

Ensuring the Sustainability of Universal Service

**Remarks by FCC Commissioner Kathleen Q. Abernathy
(As prepared for delivery)**

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Thank you for that kind introduction. It is a pleasure to be here with you today. It is truly a privilege to speak to a group of companies that have made the goal of universal service a reality for rural America. These days, most of us take telephone service for granted, but I know that in the not-too-distant past, rural consumers were hard-pressed to obtain access, because they were largely ignored by the Bell system. Thanks to the can-do spirit of the co-ops and small commercial carriers, today most consumers who want telephone service can now obtain it at affordable rates. From my past experience in private practice representing rural carriers, and from my more recent experience at the Commission, I have a deep appreciation for the unique challenges that confront rural carriers.

These challenges of geography and topography remain with us today. For all the talk about whiz-bang services like broadband Internet access and VOIP, it still costs a great deal of money to build a network that can support these kinds of services in rural areas. The required funding has come in large part from interstate access charges and universal service payments, and both of those policy areas are therefore critical to the industry and to rural consumers. While there is no doubt that changes in technology and in the marketplace force us to consider significant reforms to the intercarrier compensation regime and to universal service policy, I give you my firm commitment that I will always bear in mind the impact of proposed policy changes on rural communities.

Today, I would like to focus on universal service policy. As Chair of the Federal-State Joint Board, I have spent a great deal of time on universal service issues, and the Joint Board is fast approaching completion of its recommended decision on the rules that govern the funding and designation of ETCs. In addition, Congress and the FCC are considering reforms to the contribution

methodology. So we are taking a fresh look at how universal service subsidies are collected *and* distributed. That's why I thought it would be useful if I provided an overview of what the Joint Board has been considering, and then I will touch on the contribution methodology debate. Then if we have any time remaining, I would be happy to take questions about other topics that may be of interest.

ETC Proceeding

The Joint Board has been focused on three main questions. First, how should state commissions and the FCC apply the public interest standard when considering applications by wireless carriers and other competitors for ETC status? Remember, applications must serve the public interest to be granted. Second, what is the appropriate scope of support — that is, should there be a cap on per-line support? Should support be restricted to a single connection? Third, what is the appropriate methodology for determining the basis of support for incumbents and competitors

— is it embedded costs, forward-looking costs, or some other methodology? I will talk about each of these issues in turn.

ETC Designation Guidelines

When competitive carriers began to apply for ETC designations after the enactment of the 1996 Act, a number of states appeared to regard entry by any new competitor as *per se* consistent with the public interest. This is perhaps not surprising, because it was federal money the state commissions were handing out. But what is perhaps more surprising is that the FCC, when stepping into the shoes of state commissions that lacked jurisdiction over the ETC designations, took a similar approach, focusing primarily on the benefits of increased competition, without carefully considering the long-term impact on the growth of the high-cost fund.

Now, faced with dramatic growth in the funding of competitive ETCs, many policy makers are recognizing that a more rigorous designation process is necessary.

While promoting competition is undoubtedly a core goal under the

Telecommunications Act of 1996, the use of universal service funding to *create* competition where market forces alone cannot support it is not necessarily in the public interest. Particularly in very high-cost rural study areas, where the cost of providing service far exceeds retail rates, regulators must carefully consider whether the benefits of subsidizing an additional ETC outweigh the costs.

I am happy to report that, in the federal arena, the FCC just completed an ETC proceeding involving a wireless carrier called Virginia Cellular, and for the first time we took a significant step towards creating a more rigorous application process. In addition, the Joint Board is considering more comprehensive measures, as I will describe in a moment.

The FCC already has implemented several new requirements in the Virginia Cellular case. There, the Commission made clear that any carrier that wants to be an ETC must offer quality services at affordable rates throughout the designated service area. The ETC also must be ready, willing, and able to serve as a carrier of

last resort and otherwise be prepared to fulfill the goals set forth in section 254 of the Act.

To this end, the FCC required Virginia Cellular to submit build-out plans to document its proposed use of federal universal service funding for infrastructure investment. The Commission also considered the carrier's commitment to provide high-quality service. Moreover, for the first time we considered the increasing demands on the universal service fund. While at one point the cost of granting ETC status to new entrants may have appeared minimal, the dramatic rate of growth in the flow of funds to competitive ETCs compels us to consider the overall impact of new ETC designations on the stability and sustainability of universal service. Finally, I strongly support our decision to increase our regulatory oversight by imposing reporting requirements on Virginia Cellular and by reserving the right to conduct audits and revoke this ETC designation in the event of a failure to fulfill the requirements of the statute and this Order. All of these requirements are consistent with the statutory framework,

and while they arguably should have been imposed much earlier, I believe we are now on the right track.

In the Joint Board proceeding, I have been strongly supportive of issuing federal guidelines urging *all* state commissions to conduct a rigorous application process. Again, universal service support is not a free lunch. Carriers that want to be ETCs must be prepared to stand as the sole provider of service to a rural area. They therefore must be able to demonstrate their financial stability and their plans to build out facilities in a reasonable time so they can serve all customers upon reasonable request. They must provide high-quality service, and they must be able to remain operable during natural disasters and other emergencies. Finally, they must offer local usage — if not an unlimited amount, then at least enough to qualify as a bona fide basic local telephone service.

Most of my colleagues on the Joint Board — hopefully all of us — agree with these principles. We also agree that in rural areas,

regulators must apply an even more exacting standard of review, consistent with the framework established by Congress. The statute establishes a different standard for rural areas, and it is clear to me that Congress wanted regulators to take an extra hard look at applications for rural study areas before designating any additional ETCs.

Another key issue that the Joint Board has been considering is accountability. Once a competitive carrier is designated as an ETC, we must ensure that universal service funds are invested in the network, rather than used to pad the bottom line. The annual certification process should be used to check compliance with build-out commitments, and we also should have a more stringent audit process for ETCs. I am concerned that, up until now, too many states have rubber-stamped ETCs' assertions that they are using universal service funds for the provision of the supported services. I am generally no fan of intrusive regulations, but this is a special case: If a company is going to apply for governmental funding, it must submit to governmental oversight.

Scope of Support

In addition to the ETC designation process, the Joint Board has been considering the appropriate scope of federal universal service support. I recognize that this is a very difficult and controversial issue. As recipients of USF dollars, rural carriers are reluctant to consider any proposals that could diminish the available funding. But I think the proposals that have been made to the Joint Board are important to consider, because they force us to think about the core purposes of universal service support and how to ensure that it will be sustainable over the long haul.

A majority of Joint Board members, myself included, have been willing to consider restricting support to primary connections. The Joint Board has recommended such an approach in the past, but the FCC declined to implement it. The principal argument for such a restriction is that Congress intended to ensure that all Americans have affordable access to local exchange service, 911 service, and other basic services, but it did not call for subsidizing services that are not part of the universal service definition, such as

mobility, fax lines, or Internet access. Policymakers of course want all consumers to have the broadest possible choice of services, but the question is how many of those services should be subsidized. This question is all the more pressing as the demands for funding grow over time. Universal service is now a \$6 billion program. The amount of support flowing to competitive carriers has been growing at a dramatic rate in the last few years. All of these considerations prompt me to consider whether we are able to continue funding an unlimited number of connections and an unlimited number of service providers, as we do under our existing rules.

On the other side of the equation, I am receptive to concerns the implementing a primary-line restriction could be very difficult from an administrative standpoint. In addition, I also appreciate the concern that limiting funding could deter infrastructure investment in rural areas. These are significant concerns, and I would not lightly adopt a restriction on the scope of support — I would do so only if convinced that the chosen approach is most

consistent with the public interest. At this point, I am pleased that the Joint Board appears poised to recommend that the FCC give these proposals serious thought. I have not made a final decision on the appropriate policy, and I look forward to working with you as the FCC considers the Joint Board's recommendations and further develops the record.

Basis of Support

The final issue pending before the Joint Board concerns the basis of support. I have long been concerned that funding competitive carriers based on the incumbent LEC's embedded costs is a flawed concept. I think most of my colleagues on the Joint Board agree with me. What remains uncertain is what we should do instead. Some parties argue that competitive carriers should receive support based on their own embedded costs. This appears to have some merit, but it remains unclear how the FCC would determine those costs, and whether such an approach would reduce or instead increase overall funding. NASUCA and other parties have argued that the FCC instead should fund all ETCs —

competitors and incumbents alike — based on their forward-looking costs, or based on the lowest provider’s forward-looking costs. Ever since the Rural Task Force proceeding, the FCC has recognized that it would be extremely difficult, and perhaps impossible, to model forward-looking costs reliably in rural areas. Whether the FCC could estimate costs by some other methodology remains to be seen.

In my role as Joint Board Chair, I have directed the Board to continue investigating these issues following the release of the upcoming Recommended Decision. As with other issues, your participation is invaluable. I hope we the Joint Board is able to develop a recommendation this year, so that the FCC can adopt reforms immediately upon the expiration of the RTF Plan [in 2006].

Contribution Methodology

As I have been discussing, the distribution side of universal service presents a number of hard questions. The same is true of the contribution side. For some time, the FCC has been exploring

alternatives to the existing contribution methodology, which draws support only from interstate telecom service revenues. As broadband services and VOIP become more prevalent and generally go without assessment, the inadequacies of our current approach become more apparent. The lines between interstate and intrastate services are increasingly fuzzy, as are the differences between telecommunications services and information services. I believe that the FCC or Congress will need to make significant changes to ensure the sustainability of universal service.

Several trends have combined to put upward pressure on the contribution factor, which has hovered around 9 percent over the last year or so. Higher contribution factors translate into an increased funding burden for consumers. While long distance revenues grew between 1984 and 1997, they have since been flat or in decline as a result of price competition and substitution of wireless services and e-mail. Because federal universal service contributions by law may be assessed only on interstate revenues, this shrinking of the revenue base has caused the contribution

factor to rise steadily. Another important trend has been the increasing prevalence of bundled service plans. For years, wireless carriers have offered buckets of any-distance minutes at flat rates, and now wireline carriers are offering packages that include local and long distance for a single price. In addition, many carriers offer business customers bundles that include local and long distance voice services, Internet access, and customer premises equipment. Such bundling has been a boon for consumers but has made it difficult to isolate the revenues from interstate telecommunications services. And the problem is likely to get worse as bundling becomes more and more popular.

In December 2002, the Commission adopted a number of measures to stabilize the universal service contribution factor in an effort to mitigate the growing funding burden on consumers. Most importantly, the Commission substantially increased the safe harbor amount that wireless carriers must contribute. While this was a helpful step, I believe that more fundamental reform will be

necessary to ensure the sustainability of universal service funding in the long term.

At this point, I believe policy makers have two primary choices. First, Congress can amend the Telecommunications Act to give the FCC authority over intrastate revenues. Such a change would prevent carriers from shifting revenues from one jurisdiction to the other to avoid assessment. It also would lead to a more stable and predictable contribution factor, since total revenues fluctuate much less than interstate revenues. But expanding the FCC's authority to include intrastate telecommunications revenues would do nothing to address the leakage of traffic to service categories that are not assessed, such as information services. To respond to that trend, the FCC would need to invoke its permissive authority to assess the telecommunications component of broadband information services — which I have been willing to consider, but some of my colleagues have not.

Apart from a legislative solution, the other leading proposal has been to replace the revenue-based system — in whole or in

part — with one that assesses contributions based on end-user connections or assigned telephone numbers. The advantage of such an approach is that it would no longer matter whether a service is a telecom service or an information service. The carrier that provides the connection or telephone number would pay a flat fee, and all traffic that flows over the pipe would accordingly be covered. A connection-based plan thus would be more future-proof than our existing revenue-based model, because it simply wouldn't matter how services are classified or what their jurisdiction is.

A key objection, however, is that a pure connection-based approach might not meet the statutory requirement that all carriers contribute to universal service on an equitable and nondiscriminatory basis. In particular, long distance carriers, which traditionally have been the primary supporters of universal service, have very few end user connections, and they would therefore pay little or nothing under a connection-based approach. It may turn out that long distance ceases to exist as a stand-alone

business some day soon. In any event, using a connection-based methodology may prove to be the best option, because after all, it is consumers, not carriers, who ultimately bear the cost of universal service contributions. But it has been my objective to ensure that our universal service rules apply in an evenhanded manner and do not give any industry segment an artificial advantage or disadvantage. So I have tried to ensure that long distance carriers will be significant participants in any contribution methodology we adopt.

I do not know when the Commission will consider an order that further modifies the contribution methodology. It is possible that the Commission will hold off to give Congress an opportunity to enact legislation, but it is also possible that the Chairman will ask the commissioners to consider reform sometime in the next several months. As with the ETC proceeding, I have every expectation that you will be active and helpful participants in this ongoing policy debate.

Thank you very much. I will be happy to take a few questions if we have time.