TESTIMONY OF BOB ROWE
Chairman, Montana Public Service Commission
before the
HOUSE COMMITTEE ON ENERGY AND COMMERCE
SUBBCOMMITTEE ON TELECOMMUNICATIONS AND THE INTERNET
Hearing on "The Future of Universal Service"
September 24, 2003

SUMMARY

A. Several basic questions help provide perspective in considering universal service.
   a. Is universal service "the problem" or is it in fact one of the Telecommunications Act's greatest successes?
   b. What is the appropriate balance in the high cost fund portion of universal service between a focus on support for customers and support for a network capable of providing "reasonably comparable" rates and services?

B. Factors driving growth in the fund.
   a. Moving to replace intercarrier payments with universal service support, through CALLS and MAG is the largest driver of recent fund growth. Further modifications of the intercarrier payment system could put even greater pressure on the fund.
   b. The recent but dramatic growth in certification of "competitive eligible telecommunications providers" (CETCs), especially wireless CETCs is a relatively new but potentially very significant driver.

C. Summary of current issues in universal service.
   a. Contributions. Should contributions to support universal service be based on the number of connections, capacity of the line, telephone numbers, or modification of the current revenue-based method either by broadening the base or deepening it?
   b. Eligibility. What should the standards be for ETC or CETC certifications?
   c. What costs should payments be based on? (Eligibility and cost basis for payment are currently being considered by the Joint Board.)
   d. Large company issues.
      i. Does the separate "non-rural" (large company) fund achieve the goals of Section 254, including "reasonable comparability" of rural and urban rates and services, and "sufficiency" of support?
      ii. Is the FCC's Hybrid Cost Proxy Model, as currently maintained, an appropriate basis for awarding support to non-rural carriers?
   e. Covered services.
   f. Further modification of inter-carrier compensation systems.

D. Narrow versus broad approach to issue resolution.
   a. Focused legislation, including contributions.
   b. Oversight and Joint Board action on "portability" issues.
   c. Rigorous and structured approach to any further intercarrier compensation modifications.

E. The critical role of Congress.

TESTIMONY OF BOB ROWE
Chairman, Montana Public Service Commission
before the
HOUSE COMMITTEE ON ENERGY AND COMMERCE
SUBBCOMMITTEE ON TELECOMMUNICATIONS AND THE INTERNET
Hearing on "The Future of Universal Service"

September 24, 2003

Mr. Chairman and Members of the Committee, I am Bob Rowe, Chairman of the Montana Public Service Commission, and a member of the Federal-State Joint Board on Universal Service. I am speaking only on my own behalf. I commend you for holding this important and timely hearing. I am truly honored to be here.

Real challenges face the federal universal system, as they do the entire telecommunications sector. However, I have perhaps more optimism now about the ability to address the challenges facing universal service than I have in quite some time.

Why am I optimistic? Experience and an appreciation of the risks of failure to act wisely have made the discussion of universal service issues more informed and constructive. I credit that to hard work among industry and consumer stakeholders, to an engaged and effective Joint Board and FCC, and to leadership by Congress. More on that later.

My testimony will briefly cover the following areas:

1. Several basic questions about universal service.

2. Factors driving the past and future growth in the fund.

3. Summary of current key issues in universal service.

4. Narrow versus broad approaches to issue resolution.

5. The critical role of Congress.

I will conclude by suggesting a combination of measures, including strong and continuing Congressional oversight. These suggestions build in part on approaches developed through the Universal Service Summits convened by Senators Burns and Dorgan, along with focused legislation in several areas, especially contributions to support universal service. I also suggest for consideration a possible approach to addressing difficult issues in intercarrier compensation.

A. Several Basic Questions About Universal Service.

Two questions seem especially important to me, and help shape the solutions we craft:

1. Is universal service the problem or the solution?
2. Is universal service best understood mainly as a support system for customers or for networks that serve customers?

Is universal service the problem or the solution?

It is disturbingly easy to encounter those who believe that the universal service system is itself "the problem," especially the high cost fund portion. I believe that the programs embodied in Section 254 may perhaps be the Telecommunications Act's most tangible success. Each of the four programs - high cost fund, schools and libraries, rural telemedicine, and lifeline-link-up – has produced real achievements. In particular, the high cost support programs have allowed service providers to maintain their networks while keeping rates affordable.

Universal service really is working in Montana. The seventeen rural carriers have built high quality networks capable of supporting a wide range of services. They have deployed DSL in 183 rural communities, including remote, low income areas such as Crow Agency on the

Crow Reservation.[1] Rural carriers have formed consortia to provide switched ATM backbone and to provide at least 123 state-of-the-art video studios (Vision Net, Mid-Rivers and Range) for everything from distance learning to supporting local businesses. Every Native American Indian Reservation in Montana has, for example, at least one video studio operated by Vision Net. Most of these efforts are not supported by universal service,[2] but the high cost fund has helped pay for the critical local network facilities over which all these services originate and terminate, facilities on which services such as DSL are directly deployed.[3] A map of facilities deployed by rural Montana carriers is attached to this testimony.

The other programs supported by universal service have also produced real successes.[4]

The very high level of service provided in some of the nation's most challenging areas shows that the program is successful and important. Essential reforms should be built upon this foundation.

Support for customers or for the network?

Many still argue that the existing high cost support system should be replaced with one that makes payments to individual customers, as does the current Lifeline program. Congress resolved this issue in the 1996 Act, saying that rates and services should be reasonably comparable between urban and rural or insular areas, not customers. It is worth noting, however, that factors such as small local calling areas in many rural areas (compared to the hundreds of

[1] All four of the Project exchanges on the Crow Reservation have DSL. Exchanges with as few as seventy lines have been provisioned with DSL.

[2] For example, universal service does not support transport, which can be a key cost driver for everything from connecting remote households [Joint Board Recommended Decision, Released July 10, 2002 (FCC 02J-1), Bob Rowe Separate Statement Concurring in Part Dissenting In Part (pp. 43-53)], to getting broadband traffic back to the Tier 1 Internet [Victor Glass, "NECA Rural Broadband Cost Study: Summary of Results," June 21, 2000; Victor Glass, "Rural Realities: Will rural dwellers be forgotten in the broadband boom?" July 15, 2002].

[3] .Support for the loop has also likely allowed carriers to allocate more resources for advanced services deployment than otherwise would have been the case.

[4] On June 9, 2003, the FCC issued a Notice of Proposed Rulemaking, requesting comments on a Joint Board recommendation concerning the Lifeline and Link-up programs.

thousands who may be within an urban local calling area make rural customers' total phone bills higher than urban customers' even where the nominal local exchange rate is lower. Moreover, non-metropolitan status correlates very closely with low per capita income. I offer two examples:

1. InterBel Telephone Cooperative serves about 3110 access lines in several small communities in Northwest Montana. The residential and business basic exchange rates, including the Subscriber Line Charge, are $18.50 and $26.20. Without universal service support, these figures would be $81 higher each month. The per capita income in Eureka is $12,619[5]. For the State of Montana as a whole the per capita income was $17, 151.
2. If it were not for universal service support, local rates on the Crow Reservation could be as high as $60 for residential customers and $70 for business customers. Per capita income on the Crow Reservation was $9,440 dollars in 1999, with 21.8 percent unemployment.

Getting services to customers at affordable and comparable rates is obviously a fundamental goal. However, we must also remember that existing universal service arrangements arose out of the system of payments created over the years to pay for building, maintaining, and operating the "network of networks" that served most telecommunications carriers and most of their customers. Initially, most of this occurred by the independent companies allocating some of their costs to the interstate jurisdiction. These costs were then recovered through the "settlements" between AT&T and the independent carriers.[6] With divestiture, this system was modified to incorporate "access payments" by the inter-exchange

[5]U.S. Census Bureau, 2000 Census.
[6] The initial "Ozark Plan," following out of the 1934 Act, was driven by the distance traffic had to be hauled and the hold time for interstate calls, and resulted in as much as 85 percent of costs being assigned to the interstate

carriers to the local carriers, to support the local network required by IXC customers to originate and terminate long distance calls. This has been compared to "rent" paid for use of the local networks. The FCC created a variety of programs to support specific services, such as high-cost loops and switches deployed by smaller carriers. At the same time, a portion of the "non-traffic sensitive" costs were moved to end user payments, and the "subscriber line charge" (SLC) was created.

After passage of the 1996 Act, even more costs where shifted to end users, as the FCC tried to make "implicit" support explicit (at least as to interstate costs), to lower interstate access charges, and to move more "non-traffic sensitive" costs to end users. The CALLS (Coalition for Affordable Local and Long Distance Service) program for large companies and the MAG (Multi-Association Group) program for small companies are the prime examples.

As will be noted below, a network focus, in addition to a customer focus, helps provide analytical clarity, sheds additional light on one of the key cost drivers (further replacement of access by universal service type payments), and helps focus the discussion about what services should be covered by universal service. This history shows that one cannot understand universal service solely as a program for reducing customers' rates. Equally important, it has been used as a method of financing the construction of quality plant in high-cost areas.

B. Factors Driving Growth In The Fund.

High cost loop support was capped by the FCC in 1994. The cap was intended to be temporary, while universal service was "reformed." Instead the cap has remained in place,

---

jurisdiction for some rural carriers. From 1981 to 1997, the interstate allocation of loop costs was gradually moved to a uniform 25 percent.

although modified when the FCC adopted recommendations of the Rural Task Force. The attached tables and charts were provided by NECA[7] at my request.

Illustration 2 summarizes the current elements of universal service. Rural health care ($20 million per year), and the Lifeline and Link-up programs for low income customers ($741 million) are by far the smallest components. The Schools and Libraries program is substantial, but has been capped at $2.25 billion since 1997, and therefore is not a driver of current fund growth. Programs comprising the High Cost Fund are projected to total $3.4 billion for 2003. Illustration 3 shows the growth in total high cost fund support since 1998, roughly a doubling in size.

Illustration 4 shows growth in the High Cost Fund from 1998 through 2003, by components. The most significant increases in recent years, by far, have resulted from two similar decisions. First, the "CALLS" plan adopted by the FCC caused a roughly $650 million increase in the high cost fund. This new money limits how much SLC charges may increase in rural areas as a result of the decision to reduce access payments paid to price cap regulated (mainly large) ILECs. Then, the "MAG plan" as adopted by the FCC, created a similar support plan, the Interstate Common Line Support (ICLS) program for rate-of-return regulated (mainly small) ILECs. This program now costs about $425 million per year. These two programs, costing more than $1 billion per year, were designed to reduce interstate access charges.

Other factors have also caused costs to increase.[8] Illustration 5 shows estimated ILEC and Competitive Eligible Telecommunications Carrier (CETC) funding, annualized, based on

---

[7] NECA operates the various intercarrier rate pools, conducts economic and technical analysis, and provides other services to the telecommunications industry. It does not take positions on policy issues. Use of this material does not constitute an endorsement by NECA for any position in this testimony. This information was derived by NECA from reports filed with USAC and other publicly-available information.

[8] Loop support increased due to regulatory changes resulting from MAG and RTF implementation, where the cap was increased and the payment calculation modified to incorporate growth in the number of loops and in DGP-CPI.

third quarter, 2003, numbers. ILECs will receive $3.41 billion this year. CETCs will receive $251 million. Recent analysis indicates this figure may be exceeded.

Illustration 6 shows the growth in the number of CETCs and funding from the third quarter of 2002 to the third quarter of 2003. There were 30 CETCs in the third quarter of 2002, and 165 one year later. CETCs received $56 million (1.8 percent of the fund) in 2002 and $ 252 million (7.3 percent of the fund) one year later. It is generally agreed that there is substantial potential for further growth from CETC certification.

C. Summary of Issues in Universal Service.

1. **Contributions.**[9] Currently, universal service is supported by an assessment on interstate revenue. The FCC has made several adjustments to the contribution base (most notably increasing the portion of wireless revenue assumed to be interstate and therefore subject to the assessment from 15% to 28.5% and basing assessments on prospective revenues). As a result, the assessment has temporarily stabilized at slightly above nine percent. However, most observers expect this to be a temporary reprieve from an increasing assessment on a decreasing base. Alternatives proposed by various parties include:

   a. Per connection assessment;

   b. Capacity based assessments;

   c. Per-telephone number and number equivalent assessments; and

   d. Modifications to the revenue-based approach either by:

[9] The "contribution" issue was not referred by the FCC to the Joint Board. However, the Joint Board did hold a public meeting on the subject June 21, 2002, and state members did submit two sets of comments to the FCC, most recently on May 20, 2003.

i. *broadening* the base to include more services (such as broadband services in addition to DSL), or by eliminating the wireless "safe harbor," or

ii. *Deepening* the base to allow assessment for the federal fund to be based on intrastate as well as interstate revenue (with a similar modification for state funds).

Most of these proposals have been subjected to criticisms based on possible illegality under Section 254 as interpreted by the courts[10]; administrative workability, fairness, or other grounds. Most current attention is focusing either on the number and number-equivalent approaches (developed most thoughtfully by FCC Commissioner Martin), or on expanding the revenue base to include more telecoms revenue. Notably, the federal and state members of the Joint Board submitted a letter to Senator Burns stating that deepening the base to include intrastate revenue was a workable option.[11]

It has also been suggested that Congress clarify that any of the approaches are acceptable, based on a determination by the FCC, thereby eliminating any possible legal barrier to an approach determined most workable by the Commission.

2. Eligibility.[12] The Joint Board is currently examining numerous questions regarding carrier eligibility for universal service support. What standards should "competitive eligible telecommunications carriers" (CETCs) have to meet in

[10] See, Texas Office of Public Utility Counsel v. FCC, 183 F. ed 393 (5th Cir. 1999), prohibiting assessment of intrastate revenues to support the Schools and Libraries program. Others have suggested that a per-connection or per-telephone number approach would not comply with the statute that requires all interstate carriers to contribute, or would not be equitable and non-discriminatory. See 47 U.S.C. Section 254(d).

[11] Letter dated May 19, 2003, Attachment 1. While the state members of the Joint Board endorsed this approach, it is likely to be strongly opposed by a number of state commissions.

[12] Eligibility-related and cost and payment issues were included in the "portability" referral from the FCC to the Joint Board. The Joint Board held a very productive *en banc* hearing in Denver on July 31, 2003, and is currently

order to be certified by a state commission or the FCC under Section 214, especially in areas served by rural carriers? Should the FCC adopt a set of standards applicable to currently-certified ETCs and CETCs alike? Should this issue continue to be left to the state commissions? Should the FCC set a floor, with state commissions able to build on this floor? Could a set of wireless-appropriate standards be developed? Could a "best practices" or model standards for state commission consideration be developed? Are there relevant differences between wireline CETC applicants (often rural overbuilders) and wireless CETC applicants? Is there a risk of diminished quality if one set of carriers faces a lower standard than does another? How should state commissions evaluate the "public interest" component of the current statutory standard, and should they consider the effect on the federal fund of multiple ETC designations?

3. **Cost basis for payment.** Currently, all "nonrural" companies, including all the Bell Companies, receive support based on forward looking costs, determined through the FCC's Hybrid Cost Proxy Model (HCPM). Small companies receive support based on embedded (historical) costs. CETCs receive support based on (and on a per-line basis identical to) the support of the incumbent for whose area the competitive carrier is granted ETC status. The Joint Board is currently considering a number of issues here as well. For example, should the CETC receive payment based on the incumbent's costs, or on its own costs, and should those be forward looking or

---

considering comments. This proceeding also concerns specific issues such as whether support should be limited to a "primary line," and how primary line would be defined.

embedded? Given concerns about the HCPM, should it ever be used for rural carriers, and should it continue to be used even for large carriers?

4. **Large Company Issues.** The 10th Circuit Court of Appeals remanded to the FCC its "large company" Ninth Report and Order.[13] In turn, the FCC referred this issue to the Joint Board, which issued a recommendation on October 16, 2002. The Joint Board suggested several modifications, which the FCC is now considering. The FCC's order is expected soon. In my opinion, the combination of an imperfect cost model[14] with the formula used to award support does result in significant under-funding to areas served by the largest companies. This includes many states in the west, but also New England states such as Maine and Vermont (a rural state in which 85 percent of lines are served by Verizon).[15] In my dissent to the Joint Board recommendation, I argued that Section 254 requires that rates and services in rural and insular areas be "reasonably comparable" with rates and services in urban areas. Comparing rural

[13] Qwest Corp. v. FCC, 258 F.3d 1191 (2001). The FCC's order was challenged by Maine, Vermont, and Montana, as well as by Qwest. The court held, *inter alia*, that the FCC did not provide an adequate explanation for its decision that the non-rural mechanism in the Ninth Report and Order achieved the statutory principles in Section 254; that the FCC failed to define the key statutory terms "reasonably comparable" and "sufficient"; that it did not adequately explain the 135 percent of national average funding benchmark.

[14] Montana, Maine, and Vermont have repeatedly urged the FCC to address problems with inputs, formulas and maintenance of the model, but have generally been frustrated in their attempts to obtain critical information about the model. See, letter to the FCC from counsel for the Vermont Public Service Board, September 12, 2003 (Attachment 2). Possible problems include but are not limited to assuming that cabling runs on straight compass lines, underweighting the cost of traveling over mountains or rivers; apparently ignoring physical barriers such as highways or railroads; apparently not accounting sufficiently for physical barriers such as shallow bedrock or rocky soil; not accounting for increased maintenance cost in snowy regions; inconsistently treating broadband facilities.

In the 10th Circuit litigation, Qwest mounted an unsuccessful general challenge to the use of forward looking cost models for universal service purposes. Based on several years of experience, one wonders how a court would view under Section 254 the model as implemented and maintained. The Congress could instruct the FCC, if it continues to use cost models, to adequately staff and maintain the model, and to document and publicly disclose all modifications to it.

[15] Only eight states receive high cost fund support under the large company program. Qwest serves fourteen states, including twelve of the fifteen least densely populated states, but receives high cost fund support for only two states: $10.307 million per year for Montana and $7.243 million per year for Wyoming. (It must be noted that many of the highest cost areas within those states are served by rural carriers.) Verizon will receive $9.259 million per year in high cost model support in Vermont and $5.529 million per year in Maine [based on 4th quarter 2003 projections by USAC].

rates[16] with a national average and then providing support only for costs exceeding 135 percent of the national average falls far short of this clear directive. A rural or insular area might be required to have rates or costs as high as 165 percent of the urban average cost before it would be eligible for support under the current system.

5. **Covered services.** The Joint Board is required periodically to review the list of services eligible for support, and recommend changes. "On July 10, 2002, the Joint Board recommended that the list remain unchanged on July 10, 2002 [Recommended Decision, Release Date (FCC 02J-1)]. The FCC issued an order adopting that recommendation on July 14, 2003. In that proceeding, I dissented in part, suggesting that a focus on support for the network over which most services are provided would be a more reasonable approach than attempting to evaluate specific services. For example, the primary requirement for DSL service (or similarly, high speed wireless service) is a robust network, with clean loops. This is consistent with the "no barriers" approach advocated by the Rural Task Force.[17]

6. **Further modification of inter-carrier compensation systems.** Many carriers, including but not limited to the largest ILECS and the IXCs, argue that further modification of inter-carrier compensation is required because of a variety of threats to the current system. The full scope of the problem is being identified only now, including through specific data requests by the FCC. It is abundantly clear, however, that rural carriers are much more dependent on access payments than the larger

[16] Or costs, as there are many variables in rate comparability, including but not limited to the size of the local calling area, how costs are assigned to different rate elements, the depreciation rates assumed, and so on.

[17] The Rural Task force recommended to the Joint Board and the FCC a "no barriers to advanced services" policy, including universal service support for plant that can (as built or with the addition of elements) provide access to advanced services; encouraging carriers to remove infrastructure barriers to such access; and, sizing the federal universal service fund so that it does not present barriers to investment in plant needed to provide access to advanced services. See, Joint Board's Recommended Decision concerning covered services, Separate Statement of Commissioner Rowe, Sections IV and V (July 10, 2002), pp. 47-52.

carriers. "Bill-and-keep" approaches are especially problematic for small carriers because they lack the ability to average costs over a larger area and the current pooling mechanisms function like high-cost support but are vulnerable if bill-and-keep is adopted. Also, intrastate access may eventually be as significant a concern as interstate access. If universal service support is further substituted for access payments, the upward pressure on the fund could be tremendous.

A. Narrow Versus Broad Approaches To Issue Resolution.

Generally, one group of stakeholders prefers focusing on a particular issue, principally stabilizing the revenue base. Another group argues that a comprehensive approach is required, one that addresses all issues as part of the same package. The narrow approach is advocated based on feasibility, and the urgency of the contributions issue. The broader approach is advocated based on the desirability of addressing all related issues, especially including intercarrier payments, in a consistent manner, and that does not risk making decisions on narrower issues that may limit the ability to address the larger issues. Some have said that it is unwise to resolve contributions issues without also addressing eligibility issues at the same time.

A reasonable middle approach might be: 1. to move forward with a focused approach to the contributions issue, including legislation; 2. to address the portability issues through the ongoing Joint Board process, with Congressional oversight; and 3. to address intercarrier payments through a rigorous, structured approach. For consideration, I suggest exploring a structured, analysis-based approach to resolving intercarrier payments concerns. We can learn some positive and negative lessons from "alternative dispute resolution" efforts such as CALLS,

MAG, Rural Task Force, and the Qwest Multi-state Section 271 collaboratives. Such a process would require effective participation by all affected, especially the small carriers who are especially vulnerable to changes in access revenue. It would likely benefit from a high degree of transparency and independent facilitation; it should have access to sound and extensive analysis. Its decision rules and eventual deliverable product (e.g., a recommendation to the FCC, along with any dissents) should be clear. It would be difficult to achieve a rigorous outcome based purely on consensus. Therefore, it might be desirable for the facilitator to be charged as an arbitrator or decision-maker. As noted before, revision of intercarrier compensation has strong implications for universal service, and also potentially implicates the process of jurisdictional separations.[18]

B. The Crucial Role of Congress.

Throughout implementation of the Telecommunications Act, Congressional oversight has been valuable, and has been appreciated by all of us concerned with day-to-day implementation. It's easy for us to get lost in the forest, and Congress regularly provides a good beacon guiding us back to the main path.

I particularly commend to you the unique efforts of your Senate colleagues. As you know, Senators Burns and Dorgan, with strong support from Senators Stevens, Rockefeller, and others have convened two Summits. I was privileged to help moderate these two sessions. They were unique: The Senators sat at the table with a very broad spectrum of stakeholders, participating in a very lively give-and-take, furthering everyone's understanding,

[18] The separations process identifies and assigns costs to the interstate and intrastate jurisdictions, and matches those costs with cost recovery. A separations process of some sort is required when a provider of telecommunications service is regulated by two jurisdictions at once. Smith v. Illinois, 282 U.S. 133 (1930).

and significantly clarifying the issues and options. No stakeholder perspective that asked to participate was excluded. (Reporters and investment analysts were not invited in until the end of the meeting, but were then free to talk to participants.) The Senators, of course, will decide what they do with this input. I commend this process to you, and urge you to discuss the results with your colleagues in the Senate. Specific options include formal oversight proceedings, a Sense of the Congress resolution on several key topics, and specific legislation, focused on issues including the contribution base.

C. Conclusion.

When I drive across Montana or other rural areas, when I see a rural telemedicine facility, when I'm in a school where students are learning on-line, I recognize universal service as a rip-roaring success. The programs included in universal service do face significant challenges. Some of those challenges are especially time-critical. All stakeholders desire a greater degree of certainty as they plan how to meet their customers' demands. Modifications should be designed to preserve what works, and to achieve Congress's vision in the remarkable language of Section 254.

ILLUSTRATION 1

MONTANA RURAL CARRIER DEPLOYMENT

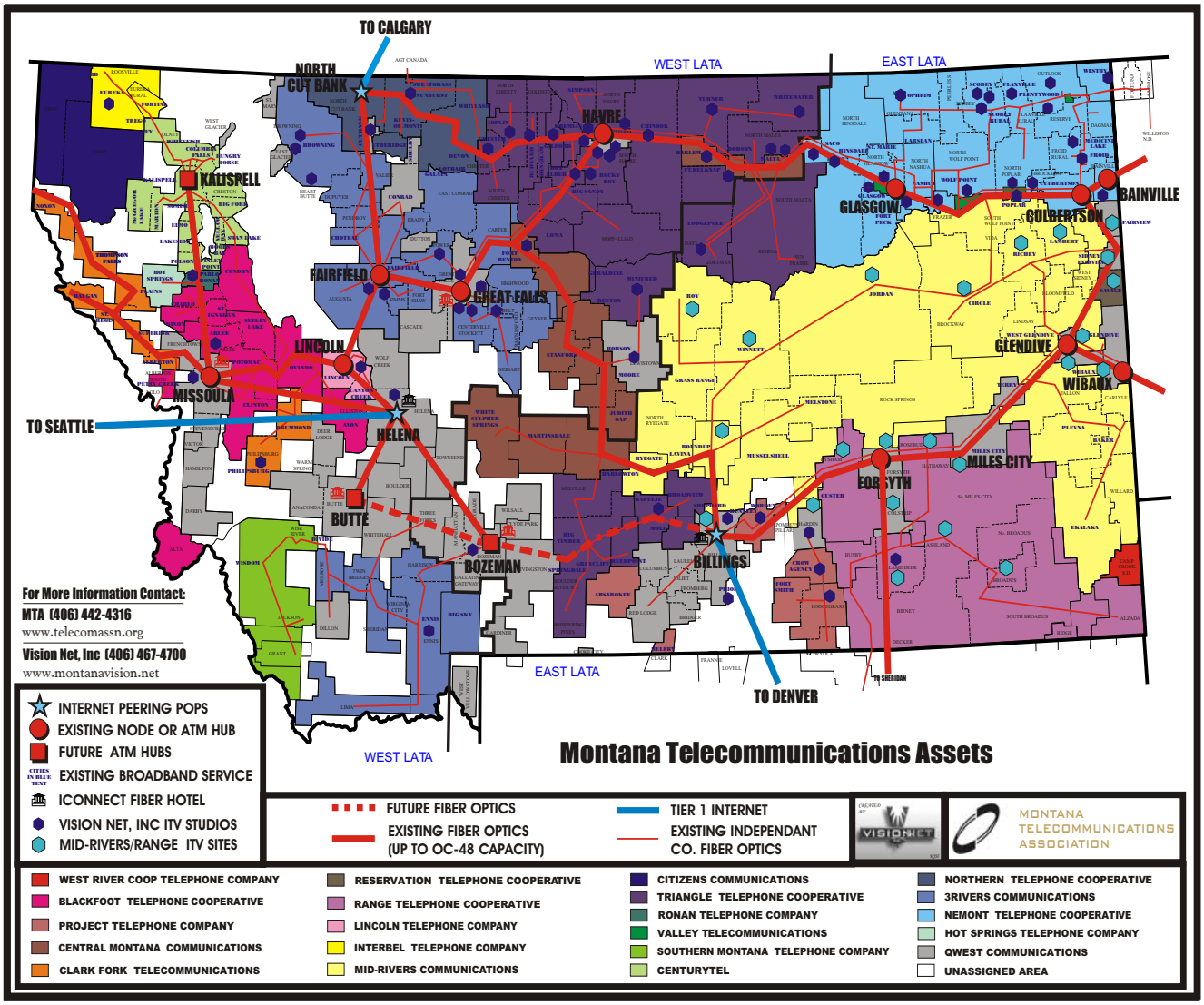


ILLUSTRATION 2

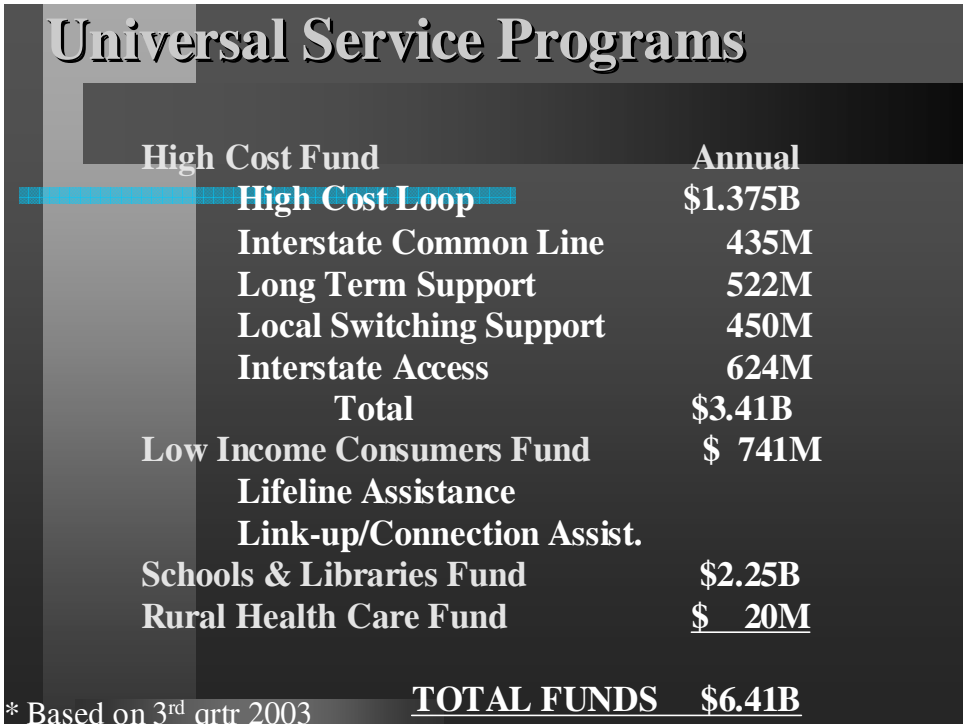


ILLUSTRATION 3

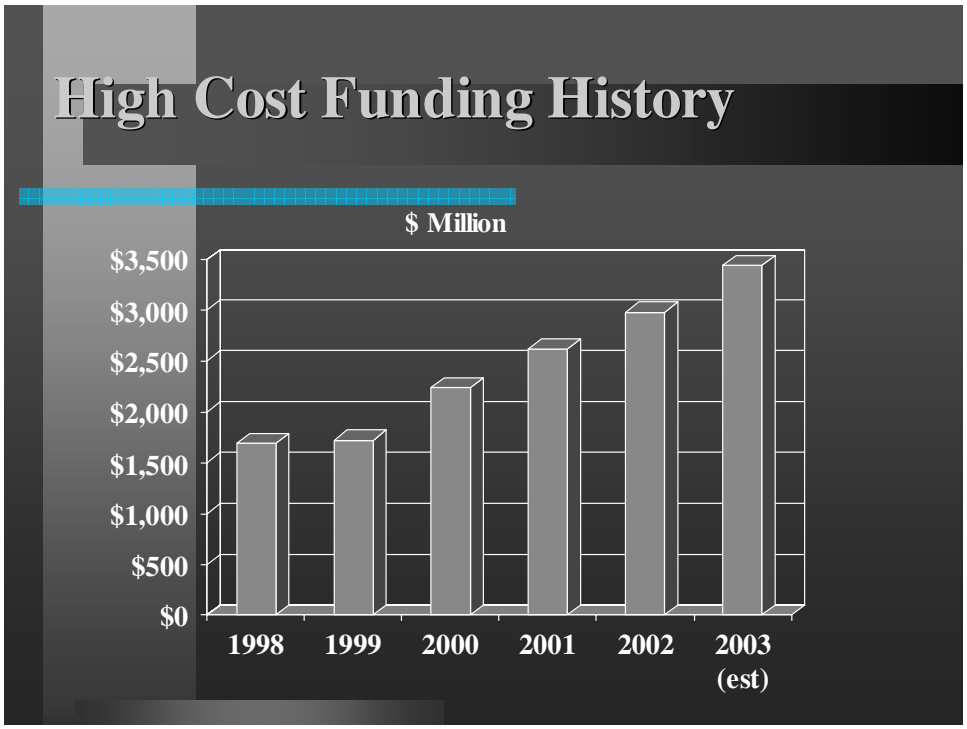


ILLUSTRATION 4

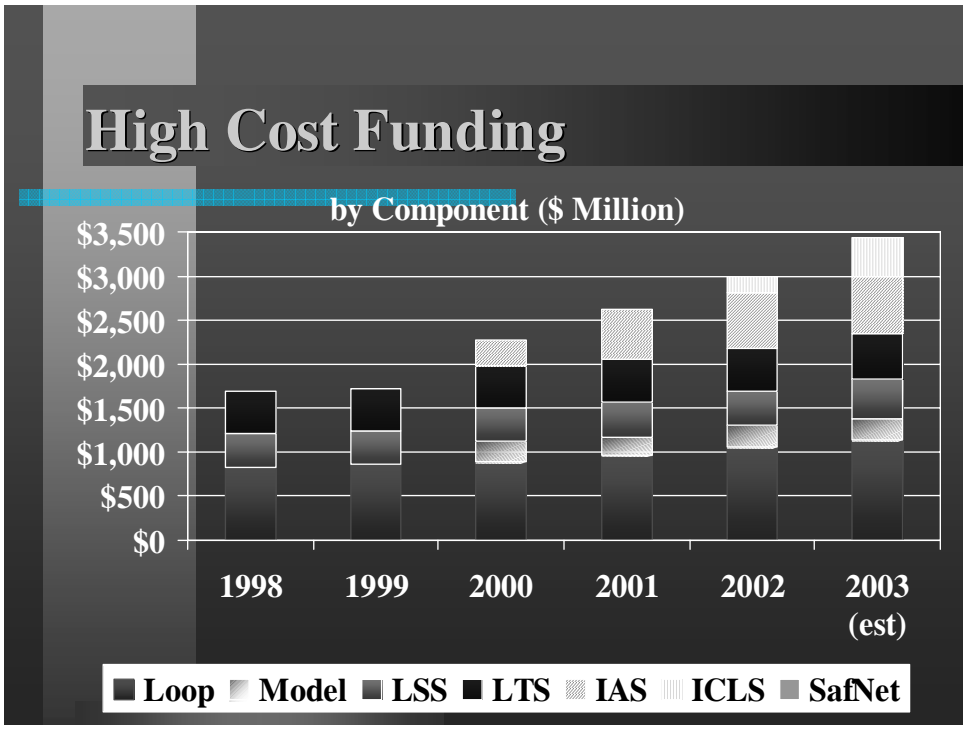


ILLUSTRATION 5

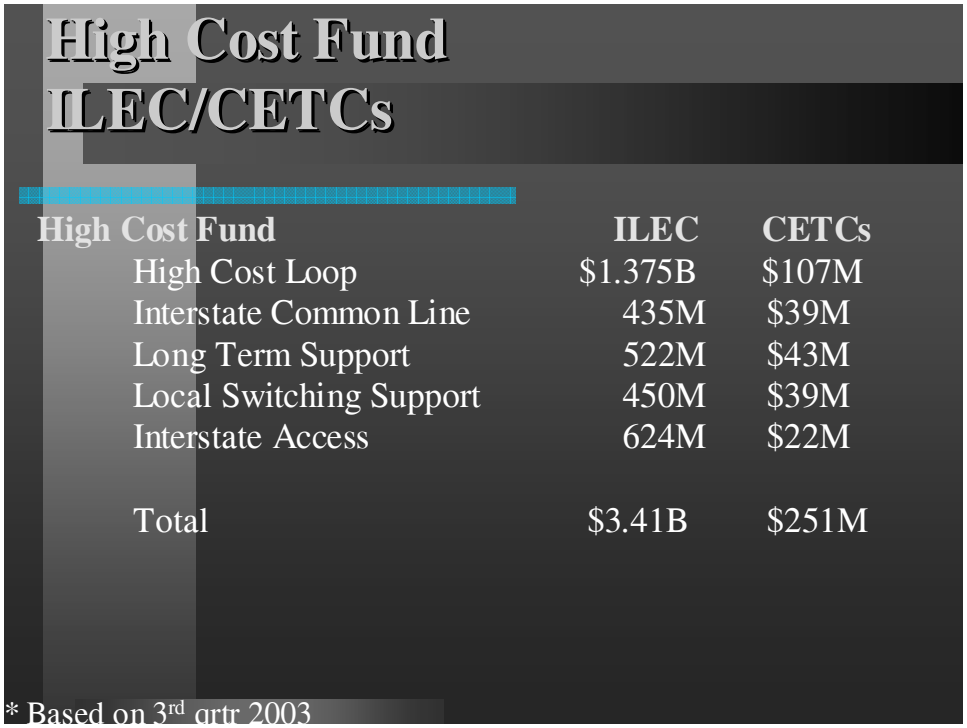
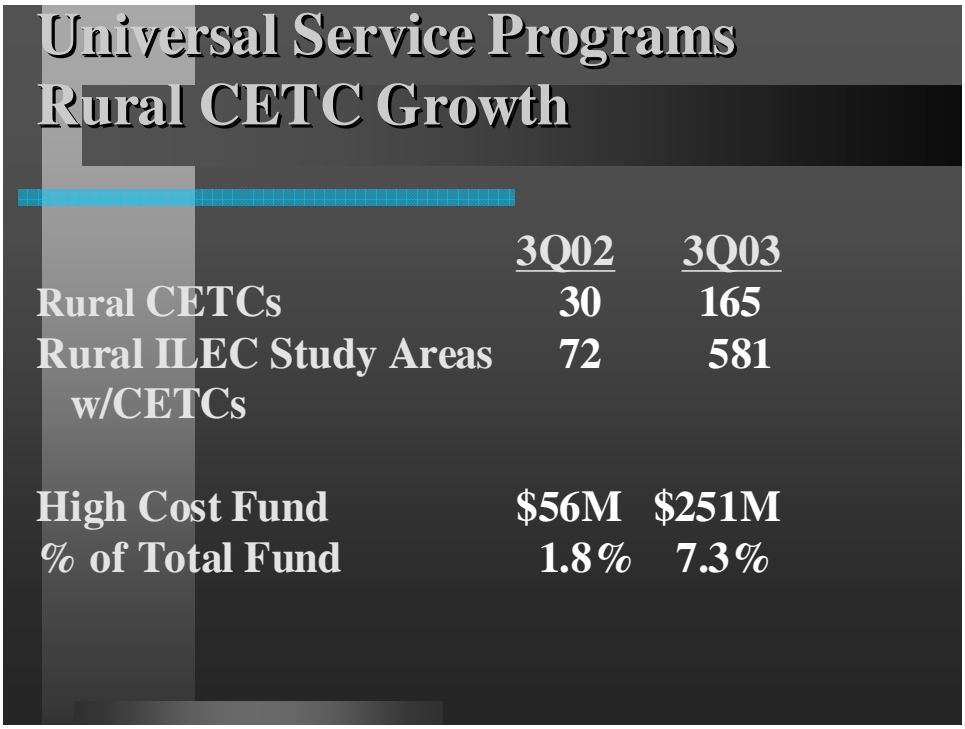


ILLUSTRATION 6



Attachment 1
Joint Board Members Letter to Senator Conrad Burns Concerning Universal Service Support

FEDERAL STATE JOINT BOARD ON UNIVERSAL SERVICE
445 12TH STREET, S.W.
WASHINGTON, D.C. 20554

May 19, 2003

The Honorable Conrad Burns
187 Dirksen Senate Office Building
United States Senate
Washington, DC 20510

Dear Senator Burns:

The members of the Federal-State Joint Board on Universal Service greatly appreciate your taking time to meet with us on April 21, and we are writing in response to your request that we suggest legislative changes to strengthen the federal universal service support mechanisms. We also include a brief summary of ongoing efforts by the FCC and the Joint Board to use existing statutory authority to promote the goals you identified, including ensuring that support is distributed equitably, efficiently, and with adequate oversight. We share your commitment to preserving and advancing universal service, and we thank you for the opportunity to work with you on this critical public policy objective.

We are pleased to offer two informal legislative suggestions, but we note that the Joint Board has not had an opportunity to seek public comment on any proposals. And although three federal Commissioners serve on the Joint Board, the full Commission has not had a chance to provide its views on the issues we raise below.[19]

Our principal suggestion for your consideration concerns the FCC's authority to assess contributions for the federal universal service mechanisms. As you have recognized, universal service can be sustained over time only if a stable and broad contribution base is available. The FCC's limited authority to assess contributions presents a significant obstacle to achieving this goal. Although the FCC initially determined that it had jurisdiction to require contributions based on the provision of interstate *and* intrastate services, the U.S. Court of Appeals for the Fifth Circuit later held that the Commission may impose fees only based on *interstate* services.[20] In recent years, the pool of interstate revenues has been on the decline, and demands for high-

[19] In addition, while individual members of the Joint Board may have additional recommendations for legislative action, the Joint Board unanimously supports the two suggestions discussed below.
[20] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999).

cost support have steadily increased. As a result, the universal service contribution factor has climbed rapidly and now exceeds 9.1 percent. This percentage almost certainly will continue to rise going forward.

Granting the FCC explicit authority to assess contributions based on interstate *and* intrastate revenues would yield substantial benefits. Most importantly, the much broader contribution base would dramatically lower the contribution factor (from 9.1% to less than 3%, based on current funding needs). Consumers presumably would find the lower assessment rate less objectionable, even if overall contributions remain the same. Consumers also might find it less confusing to pay a USF surcharge on all revenues rather than on interstate revenues only, given the greater fluctuations in long-distance calling and the seeming arbitrariness of contributing based on some telecommunications services but not others. Moreover, as the marketplace continues to evolve towards bundled service offerings that include local and long-distance services at a flat rate, a total-revenue assessment would eliminate the difficult task of calculating the portion of such bundles that should be assigned to the interstate jurisdiction.

If Congress were inclined to adopt such a proposal, we believe it could be accomplished through minimal textual changes. Section 254(d) could be amended as follows:

> Section 254. Universal Service.
> * * *
> (d) Telecommunications carrier contribution
> **Notwithstanding the provisions of Section 152(b) of this Title**, ~~E~~every telecommunications carrier that provides ~~interstate~~ telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service. The Commission may exempt a carrier or class of carriers from this requirement if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution to the preservation and advancement of universal service would be de minimis. Any other provider of ~~interstate~~ telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires.[21]

In addition, Congress might also wish to consider a minor modification to the Communications Act to address the Government in Sunshine restrictions as applied to the Joint Board. The Joint Board conducts numerous conference calls and meetings, and at least one of the three FCC commissioners must be absent at all times. As you witnessed at our April 21 meeting, this restriction makes it difficult for the Joint Board to conduct its business. We believe that the Joint Board could significantly improve its deliberative processes if Congress clarified that the Government in Sunshine restrictions were not intended to apply to the participation of the three FCC commissioners in the activities of the Joint Board. Specifically, the new language could specify that matters before the Joint Board do not become "official agency business" prior to the adoption of a Recommended Decision by the Joint Board, or that FCC commissioners

[21] Alternatively, the introductory clause could be omitted if Congress amended section 152(b) to include an exception cross-referencing section 254(d).

deliberating in their capacities as Joint Board members are not conducting or disposing of Commission business.

Finally, we wish to emphasize that, even if Congress chooses not to amend the statute, we remain firmly committed to doing everything in our power to advance the policies embodied in section 254. The Commission is considering changes to its contribution methodology under existing authority (the state members of the Joint Board have provided input in this proceeding, but the Joint Board has not been asked to provide a formal Recommended Decision). The Commission and Joint Board also are reviewing each of the support mechanisms to ensure that funds are disbursed in an equitable and efficient manner and to develop additional means of rooting out waste, fraud, and abuse. We briefly summarize these efforts below.

First, the Commission and Joint Board are reviewing the high-cost support mechanisms to ensure the sufficiency and sustainability of funding. The Joint Board has commenced a critical proceeding, in which we recently received opening comments, focusing on the intersection of competition and universal service in rural areas. Parties were asked to comment on several aspects of the process for designating competitive carriers as eligible telecommunications carriers ("ETCs"), including whether the FCC should establish guidelines for consideration by the state commissions, which generally make these determinations under section 214(e)(2) of the Act. The Joint Board's public notice also sought comment on the manner in which competitive ETCs receive support (often called the "portability" of support), the consequences of supporting multiple lines per household, and the overall impact of supporting multiple ETCs on the growth of the universal service fund. The Joint Board plans to hold a public forum on July 31, 2003, to hear more about portability from interested parties, including rural LECs, wireless carriers, competitive LECs, and others.

The Commission also is considering two Joint Board Recommended Decisions issued in 2002 pertaining to high-cost support.[22] One recommendation concerns the core services that are funded by the federal support mechanisms. Supported services include voice-grade local service, access to 911, access to interexchange services, and other basic local services. The Joint Board recommended preserving the status quo, and the FCC will release an order in response to that recommendation by mid-July. The other recommendation concerns the "non-rural" support mechanism, which provides funding to the Bell carriers and other large LECs to the extent they serve high-cost areas. In 2001, the U.S. Court of Appeals for the Tenth Circuit held that the FCC did not adequately explain how this support mechanism would ensure that states are able to set affordable rates that are reasonably comparable in both rural and urban areas. In particular, the court directed the Commission to consider how to induce states to develop their own support mechanisms to fund high-cost areas within their borders, since the federal mechanism aims primarily to equalize cost differentials *among* the states. The Joint Board suggested ways to respond to the court's concerns, and the Commission will complete its consideration of these issues by October.

Second, the FCC is taking steps to improve the efficiency, effectiveness, and

[22] We note that some members of the Joint Board have dissented from part or all of each Recommended Decision.

accountability of the support mechanisms for schools and libraries, rural health care facilities, and low-income consumers. On April 23, the Commission adopted an order that makes several important changes to the schools and libraries ("E-Rate") program. The Commission both eliminated unnecessary impediments to the flow of support to deserving applicants and complemented existing measures to combat waste, fraud, and abuse. The Commission also sought further comment on the waste, fraud, and abuse issues and held a public forum on May 8 to discuss concrete proposals to close any loopholes that may permit wasteful spending.

The Commission's pending rulemaking on the support mechanism for rural health care facilities likewise seeks to eliminate obstacles to legitimate funding requests without sacrificing cost-effectiveness. As the Notice of Proposed Rulemaking recognized, facilitating telemedicine by connecting rural health clinics to regional hospitals and universities takes on added importance in light of the increased threat of bioterrorism.

Lastly, the Commission is reviewing the low-income support mechanisms, Lifeline and LinkUp, with an eye toward cutting red tape and ensuring adequate oversight and accountability. The Joint Board released a Recommended Decision last month containing suggestions for modifying the eligibility rules and outreach mechanisms, as well as proposals to prevent waste, fraud, and abuse.

In closing, we reiterate our eagerness to work with you and the Telecommunications Subcommittee to strengthen universal service, including through the legislative process, where necessary. We look forward to continuing the dialogue we have started and welcome any questions about our legislative suggestions or ongoing rulemaking proceedings.

Sincerely,

_____ _____

Kathleen Q. Abernathy
FCC Commissioner

Federal-State Joint Board

Nanette Thompson
Commissioner, Regulatory Commission of Alaska

Chair of Joint Board

Kevin J. Martin
FCC Commissioner

Thomas Dunleavy
Commissioner, New York Public Service Commission

Jonathan S. Adelstein
FCC Commissioner

Billy Jack Gregg
Director, Consumer Advocate Division
West Virginia Public Service Commission

Lila A. Jaber
Chairman, Florida Public Service Commission

Bob Rowe
Chairman, Montana Public Service Commission

ATTACHMENT 2
LETTER FROM COUNSEL FOR THE VERMONT PUBLIC SERVICE BOARD CONCERNING COST MODEL ISSUES

September 12, 2003

VIA ELECTRONIC FILING

Marlene H. Dortch, Secretary
Federal Communications Commission
Office of the Secretary
c/o Vistronix, Inc.
236 Massachusetts Avenue, N.E. Suite 110
Washington, D.C. 20002

Re: CC Docket No. 96-45

Dear Ms. Dortch:

On September 11, 2003, Joel Shifman, Senior Advisor to the Maine Public Utilities Commission (Maine PUC), Peter Bluhm, Director of Regulatory Policy of the Vermont Public Service Board (Vermont PSB), and I had a teleconference with Christopher Libertelli, Senior Legal Advisor to Chairman Powell, on issues related to universal service support for Vermont and Maine customers.

In particular, Vermont and Maine complimented the Wireline Competition Bureau on its efforts to improve the model, document versions of changes, and move to a systematic change management system where all changes would be documented and published in releases. However, Vermont and Maine expressed concerns that the information that they had requested to identify all changes to the model structure inputs made since the Staff began "updating" the model still had not been provided. Vermont and Maine stressed the importance of identifying each change made to the model so that they could evaluate the appropriateness of the change and determine the impact of the change on their customers' support levels. Without this information they would not be able to access whether the FCC's method for determining support was reasonable.

The FCC's recent request for comment on whether it should eliminate special access lines and inputs illustrated the problem. Vermont and Maine asked the Bureau to provide information that it had generated showing the impact of removing special access lines. The Bureau refused to provide this information. It was impossible for Maine and Vermont to calculate the impact themselves for several reasons. Outside parties do not have a model version that includes all the changes and "corrections" that the FCC staff has made. Also, parties have to run results for the whole country to determine a revised nationwide average before they can identify the impact on any one state. Running the model in this way takes several days and requires several banks of computers. When the Bureau effused to provide the information,

Vermont and Maine asked several larger carriers fore their results. While other carriers had the resources to run the model with changed inputs, their results varied from carrier to carrier. In fact, the carriers' data runs inexplicably had produced widely different results, illustrating the instability of the model. Therefore, Vermont and Maine were unable to determine the impact and could not file comments. Unless the Bureau develops a model release that produces consistent and reliable results when run by all parties, it is impossible for parties to determine with any certainty what the results will be.

Vermont and Maine expressed continuing interest in working with the Bureau to make the USF support/model process more open and simpler. This would include advance notice and an opportunity for third parties to verify effects of changes before they were formally adopted. Overall, Vermont and Maine said they are interested in achieving: 1) a theoretically sound method of delivering support that is predictable and stable; 2) an open process that allows changes to the model and inputs to be objectively evaluated based on common assumptions; and 3) sufficient support so that rates charged in Vermont and Maine are reasonably comparable to rates charged in urban areas of the country. Vermont and Maine continued to express concern that their support has changed due to undocumented/unreasonable changes in the model, even though their costs have not changed materially.

Pursuant to Section 1.1206 of the Commission's rules this letter is being electronically filed with your office. If you have any question concerning this submission, please contact the undersigned.

Sincerely,

Elisabeth H. Ross
Attorney for the Vermont Public Service Board

cc: Chris Libertelli