

Responses to Chairman Markey's April 2, 2007 Letter

Universal Service Contribution Factor

(1) Please identify what you believe to be the root cause for this significant increase in the contribution factor.

Several factors contributed to the two percent increase of the contribution factor for the second quarter of 2007. The largest single factor was prior period adjustments that acted to reduce the Universal Service Fund's revenue requirements in previous quarters. Specifically, these prior period adjustments arose from additional contributions made by AT&T and Verizon on past under-reported revenue, and from a change in the amount of funds that the Universal Service Administrative Company held in reserve for bad debts. The absence of these prior period adjustments caused a 1.5 percent increase in the contributions factor. The remaining 0.5 percent of the increase was due to reductions in the funding base, increases in program demand, including for high-cost support.

(2) What impact did the Commission's designation of Digital Subscriber Line Service as an "information service" have on the contribution base? What would be the impact on the overall contribution base if all broadband Internet access services were required to contribute, regardless of their designation as "information services"?

As part of the *Wireline Broadband Internet Access Service Order*, the Commission took an important step in ending the regulatory inequalities that existed between cable and telephone companies in their provision of broadband Internet services. Because cable modem providers were not subject to a universal service contribution obligation for cable modem Internet access, the Commission does not have historic data for these services. In leveling the playing field between the services, the Commission required telephone companies to continue contributing to the universal service fund on their DSL Internet access services based on their existing contribution levels for 270 days following the November 16, 2005, effective date of the order. On November 16, 2005, telephone providers paid approximately \$123 million per quarter into the USF for their DSL Internet access services. On August 14, 2006, telephone providers were no longer required to contribute based on DSL revenue. This change occurred in the third quarter of 2006 and had no impact on the 2 percent rise in the contribution factor in the second quarter of 2007.

(3) Does the Commission plan to take any action to broaden the contribution base to reduce the contribution factor and the corresponding burden placed on consumers? If so, please describe the planned action and the timeframe in which the Commission intends to act.

Preserving the stability of the universal service contribution system is one of the Commission's most important responsibilities. Changes in technology and increases in the number of carriers who are receiving universal service support have placed significant pressure on the stability of the fund. In June 2006, the Commission took action to broaden the contribution base to reduce the contribution factor by requiring interconnected Voice over Internet Protocol (VoIP) providers to contribute to the fund. In June 2006, the Commission also took steps to preserve and advance universal service by raising the mobile wireless safe harbor to 37.1 percent. Although the Commission took these interim steps to stabilize the fund, the system requires fundamental reform and I support modifying the current contribution system and moving to a more

competitively and technology neutral system based on telephone numbers. The June 2006 Order currently is on appeal. The court should issue its decision soon and we will then review further steps.

Distribution of Universal Service Support

(1) Mr. Billy Jack Gregg, Director of the West Virginia Consumer Advocate Division and a member of the Joint Board, stated in his recent testimony before the Senate Commerce, Science, and Transportation Committee that the Commission's failure to implement the original version of the portability rule (54.307(a)(4)), and adequately define "captured and new lines," is estimated to have added more than \$1 billion to the Universal Service Fund since 2003. Do you agree? Please explain your answer.

Generally yes, since 2003, high-cost universal service support distributed to competitive eligible telecommunications carriers (ETCs) has increased from \$129.6 million to \$979.9 million, or almost \$1 billion per year. Total support distributed to competitive ETCs from 2003 to 2006 was almost \$2.1 billion.

Currently the Commission subsidizes multiple competitors to provide services in high-cost rural areas. Before I became Chairman, I dissented from this Commission policy of using universal service support as a means of creating government-managed "competition" for phone service in high-cost areas. I agree that this policy results in "the subsidies generated by the Commission's universal service rules now support[ing] multiple wireless networks providing services that for many consumers are effectively a complement, not a substitute, to the service already offered by the subsidized wireline incumbent local exchange carrier." I also warned that this policy could make it difficult for any one carrier to achieve the economies of scale necessary to serve all of the customers in a rural area, leading to inefficient and/or stranded investment and a ballooning universal service fund. I remain hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier.

(2) Is the Commission currently reviewing whether it would be meritorious to resurrect the original version of the portability rule (54.307(a)(4)), which would eliminate an incumbent local exchange carrier's universal service support when it loses a customer to a competitor? Likewise, is the Commission reconsidering the merits of defining "captured and new lines"? If not, why not, particularly given that the original version of rule 54.307(a)(4) was previously considered and adopted by the Commission?

I agree that the Commission's current policies result in "the subsidies generated by the Commission's universal service rules now support[ing] multiple wireless networks providing services that for many consumers are effectively a complement, not a substitute, to the service already offered by the subsidized wireline incumbent local exchange carrier." As you indicated, the Federal-State Joint Board on Universal Service (Joint Board) tried to address this issue by limiting support to one "primary line" for each consumer. As you note, Congress has prohibited the Commission from implementing this requirement. Without the obligation to limit support to one line, the Commission cannot effectively implement a "portability" rule, as any consumer would be able to designate multiple lines for universal service support.

As recently recommended by the Joint Board, the Commission currently is considering abandoning or modifying the identical support rule. Under the identical support rule, both incumbent rural LECs and competitive ETCs receive support based on the incumbent rural LEC's costs. As noted by the Joint Board, fundamental differences exist between the regulatory treatment of competitive ETCs and incumbent LECs. For example, competitive ETCs are not subject to rate regulation. In addition, competitive ETCs may not have the same carrier of last resort obligations that incumbent LECs have. Furthermore, incumbent rural LECs' support is cost-based, while competitive ETCs' support is not based on their costs.

(3) Would you support implementation of the primary line restriction recommended by the Joint Board in 2004 if Congress lifted the prohibition on this policy? Please explain your answer.

As a member of the Joint Board, I recommended the adoption of a primary line restriction. Congress subsequently prohibited the Commission from adopting such a restriction. If Congress lifted the current prohibition, I would support the adoption of a primary line restriction.

(4) Why does the high cost program provide support that enables each customer in a high cost area to get multiple subsidized landlines and mobile phones, but Lifeline and Linkup customers elsewhere must choose and only are permitted to obtain support for a single landline or mobile phone? In other words, if mobility is so important, and customers in high cost areas may have a subsidized landline and a mobile phone, don't low-income customers outside high cost areas deserve the same policy?

I believe we need to limit the ability of rural consumers to receive support for multiple phones as well. Indeed, I agree that the current Commission policies result in "the subsidies generated by the Commission's universal service rules now support[ing] multiple wireless networks providing services that for many consumers are effectively a complement, not a substitute, to the service already offered by the subsidized wireline incumbent local exchange carrier."

(5) Given the rise of Voice over Internet Protocol ("VOIP") services, do you believe universal service should provide subsidies for the deployment of broadband service, or should it remain limited to funding voice-grade access?

Encouraging the deployment of affordable broadband services is a top priority. I believe that a modern and high-quality telecommunications infrastructure is essential to ensure that all Americans, including those living in rural communities, have access to the economic, educational, and healthcare opportunities available on a broadband network.

The Act views universal service as an evolving level of telecommunications services. Our universal service program must continue to promote investment in rural America's infrastructure and ensure access to telecommunications services that are comparable to those available in urban areas today, as well as provide a platform for delivery of advanced services. Indeed, in the Joint Board's 2002 Recommended Decision, I urged the Commission to explore how, and to what extent, the federal universal service support mechanism could assist the deployment of broadband and advanced services, or at least the removal of barriers to such deployment, particularly in rural, remote and high cost areas throughout the country. At an *en banc* meeting of the Joint Board held on February 20, 2007, I and many of my Joint Board colleagues

expressed support for exploring whether and how to support explicitly broadband as part of the high-cost universal service mechanism.

(6) If universal service has a role to play in making broadband more accessible and affordable, do you believe that this should be the case solely for consumers in high cost areas? Should low-income consumers benefit from the same policy?

The concept and principle of universal service applies to both high cost and low-income consumers, although through different programs. Consumers living in high cost areas receive support through the high cost program while low income consumers are supported by the Lifeline and Link-Up programs. I believe we should be concerned about making broadband more accessible and affordable for everyone.

Reverse Auctions

(1) Would you still consider it “subsidizing competition” if the Commission implemented its original policies regarding portability and “captured and new” lines, thereby permitting multiple carriers to “win” universal service support when they serve customers in the same high cost areas without enlarging the overall subsidy funding? Wouldn't this reflect a policy of “creating competition for subsidy” rather than the current policy of dual or multiple subsidizations? Please explain your answer.

I believe that reverse auctions could provide a technologically- and competitively-neutral means of controlling fund growth and ensuring a move to efficient technology over time. If the Commission implemented a reverse auction and limited the number of lines, but allowed multiple providers to receive support, it could serve to stem growth. If, however, it did not limit the number of lines and allowed more than one winner to receive support, I am concerned it would not stem the growth of the fund. Indeed, it could undermine the incentive for anyone to bid to provide service for less support since they would otherwise be entitled to receive the higher support of another bidder.

As I have stated before, I am concerned about the Commission's policy of using universal service support as a means of creating government-managed “competition” for phone service in high-cost areas. I am hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier. Such a policy could also make it difficult for any one carrier to achieve the economies of scale necessary to serve all of the customers in a rural area, leading to inefficient and/or stranded investment and a ballooning universal service fund.

(2) As you know, Section 214(e) of the 1996 Act states that a State commission or the FCC “shall” designate more than one “eligible telecommunications carrier” (ETC) in a non-rural market and “may” designate more than one ETC in a rural market. Only ETCs are eligible to receive Federal universal service support. Since Section 214(e) expressly permits designation of multiple ETCs in non-rural markets, would a policy to implement a reverse auction that distributed support to a single “winner” run afoul of this provision in the statute? Please explain your answer.

Section 214(e) states that a “[a] common carrier designated as an eligible telecommunications carrier ... shall be *eligible* to receive universal service support in accordance with section 254.”

Neither section 214 nor section 254 specify a specific amount of universal service support. As such, it seems ETC designation could be required to be “eligible” to participate in any auction.

(3) In addition, while the statute provides a State commission or the FCC with some discretion to designate more than one ETC in rural markets, do you believe a blanket prohibition on the distribution of universal service support to more than one ETC effectively eliminates this discretion altogether? Please explain your answer.

A reverse auction is not a blanket prohibition on multiple ETCs. Indeed, the auction would be conducted among all “eligible telecommunications carriers.”

(4) What do you believe are the implications on competitive choice for rural consumers if only one carrier can win a subsidy to serve consumers in a high cost area?

The Commission has never restricted a carrier from serving an area if it chooses to do so. To date, competitive carriers have entered many areas without receiving ETC designations. As I have previously stated, I am concerned about the Commission’s policy of using universal service support as a means of creating government-managed “competition” for phone service in high-cost areas. I am hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier.

(5) Under the statute, State commissions are the primary authorities for granting ETC designations (Section 214(e)(2)), whereas the FCC only designates ETCs where the relevant State commission lacks authority (Section 214(e)(6)). Since the only benefit conferred by an ETC designation is the ability to receive universal service support, doesn't a Federal restriction that limits universal service support to a single ETC effectively preempt a State commission's express authority under the statute to designate multiple ETCs? Similarly, wouldn't prohibiting State commissions from designating new ETCs also preempt the State commissions' express authority under the statute? Please explain your answer.

A reverse auction is not a blanket prohibition on multiple ETCs. Indeed, the auction would be conducted among all “eligible telecommunications carriers.”

(6) Does your reverse auction proposal encompass “bids” that offer a more robust package of services, including affordable broadband access to the Internet, in addition to bids for subsidy offering to provide the most affordable voice-grade service? Would you favor including such attributes in a reverse auction mechanism?

As I have previously stated, encouraging the deployment of affordable broadband services to all Americans is a top priority of mine and of the Commission. Congress did not envision that services supported by universal service would remain static. Section 254(c)(1) of the Act states, “Universal service is an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services.” A system focused on subsidizing voice service competition is not sustainable in a broadband world.

I believe one of the benefits of a reverse auction would be the ability to include broadband access as a component of the service required by the participants. If the Commission moves to an auctions approach, determining the service obligations will be of fundamental importance.

(7) Will you ask the Joint Board to place a “cap” or a “freeze” on the high cost program in its entirety, or on some portion of the program, such as the funding provided to a certain class of telecommunications carriers?

First, as the Joint Board found, “incumbent LEC high-cost loop support is already capped and incumbent interstate access support has a targeted limit.”

The Joint Board recently recommended by a 7-1 vote that the Commission impose an interim, emergency cap on the amount of high-cost support that competitive ETCs may receive for each state based on the average level of competitive ETC support distributed in that state in 2006. I supported applying a cap to any carrier who does not want to receive support based on its own costs.

(8) If you cap or freeze the high cost support received by some carriers, but not others, how will this be consistent with the Commission's long-standing commitment to competitively neutral universal service policies? If the cap or freeze is not competitively neutral, how will it preserve the beneficial forces of competition, which Congress intended would reduce the size of the high cost program over time?

The current system is not competitively neutral as some carriers are required to file their costs and only receive support based on their costs while others do not. I supported applying a cap to any carrier who does not want to receive support based on its own costs.

E-Rate

(1) Do you support a permanent exemption for universal service from the Anti-Deficiency Act (ADA)? Has the Commission approached the Office of Management and Budget about re-interpreting the ADA to exempt universal service? If so, what is the status of that process?

Absent an ADA exemption, the Universal Service Administrative Company (USAC) is required to comply with the Antideficiency Act today. The Commission is committed to ensuring that funding for all of the universal service programs, including the schools and libraries program, remains current and that the fund meets its commitments while also remaining ADA compliant. At this time, the Commission staff estimates that the universal service program can continue to operate as it does today without triggering an Antideficiency Act violation.

The Commission has not approached the Office of Management and Budget (OMB) about re-interpreting the ADA to exempt universal service.

(2) I applaud your efforts to reduce the backlog in the appeals process for E-rate funding. However, one possible repercussion of this recent action may be confusion among applicants and USAC as to what is now permissible under the program. What actions does the Commission intend to take to ensure no such confusion arises and what recommendations would you generally make to improve the appeals process?

The Commission has taken steps to ensure the smooth implementation of its recent E-rate orders, while it continues to pursue simplifying the program more broadly.

In the various global E-rate appeal orders recently released by the Commission, we have provided specific processing directives to the Universal Service Administrative Company (USAC) for it to use when addressing the appeals involved in each order. Commission staff is working closely with USAC staff to ensure the correct implementation of each of our orders. In addition, these orders provided USAC with specific direction on how to expand its outreach program and educational efforts to better inform applicants on the various application requirements and to provide applicants with opportunities to cure certain minor administrative errors.

We expect that such additional outreach and educational efforts, as directed in our orders, will better assist E-rate applicants in meeting the program's requirements and minimize confusion regarding such requirements. We also believe that our direction to USAC will provide for a more effective application processing system that will ensure eligible schools and libraries will be able to realize the intended benefits of the E-rate program and improve the appeals process.

Nevertheless, I recognize that the E-rate application process remains complex and confusing for many schools and libraries. One of the first actions that I took after becoming Chairman was to propose a notice of proposed rulemaking, subsequently adopted by the Commission, that seeks to reform the E-rate appeals process and to improve the E-rate application and disbursement process. I remain hopeful of implementing more comprehensive programmatic reform.

(3) Do you support ensuring that the most financially-strapped school districts continue to obtain the highest E-rate subsidy? Do you support making certain telecommunications services available for financially-strapped entities for free? Would you support bringing the highest bandwidth services to the most financially-strapped school districts by making their subsidized level conducive for deployment to such school classrooms?

I believe that E-rate funding should be used to ensure that all classrooms, including those in financially strapped school districts, have access to the highest quality of telecommunications and advanced services. E-rate makes telecommunications and advanced services substantially more affordable to the financially strapped schools.

In the 1997 Report and Order (FCC 97-157, rel. May 8, 1997), the Commission found that requiring schools and libraries to pay a share of the cost of E-rate services should encourage them to avoid unnecessary and wasteful expenditures because they will be unlikely to commit their own funds for purchases that they cannot use effectively. The Commission also noted that a percent discount encourages schools and libraries to seek the best pre-discount price and to make informed, knowledgeable choices among their options, thereby building in effective fiscal constraints for program beneficiaries. The Commission should continue its vigilance against waste, fraud and abuse.

(4) Do you support lifting the cap on the E-rate program, which is currently set at \$2.25 billion per year?

The \$2.25 billion cap was established by the Commission in its 1997 Report and Order (FCC 97-157, rel. May 8, 1997). I support maintaining the cap while the Commission examines how to

ensure that E-rate support enables the neediest schools and libraries to obtain essential communications services more efficiently.