “safe harbor” for that provider unless and until the Commission establishes a different going forward rule/interpretation, whether through rulemaking or adjudication.

## **II. THE COMMISSION HAS PROPOSED REASONABLE PRINCIPLES TO GUIDE CONTRIBUTION, BUT THE TEST WILL BE HOW THEY ARE APPLIED IN PRACTICE.**

The Commission opens the FNPRM by proposing three goals of its universal service contribution methodology: Efficiency, Fairness, and Sustainability. Level 3 has no objection to these goals as ones that should undergird any universal service contribution system. Indeed, the discussion of each of these goals, as set forth in paragraphs 23-25 of the FNPRM, is unobjectionable. However, that discussion fails to include some important dimensions that also need to be considered.

With respect to efficiency, for example, the FNPRM discusses that rules should “operate clearly within the evolving structure of the marketplace,” “clos[e] loopholes,” and result in

“clearer, simpler rules that can be applied in new situations” to “deter gaming of the system and save consumers, companies, and the government money.”<sup>4</sup> While these are all important objectives, the FNPRM fails to include that an efficient universal service contribution system should also take into account not just the direct costs of operating the contribution systems (such as accounting, auditing and legal costs), but also the deadweight costs that a system as a whole imposes. It is well established that systems that tax usage and highly elastic discretionary services cause substantially more deadweight loss than one that focuses on more inelastic services.<sup>5</sup> One study found that for every \$1 billion of universal service support collected through long distance rates, “the U.S. economy would suffer an additional efficiency loss of \$1.25 billion.”<sup>6</sup> Studies compiled by the Mercatus Center at George Mason University likewise show that the elasticity of demand for subscription-based wireless services, for which consumers purchase a bucket of minutes, is between -.43 and -.71,<sup>7</sup> while demand for broadband services is highly elastic, ranging from -1.5 to -3.76, with a likely average of about -2.75.<sup>8</sup> As the Mercatus

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<sup>4</sup> FNPRM ¶23.

<sup>5</sup> See e.g., J. Hausman & H. Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal Service Subsidies*, 16 YALE J. ON REG. 19 (1999) (“Hausman & Shelanski”); Comments of Mercatus Center, George Mason University, at 12, WC Docket No. 05-337 (Mar. 27, 2008) (“Mercatus Comments”).

<sup>6</sup> Hausman & Shelanski, 16 YALE J. REG. at 43.

<sup>7</sup> See Mercatus Comments at 12 (citing Jerry Hausman, *Cellular Telephone, New Products, and the CPI*, J. BUS & ECON. STAT. 188, 191 (1999) (estimating a demand elasticity of approximately -0.5 with 1988-1993 data); Jerry Hausman, *Efficiency Effects on the U.S. Economy from Wireless Taxation*, 53 NAT’L TAX J. 733, 738 (2000) (estimating a demand elasticity of -0.71); Mark Rodini et al., *Going Mobile: Substitutability Between Fixed and Mobile Access*, 27 Telecommunications Policy 457, 470 (2003) (estimating an elasticity of -.43 with respect to the monthly access charge and an overall price elasticity of demand of -.6 with 2000–01 data); Christopher Garbacz & Herbert G. Thompson, Jr., *Universal Telecommunication Services: A World Perspective*, Info. Econ. & Pol’y 495 (2005), tbl. 5 (estimating an elasticity of -0.45)).

<sup>8</sup> See *id* at 14. (citing Robert W. Crandall and James H. Alleman (eds.), BROADBAND (2002) at 283-84; Austan Goolsbee, The Value of Broadband and the Deadweight Loss of Taxing New

Center explains, “[a]t a demand elasticity of -2, a 10 percent universal service assessment would reduce [broadband] subscribership by 20 percent,” and at -2.75, “a 10 percent assessment reduces [broadband] subscribership by 27.5 percent,” reducing subscribership by 20 million subscribers or more for every 100 million broadband subscribers.<sup>9</sup> It would be arbitrary and capricious for the Commission to ignore deadweight loss and its impact on consumer welfare and service adoption that results from different alternative contribution mechanisms.<sup>10</sup>

In discussing principles of fairness and sustainability, the FNPRM focuses on the need to ensure that similar or highly substitutable services are treated similarly, and that the methodology be “dynamic enough to keep pace with changes in the marketplace.”<sup>11</sup> Again, while these are reasonable objectives, in its statement of goals, the FNPRM ignores the critical importance of speedy decision-making and guidance in promoting fairness and sustainability. Some services are declared to be telecommunications services long after they have entered the market (for example, audio bridging) – and the FNPRM itself seeks comment on how to treat a wide range of extant enterprise services.<sup>12</sup> As the remainder of the FNPRM proves, the Commission cannot hope to eliminate all line drawing, so its objective should be to provide guidance quickly.

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Technology, NBER Working Paper No. 1194 (2006) at 11).

<sup>9</sup> *Id.*

<sup>10</sup> *See, e.g., Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 863-864 (1984); *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (holding that a rule will be deemed arbitrary and capricious if the agency “entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise”); *see also Illinois Pub. Telecomm. Ass’n v. FCC*, 117 F.3d 555, 566 (D.C. Cir. 1997) (finding that the Commission’s failure to explain its decision not to provide interim compensation for certain carriers as required by statute, and its failure to cite a reasonable justification for the interim rate it chose, was arbitrary and capricious).

<sup>11</sup> FNPRM ¶25.

<sup>12</sup> *See id.* ¶ 41, *et seq.*

Thus, the key to maintaining a proper balance among the Commission’s goals is rapid adjudication and enforcement—which in many ways are more critical to maintaining fairness and sustainability than writing broad rules. As discussed further in Section III, below, providing rapid guidance will better ensure that all providers of competing services understand their USF contribution obligations, rather than being left to compete as to the level of regulatory risk they are willing to endure. Moreover, if the Commission creates a mechanism that encourages providers to present hard questions for rapid resolution, the Commission will improve its own awareness of the marketplace and can thus better ensure that USF contribution mechanisms remain sustainable over time.

**III. THE COMMISSION SHOULD NOT TRY TO ESTABLISH A NEW GENERAL DEFINITION OF THE TELECOMMUNICATIONS AND INFORMATION SERVICE PROVIDERS SUBJECT TO CONTRIBUTION REQUIREMENTS, BUT SHOULD INSTEAD PROCEED ON A CASE-BY-CASE WITH AN EXPEDITED PROCESS FOR OBTAINING “SAFE HARBOR” GUIDANCE.**

In Section IV of the NPRM, the Commission asks whether it should proceed through clarifications around individual services or should determine contribution obligations through a broader definitional change. The Commission’s proposed definitional change is so broad as to encompass practically any Internet-based service including those that are not close substitutes with PSTN services, and thus should be rejected. Instead, the Commission should proceed with expedited case-by-case adjudication.

The proposed broader definition of assessable services lacks discernible boundaries and, indeed, would overturn the careful balance Congress struck with respect to universal service assessments in adopting Section 254. The Commission’s proposed definition of services subject to contribution is:

“Any interstate information service or interstate telecommunications . . . if the provider also provides the transmission (wired or wireless), directly or indirectly through an affiliate, to end users.”<sup>13</sup>

Information services, however, by definition are provided “via telecommunications.”<sup>14</sup> The Commission has thus long held that an information service provider does not become a telecommunications carrier simply because it purchases telecommunications and incorporates those telecommunications into an information service.<sup>15</sup> Similarly, under those same

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<sup>13</sup> FNPRM ¶ 75.

<sup>14</sup> 47 U.S.C. 153(24).

<sup>15</sup> See, e.g., *Fed.-State Joint Bd. on Universal Serv.*, Report to Congress, 13 FCC Rcd. 11501, 11521 ¶ 41 (1998) (“*Report to Congress*”) (“The statutory text suggests to us that an entity should be deemed to provide telecommunications, defined as ‘the transmission, between or among points specified by the user, of information of the user’s choosing, without change in the form and content of the information,’ only when the entity provides a transparent transmission path, and does not ‘change ... the form and content’ of the information. When an entity offers subscribers the ‘capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications,’ it does not provide telecommunications; it is using telecommunications.”); *Inquiry Concerning High-Speed Access to Internet over Cable & Other Facilities*, 17 FCC Rcd. 4798, 4824 (2002) (“The cable operator providing cable modem service over its own facilities, as described in the record, is not offering telecommunications service to the end user, but rather is merely using telecommunications to provide end users with cable modem service.”), *pet. for review denied*, *Nat’l Cable & Telecomm. Ass’n v. Brand X Internet Services*, 545 U.S. 967 (2005) (“*Brand X*”); *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities Universal Serv. Obligations of Broadband Providers Computer III Further Remand Proceedings: Bell Operating Co. Provision of Enhanced Services; 1998 Biennial Regulatory Review -- Review of Computer III & ONA Safeguards & Requirements Conditional Petition of the Verizon Tel. Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with regard to Broadband Services Provided Via Fiber to the Premises*, 20 FCC Rcd. 14853, 14911 ¶105 (2005) (“*Wireline Broadband Internet Access Services Order*”) (“[W]e reject arguments that companies using their own facilities to provide wireline broadband Internet access service simultaneously provide a telecommunications service to their end user wireline broadband Internet access customers.”)

circumstances, an information service has not automatically become assessable.<sup>16</sup> As the Commission has previously recognized, however, “the Senate Report stated, the legislation ‘does not require providers of information services to contribute to universal service.’”<sup>17</sup> The proposed rule would nonetheless require providers of information services to contribute to universal service whenever the provider “also provides the transmission.”

Moreover, the proposed rule appears to extend universal service contributions beyond the bounds permitted by Section 254(d). As written, the proposed definition would subject an “interstate information service” to contribution obligations whenever the provider “also provides transmission” to end users. However, Section 254(d) does not go that far. Section 254(d)’s permissive authority permits the Commission to require a provider of “interstate telecommunications” to contribute to universal service “if the public interest so requires.”<sup>18</sup> However, “telecommunications” is a subset of “transmission,” rather than being congruent with “transmission.” Specifically, Section 3(43) defines “telecommunications” as “transmission, *between or among points specified by the user, of information of the user’s choosing, without change in the form or content of the information as sent and received.*”<sup>19</sup> Only if all of Section

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<sup>16</sup> See, e.g., *Universal Serv. Contribution Methodology*, 25 FCC Rcd. 4652, 4655 ¶ 8 (2010) (“Pursuant to [the *Wireline Broadband Internet Access Services Order*], Internet access service providers that lease or purchase transmission from telecommunications carriers to provide wireline broadband Internet access services are not required to contribute to the universal service fund for revenues derived from the provision of that service. If such providers lease or purchase transmission service that is offered on a common carrier basis, whether from an affiliated entity or a third party, they are end users of that telecommunications service, and the telecommunications carrier providing the leased telecommunications services is obligated to contribute to universal service on those revenues.”)

<sup>17</sup> *Report to Congress*, ¶ 43, quoting Senate Report at 28.

<sup>18</sup> 47 U.S.C. § 254(d).

<sup>19</sup> 47 U.S.C. § 153(50) (emphasis added).

3(43)'s conditions are met may the Commission exercise its permissive authority to require universal service contributions.

Furthermore, it is not clear from the proposed definition what constitutes "providing transmission." For example:

- To use an old example, Lexis/Nexis and Westlaw once operated with dial-up access, in which the end user called a local number that connected to a local point of presence, from which traffic was backhauled to a centralized server over private line services purchased by Lexis/Nexis or Westlaw, and then the information returned to the point of presence. The same was true of many other electronic databases. Under the new proposed rule, would the purchase of private line services connecting Lexis/Nexis or Westlaw servers with its local points-of-presence have constituted the provision of "transmission" that then made Lexis/Nexis and Westlaw subject to USF contribution obligations?<sup>20</sup>
- As a more current example, suppose an online music or video distributor (e.g. iTunes, Spotify, Netflix or Hulu) is distributing music or videos using a connection between the Internet and its servers to do so. Under the proposed rule, will the purchase and integration of that transmission between the Internet and the music/video distributor's server mean that the music/video distributor becomes subject to direct USF contribution, potentially on the entire revenue stream from its service?
- Suppose a provider operates a CDN, in which Internet content is pushed out to distributed servers where it is hosted closer to the end user. Is this providing

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<sup>20</sup> As discussed further below, if Lexis/Nexis or Westlaw were to be subject to USF contribution assessment, other proposed rules would then make all Lexis/Nexis or Westlaw revenue assessable unless Lexis/Nexis or Westlaw offered transmission on a standalone basis. *See* Section IV, below.

“transmission” under the proposed rule because the original content is pushed out to be stored and replicated at distant servers?

- Or, suppose a provider operates a cloud based data storage service. Is the connection from some point on the Internet (e.g., an interconnection point between two backbones) to the data storage servers providing “transmission” as part of the cloud-based service?

By proposing a rule that would include all “transmission” provided, whether as non-telecommunications transmission, standalone telecommunications or as integrated into *any* information service, the FNPRM would greatly expand the scope of universal service contribution assessment to include entities offering Internet-based services that would have no way of knowing that they were now subject to universal service contribution accounting and reporting requirements.

A better way of proceeding that avoids the problem of expanding universal service contribution into a broad range of Internet activity and services is the way the Commission has proceeded—to examine on a case-by-case basis when a new service is a close substitute for an assessable common carrier service, and not a product with significant and differentiating added benefits. In *Brand X*, for example, the Supreme Court focused on whether a product was a single, integrated offering or a combination of separable services.<sup>21</sup> The Commission has subsequently followed this approach, and then used its ancillary authority to require USF contribution only for products that it judged to be close substitutes to common carrier products.<sup>22</sup>

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<sup>21</sup> See *Nat'l Cable & Telecommc'ns Ass'n v. Brand X Internet Serv.*, 545 U.S. 967, 997-998 (2005).

<sup>22</sup> See, e.g., *Universal Serv. Contribution Methodology Fed.-State Joint Bd. on Universal Serv. 1998 Biennial Regulatory Review*, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd. 7518, 7537 (2006) (“*VoIP USF Order*”); *Request for Review by InterCall, Inc. of Decision of Universal Service Administrator*, Order, 23 FCC Rcd 10731, 10734 (2008)

This approach is better tailored to the reality of a wide range of information services that potentially incorporate telecommunications—for many of which the telecommunications component is only a small part of the value being conveyed and the service being purchased by the consumer. It would create substantial distortions to the Internet economy to simply assume—as some proposed rules do—that the entire value becomes potentially assessable simply because it incorporates in some part some interstate telecommunications.

The main problem with the case-by-case method has been an absence of speed in any determinations. Generally, industry practices develop, USAC conducts audits, parties dispute USAC’s conclusions and then issues are presented to the FCC. This takes years, with the process biased by USAC’s institutional inclination to find every service to be included in the absence of an express FCC decision to the contrary. With the “pay and dispute” system, this puts providers in the position of having to pay substantial assessments during the years that the underlying substantive responsibility remains undetermined by the FCC. Under the current system, there is also little benefit to a contributor to raising an issue, because declaratory rulings are not provided within any defined and short period of time. Thus, a provider raising a question can simply make itself a USAC audit target while not getting any resolution—and while other competitors may be taking a similar approach but would not be making themselves an audit target. A better approach would be to build a case-by-case adjudication system that encourages contributors to present difficult questions to the Commission and yields timely results.

What the Commission should do to facilitate the case-by-case determinations and guidance that will inevitably need to be made is to develop a system of private rulings. A party

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*(InterCall I Order); Universal Serv. Contribution Methodology, Order on Reconsideration, 27 FCC Rcd. 898, 900 (2012) (InterCall II Order).*

that submits a private ruling request would present a question and proposed resolution with a rationale. The Commission would delegate authority to the Wireline Competition Bureau to issue such rulings, even when they presented new or novel issues. If the Bureau (or Commission) does not act on a request in 90 days (which would allow for third parties to review and comment), it would be deemed granted. Applications for review could be subject to de novo review by the Commission, but a private ruling would take effect on issuance, irrespective of any review. Whether affirmatively approved or deemed granted, the party could rely on the decision without retroactive liability should the decision later be altered or a new rule created (i.e., subject only to prospective changes). This would be similar to “deemed lawful” treatment of tariffs (in which an overcharging carrier is protected against refund liability), but with a longer period for public comment and Commission consideration.<sup>23</sup> A “deemed grant” or a denial without explanation would not be precedential, and a denial would not preclude the petitioner from undertaking the practice on which it requested guidance, but it would know that it was subject to risk of a later adverse determination and it would have the benefit of an initial staff response to its proposed interpretation. The Commission could always overturn a set of Bureau grants or deemed grants (or even its own adjudicatory reasoning) at a later date, but the Commission decision would be prospective only.

Such a mechanism would incent contributors to come forward with hard questions so as to be able to get protection against potential liability “overhang” from a service or reporting practice. Because all providers would be able to see the letter rulings, providers would be able to get a better sense of which interpretations were permissible, and which were not. It would also

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<sup>23</sup> See 47 U.S.C. § 204(a)(3).

give the Commission a better sense of industry practices and a much better ability to resolve issues before they become widespread problems.

The result of this would be greater fairness among contributors. More conservative contributors would not be forced to compete as to the level of regulatory risk tolerance, or at least would have better data when doing so. This will also make the fund more sustainable over the long term because it will encourage conflicting interpretations to be presented, thus allowing the Commission as a whole to make clear where it expects the boundaries to lie.

Such an accelerated private ruling system could be applied not just to questions as to whether an entity's services were assessable, but also to questions as to how to allocate revenues between assessable and non-assessable services and between jurisdictions, and how to allocate discounts in a bundle outside of the existing "safe harbors." We discuss this further in the sections, below.

**IV. THE COMMISSION SHOULD EXPEDITIOUSLY DECIDE WHEN NEW ENTERPRISE SERVICES ARE CLOSE ENOUGH SUBSTITUTES TO REQUIRE CONTRIBUTION, BUT SHOULD NOT REQUIRE SERVICES WITH TELECOMMUNICATIONS AND NON-TELECOMMUNICATIONS COMPONENTS TO CONTRIBUTE ON ALL REVENUES FOR THE SERVICE, WHETHER VIEWED AS A SINGLE SERVICE OR A BUNDLE.**

As reflected in the discussion above, closely related to the question of whether all information services that incorporate interstate telecommunications (*i.e.*, transmission between and among points specified by the end user, of information of the user's choosing, without change in the form or content of the information as sent and received)<sup>24</sup> should be treated as USF contributors is the question of how revenues from services or service packages that include interstate telecommunications should be allocated as between assessable and non-assessable components. Again, this is better addressed with a rapid system for case-by-case guidance, such

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<sup>24</sup> See 47 U.S.C. 153(50).

as the accelerated private ruling system discussed in Section III, above, than through overinclusive categorical rules, which is what the FNPRM proposes in Sections V.A.2 (contributions for services with an interstate telecommunications component) or V.A.1 (contributions from bundled services).

**A. Contributions for Services with an Interstate Telecommunications Component.**

In Section V.A.2, the Commission proposes a rule that states: “if an entity offers an assessable information service with an interstate telecommunications component, it must treat all revenues for that information service as assessable revenues, unless it offers the transmission underlying the information service separately on a stand-alone basis.”<sup>25</sup> This proposed rule would be a dramatic shift from the way that the contribution mechanisms have operated to date – and would potentially subject functionalities and value far afield from telecommunications. Indeed, it wholly reverses the “contamination” approach followed since *Computer II* in which any service with “enhanced” or “information service” functionalities was treated as an “information service” outside of common carrier regulation, rather than as a telecommunications service.<sup>26</sup> Instead, the proposed rule would, for the purposes of universal service contribution, presume that *all* information service revenues were subject to USF assessments, even if only a small part of the value was derived from interstate telecommunications.

A simple example shows why this is a bad idea that leads to substantial regulatory distortions of marketplace activity. Suppose an entity buys standalone telecommunications from a telecommunications carrier and integrates that transmission with value added enhancements that quadruple the value (and price) of the service above the bare telecommunications purchase.

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<sup>25</sup> FNPRM, ¶117.

<sup>26</sup> See n. 15, *supra*.

This definition would nonetheless make the entire revenue from the service assessable unless the entity also sold bare transmission—a business it was not choosing to be in and which could subject it to common carrier regulation.

The situation is not different when the entity builds (or purchases through IRU) its own network facilities and self-supplies them to integrate with the same value added enhancements. Once again, the entire revenue from the service would be assessable unless the provider chose also to provide standalone transmission as a separate line of business. Again, this forces the information service provider to enter the separate business of providing standalone telecommunications for a fee—which could then directly subject it to common carrier regulation.

In both of these examples, the fundamental product being offered to consumers—and being valued by them—is not the transmission meeting the definition of “telecommunications,” but the enhanced functionalities. Assessing the enhanced functionalities then creates disincentives to develop those functionalities, as well as potentially distorting competition between providers of those enhanced functionalities whose services become subject to USF assessment and those who do not. This would not be a hallmark of an efficient or fair universal service contribution mechanism.

This proposed rule also faces a second problem with respect to enterprise services—how to determine the “standalone” price. Most enterprise services, particularly for mandatorily de-tariffed non-LEC services and for non-telecommunications services, are not sold pursuant to a tariff, but instead are sold pursuant to negotiated contracts. Even if the prices could be untangled from a bundle (see Section IV.B, below), there would still be many different “standalone” prices for transmission. Imputing a high charge for the transmission component will create distortion, inefficiency and unfairness, just as imputing too low a charge could also do.

## **B. Contributions from Bundled Services.**

In Section V.A.1, the Commission proposes a rule that would state: “If an entity bundles non-assessable service or products (such as customer-premises equipment) with one or more assessable services, it must either treat all revenues for that bundled offering as assessable telecommunications revenues or allocate revenues associated with the bundle consistent with the price it charges for stand-alone offerings of equivalent services or products (with any discounts from bundling assumed to be discounts in non-assessable revenues).”<sup>27</sup> As with its proposed imputation rule for products that are a single product including telecommunications, the proposed unbundling rule also creates an overinclusive dragnet.

This proposed bundling rule appears patently designed solely to increase assessable revenue, by closing the door to reasonable alternatives. The proposed rule essentially codifies the existing bundling “safe harbors,” but does so by making them the mandatory means of addressing bundling, without permitting the consideration of any other alternative, no matter how reasonable. It is hard to see how this rule would not be arbitrary and capricious, as it could subject any revenues for any non-telecommunications services subject to USF assessment far disproportionate to the value of the telecommunications being provided.

The proposed bundling rule would interfere with a competitive procurement process for integrated solutions. In that situation, a customer will frequently issue an RFP describing the solution they seek to achieve, and then providers bid on the entire solution, including both telecommunications and non-telecommunications components. While bids can be proposed by creating standalone pricing for telecommunications elements, that fundamentally ignores the nature of the bid process in providing a market rate for the whole package. Moreover, it is not

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<sup>27</sup> FNPRM, ¶106.

even clear that *de facto* requiring a standalone price would be effective at creating a market valuation, because a package bid can also shift charges between package elements, creating lower charges for the telecommunications elements and higher charges for the non-telecommunications elements, with other provisions, such as volume or total revenue commitment discounts used to ensure that the “stand-alone” telecommunications pricing is not widely available.

Moreover, the FNPRM does not provide any guidance as to why other allocations might not also be reasonable and more consistent with the economics of a bid. As just one example, a discount over “list” prices (to the extent they exist) could be allocated across all services pro rata. It is not clear why this is not reasonable, except for the fact that it results in less assessable revenue, which itself should not be the decisional factor. Indeed, excluding other reasonable and non-abusive allocations would be arbitrary and capricious. While it is true that there can be some allocation schemes that are designed solely to avoid USF obligations, it is better to address those with rapid adjudication, such as the private ruling process outlined above.

This proposed rule regarding bundling also has the same problem of assuming a mass-market tariff-like environment, with set list prices. Inasmuch as that is not the case for enterprise services, it is also not clear what the imputed assessable amount of the bundle price would be. As with the telecommunications component of an integrated service, there will not be a single standalone price of a telecommunications component of a bundle.

**V. REGARDLESS OF WHAT THE COMMISSION DECIDES WITH RESPECT TO END USER BROADBAND SERVICES, THE COMMISSION SHOULD NOT ASSESS BACKBONE SERVICES AND OTHER MEANS BY WHICH ISPS ARE INTERCONNECTED AND INTERNET CONTENT IS EXCHANGED.**

The Commission has not assessed Internet backbone peering and transit services or CDNs to date, and should not begin doing so now, even if it decides to reverse field and assess

end user broadband Internet access. With respect to broadband Internet access, it is notable that the FNPRM does not set forth a clear theory as to why the public interest requires the extension of universal service contribution assessments to broadband Internet access services. For example, the FNPRM does not attempt to argue that broadband Internet access (as distinguished from already assessable services such as interconnected VoIP) competes with traditional common carrier service. The FNPRM leaves the distinct impression that the primary reason for extending contribution obligations to broadband Internet access services is because “that is where the money is.”<sup>28</sup>

Even if the Commission extends assessment to broadband ISPs, it should not do so with respect to Internet backbone services, whether peering or transit. In the first instance, peering and transit are the wholesale interconnection services that allow end user ISPs to exist. To the extent that the Commission assesses end user ISPs, it would already be collecting on the retail value of backbone connectivity. Assessing Internet backbones separately would be double assessment and would create a perverse incentive that favors backbone providers who also serve retail end users—where revenue would seemingly be assessed once as compared with a situation in which a wholesale backbone provider supplies a separate retail provider and revenues would be assessed twice. By comparison, in the TDM world, the Commission has never subjected access charge revenues to universal service contribution obligations, even though those revenues have been substantial.

CDNs similarly are a means by which Internet content is exchanged and made available to broadband end users. The essence of a CDN is dispersed storage and distribution closer to the

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<sup>28</sup> The statement is frequently attributed to Willie Sutton, discussing why he robbed banks. See Albin Krebs, "Willie Sutton is Dead at 79; Bank Robber Got \$2 Million," N.Y. Times, Nov. 19, 1980, 31.

end user. While they utilize transmission, the core value of the service is not transmission, but shortening the Internet distance traversed by the end user in seeking content by creating additional points at which to access the data. Moreover, CDNs in part compete with IP transit services, and thus it would create a competitive distortion to assess CDNs.

Because backbone and CDN providers are not common carriers, there is no statutory mandate to assess backbone services, CDNs and other arrangements that make the Internet usable. The public interest in an unfettered development of Internet services and innovation is best served by keeping those arrangements outside of universal service contribution.

**VI. THE COMMISSION SHOULD NOT ADOPT A VAT, AND IT SHOULD MAKE SURE THAT ANY CHANGES WITH RESPECT TO WHOLESALE SALES ARE PRACTICABLE AND IMPLEMENTABLE.**

Level 3 is encouraged that the Commission asks specifically about how wholesale services should be addressed, rather than leaving wholesale arrangements as an afterthought. The Commission should ensure that whatever changes it makes to wholesale procedures are streamlined and implementable—something that cannot be said about the current complex requirement on wholesale providers. However, both the FNPRM’s proposed VAT structure and revised reseller certification forms fail these objectives. As an alternative, the Commission should look to implement some common sense reforms, and should create the private ruling system described above, which would provide a mechanism for wholesale providers to gain greater clarity as to their contribution obligations.

The VAT proposal, while nice in theory, is unworkable in practice. There is no existing system to assign and trace “credits” through what can be very complex layers of wholesale relationships. For example, through least cost routing, many different carriers can be involved in handling a particular voice call. The number of providers involved can change frequently, as different carriers change their rate tables. A VAT system would have to track credits on a call-

by-call basis, which is simply not possible. VoIP services are even more complicated, because IP bits representing pieces of the same call can traverse different networks. It is difficult to imagine a wholesale infrastructure that could adequately document the appropriate credits and assessments.

The proposed changes to the certification process are no better. In the first instance, the existing certification process is extremely cumbersome and results in horrendous potential liabilities based on imperfect execution and record retention. To meet the “reasonable expectation” “safe harbor” (which USAC generally treats as a per se rule in audits) outlined in the Form 499-A instructions, a wholesaler must collect reseller certifications annually from each wholesale customer and ensure that the certifications are dated within the year to which they apply.<sup>29</sup> It must also check the FCC’s list of contributors every quarter and retain documentation that each wholesale customer is a current contributor to universal service.<sup>30</sup> The FNPRM proposes further to add to the required certification language to have the reseller estimate the percentage of the services that it provides using the services it is buying from the wholesaler that will be assessable and on which the reseller expects to pay universal service contributions.<sup>31</sup> This likely to vary from service to service, and even with customers that purchase large numbers of services, may vary over time. Resale customers themselves may not know the extent of

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<sup>29</sup> See Form 499-A (2012) Instructions at 21-22, *available at* <http://transition.fcc.gov/Forms/Form499-A/499a-2012.pdf>.

<sup>30</sup> See *id.* Although the instructions state that the wholesaler may use the customer’s contributor status on the FCC’s website as evidence for that quarter and to presume that the customer contributed for all previous quarters in the calendar year, because the wholesaler must file a 499-Q each quarter, it *de facto* must check each the FCC’s website each quarter rather than simply in the fourth quarter. Otherwise it faces potential true-up liability if it discovers in the fourth quarter that an entity that had been contributing previously did not contribute within that year.

<sup>31</sup> See FNPRM ¶ 169.

variation until after a quarter or year closes. This creates a situation in which wholesalers and resellers will be chasing the appropriate factors to be using with respect to particular facilities, and to track that through the wholesaler's billing systems. This adds complexity, rather than alleviating it, for entities that are not providing end user services.

There are better ways to address wholesale arrangements. One such way would be to require all telecommunications providers to assess a universal service fee and to remit those fees collected (*i.e.*, a collect-and-remittance system) except where the wholesaler has received a valid resale certificate. That would remove much of the potential for gamesmanship over universal service contribution because all wholesalers would be charging the USF contribution fee. It would also create a better incentive for retailers to provide resale certificates because the wholesaler would have no choice but to levy the USF contribution fee (and to remit the proceeds) in the absence of a certificate. At the same time, because all resale certificates collect 499 Filer ID numbers, the Commission could collect any assessments for false or erroneous certifications from the putative reseller.

The Commission should also relax the requirement for annual certifications. This is onerous and leads to "gotcha" games in audits. The Commission should allow certifications to last for multiple years, at a minimum, and should not require quarterly review of the FCC's contributor database for every wholesale customer. Again, these could be eliminated if the Commission adopted the "collect and remit" system outlined above.

## **VII. THE COMMISSION SHOULD CONTINUE TO EXPLORE CONNECTIONS AS AN ALTERNATIVE TO A REVENUES-BASED SYSTEM.**

Because of the difficulties presented by a revenues-based system, the Commission should also continue to explore end user connections. A connections-based assessment, because it is based on the fact of a connection and possibly on its capacity, would obviate the need for

attempting to isolate the value of the “telecommunications” included in a service that either combined telecommunications and information services into an integrated information services product or that bundled telecommunications and information services into a package with an overall price. Such a system would likely work best if focused on the retail provider of a connection, rather than the wholesale provider, because a retail provider may purchase capacity in bulk and then subdivide it to provide multiple end user connections.

One important key to a connections-based assessment is that it should not disincent augmentation to high capacity services. A system of assessments per voice-grade equivalent or per megabit (MB) of capacity would do that, because prices for high capacity services do not scale in 1:1 correspondence with the increase in capacity. Higher capacity services are cheaper per MB than smaller capacity services. With a per MB connection assessment, the USF assessment could quickly dwarf the facilities charges, and thus discourage augmentation.

In addition, for the reasons discussed in Section V, above, backbone and CDN services should be viewed as wholesale inputs to any assessable broadband Internet access connections, and thus should not themselves be assessed in a per connection model. Again, there is little public policy justification for extending contribution obligations of any kind to backbone and CDN services.

## **VIII. COMMENTS ON OTHER PROPOSALS WITH RESPECT TO CONTRIBUTIONS ADMINISTRATION.**

### **A. Timing of and Process for Changes to Form 499-A.**

The FNPRM asks whether the Bureau should be required to release Forms 499 and related instructions during or prior to the relevant reporting period.<sup>32</sup> The Commission should ensure that all changes to Forms 499 and related instructions, other than those due to an

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<sup>32</sup> FNPRM ¶ 347.

intervening change of statutory law or regulation, are implemented prior to the start of the relevant reporting period. When the Commission changes the instructions during or after the reporting year has commenced, it means that providers have to retroactively determine if the instruction changes altered how a provider should report and what it should owe. This makes it more difficult to bill end user recovery fees, and leads to a greater number of potential billing disputes with customers.

When the Commission seeks comment on revisions to Forms 499, it should issue a redlined version of the forms, as well the proposed revised form, so as to facilitate comment. The current process is unnecessarily opaque, forcing contributors and their counsel to scour each revised Form 499 for the changes being made. Consistent with basic principles of administrative law, the Wireline Competition Bureau should also be required to explain the reason for any proposed changes.

**B. Frequency of Adjustments to the Contribution Factor.**

The FNPRM asks whether adjustments to the Contribution Factor should continue to be made quarterly, or should be done only on an annual basis. Level 3 believes that quarterly adjustments should be retained. Otherwise, there could be wide year-to-year fluctuations.

Level 3 agrees that it makes sense to make prior period adjustments to the USF Fund over two quarters, rather than just one.<sup>33</sup> Doing so should reduce contribution factor volatility.

Furthermore, given the volatility of the USF contribution rate, in major part due to prior period adjustments, the Commission should also eliminate the current rule that assesses true-ups that increase assessable revenues based on the average of the two highest quarterly contribution factors, while assessing true-ups that reduce assessable revenues based on the average of the two

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<sup>33</sup> FNPRM ¶ 357.

lowest quarterly contribution factors.<sup>34</sup> In practice, it is difficult for contributors to make revenue projections, even on a quarter-to-quarter basis. The rule thus arbitrarily penalizes contributors with fluctuating revenues. A better approach would be use the average of four quarters or the average of the periods to which a contributor’s adjustments pertain.

An even better approach would be to shift to a collect-and-remittance system, as discussed above, with an adequate working capital allowance to cover fluctuations in remittances. This would eliminate the need for company-specific revenue projections, and the uncertainty that is inherent in them.

### **C. Pay-and-Dispute.**

The FNPRM proposes to adopt the “pay-and-dispute” policy as an official FCC policy or rule. The Commission should not ignore the fact that in many cases, “pay and dispute” imposes significant liabilities for minor errors, and should rectify that, especially if it adopts “pay and dispute” as a formal policy.

As a notable example, contributors will occasionally have a gross “fat finger” error in their 499-Q reporting forms. Contributors frequently do not discover this until they are billed—at which time it is usually too late to amend the erroneous 499-Q. Under “pay-and-dispute,” a contributor is required to pay the contribution billed on the “fat-finger” error, and then get a downward adjustment—at the average of the two lowest quarterly contribution factors—once the 499-A is filed. This can mean a substantial overpayment (for example, four times the correct quarterly amount if the contributor mistakenly reported an annual rather than quarterly revenue number), carrying costs during a year or more that it takes to calculate the adjustments after the

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<sup>34</sup> See *Federal –State Joint Board on Universal Service*, FCC 02-329, 17 FCC Rcd 24952, 24972 ¶ 36 (2002).

filing of Form 499-A. It also potentially results in a smaller refund than the actual overpayment because of the use of the two lowest quarters to calculate the refund.

The Commission should exempt “fat finger” errors from the “pay-and-dispute” process, particularly if the contributor contacts USAC within 60 days of receiving the first invoice at the amount calculated on the erroneous report. That would improve both the efficacy and the fairness of the universal service contribution process.

**D. Paper Filing.**

The FNPRM asks whether it should adopt a filing fee for paper filings.<sup>35</sup> The Commission should not do so. Paper filing occurs both when a contributor makes an initial filing, and when the electronic filing system is not working well or is too hard to use. Assessing an additional fee simply adds to the contribution burden.

**E. USF Pass-Through Charges.**

The FNPRM seeks comment on whether the Commission should bar pass-through charges or should require greater explication of pass-through charge calculations.<sup>36</sup> The Commission should do neither. USF contribution is an FCC-mandated cost, and providers should therefore be permitted to disclose the amount of that cost to their customers in a non-misleading manner. Indeed, to bar such a communication would be a prior restraint on speech, and thus run afoul of the First Amendment.<sup>37</sup>

Nor is additional explication necessary, particularly for enterprise customers. These entities not only have greater negotiating power, but frequently have their own staff and auditors to ensure that bills are calculated correctly. Here, the Commission should not impose additional

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<sup>35</sup> FNPRM ¶¶ 378-380.

<sup>36</sup> FNPRM ¶¶ 394-397 (barring pass-through charges), ¶¶ 390-393 (additional disclosures).

<sup>37</sup> See *Boardley v. U.S. Dept. of the Interior*, 615 F. 3d 508, 516 (2010)

burdens on providers of sophisticated enterprise services. For this purpose, the Commission should exclude all non-residential services, as well as any services purchased in bulk.

## **IX. CONCLUSION**

Level 3 commends the Commission for once again pursuing universal service contribution reform. Rather than making sweeping categorical changes to the definition of assessable services—which could have a large impact on the growth and development of the Internet economy—the Commission should continue to focus on service-by-service, case-by-case determinations. To facilitate and improve the efficacy, fairness and sustainability of a case-by-case approach, however, the Commission should create a system of rapid adjudications through private rulings. Such a system would increase transparency and give contributors greater certainty as to their obligations. With respect to wholesale services, the Commission should adopt a “collect and remit” approach in which wholesalers were required to collect and remit universal service assessments unless they received a reseller certification.

Respectfully submitted,



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