Tutorial on the Universal Service Contribution Methodology Proceeding

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Introduction

As most of you know, the Joint Board has had a very busy year and we have a full agenda ahead of us.

We recently issued the first Recommended Decision during my tenure as Chair, concerning the definition of supported services. The Joint Board recommended preserving the existing definition of universal service. I am pleased to report that every member of the board was deeply engaged in the process. I also believe that we made great strides in improving the collaboration by federal and state staff. I hope you will all extend your appreciation to your staff members who have performed so well throughout this process.

The Joint Board is hard at work on another recommended decision concerning the non-rural support mechanism. We are also moving towards a recommended decision on changes to the Lifeline and LinkUp programs. And we have additional proceedings planned for later this year and next year.

What I would like to do today is provide an overview of the FCC's Contribution Methodology proceeding. This proceeding has not been formally referred to the Joint Board, but it was the subject of a federal-state en banc hearing in June. Following up on the public forum, the state members of the Joint Board are planning to provide additional input to the FCC, and the FCC hopes to release a Report and Order this fall so that we can implement new rules by the second quarter of next year.

Overview of Contribution Methodology Proceeding

Existing Contribution Methodology

Under the current contribution rules, virtually all telecommunications carriers that provide interstate telecommunications services must contribute to the federal support mechanisms. Contributions are based on end-user revenues from interstate and international telecommunications services. Specifically, contributions are assessed based on a percentage factor that divides the total demand for support for the upcoming quarter by the total reported gross-billed interstate and international revenues from end user telecommunications services from six months earlier.

The current contribution factor is approximately 7.3%. It would have been much higher if the Commission had not used surplus funds from Year 2 of the Schools and Libraries program to stabilize the factor.

Carriers currently contribute about $5.4 billion per year to support the various universal service programs. Interexchange carriers pay approximately 63% of the contributions, LECs pay approximately 23%, and wireless carriers pay approximately 14%. Because it is difficult to separate wireless minutes into intrastate and interstate, wireless carriers are permitted to contribute based on a safe harbor assumption that 15% of their traffic is interstate.

Pressures on the Current Methodology

For several reasons, IXCs and other carriers that support universal service have been urging the Commission to change the contribution methodology.

One problem is the six-month lag between the reporting of revenues and the assessment of contribution obligations. For carriers with declining interstate revenues, this means that they must recover their contribution costs from a smaller revenue base than the one used for assessment purposes. This is the primary reason why AT&T charges its residential customers more than 11% of its monthly bills, rather than the 7.3% contribution factor. (IXCs also increase their line items to cover uncollectible fees and administrative costs.)

The six-month lag also causes significant competitive distortions. Bell companies entering the long distance market pay universal service contributions based on a period when their interstate revenues were much lower. Thus, Bell companies need not charge their end users nearly as much as AT&T, WorldCom, or Sprint to recover their costs, which means they have a significant pricing advantage.

Another problem is the ongoing decline in interstate minutes and revenues. As total revenues fall, the percentage factor must increase to ensure sufficient funding for universal service. Were it not for the Commission's recent action to stabilize the contribution factor — an action we have committed not to repeat — the factor would have soared to nearly 9%, and probably to more than 10% in the not-so-distant future.

Marketplace developments also are blurring the distinctions between interstate and intrastate revenues, and between telecommunications services and other types of services. As providers offer bundles of services and flat-rate pricing plans — including both local and long distance services, and sometimes a combination of telecommunications services, information services, and CPE — it is increasingly different to separate out revenues from interstate telecommunications services. In particular, as bundled plans offered by wireless carriers increase in popularity, some have argued that the 15% safe harbor does not capture the full extent of interstate usage over wireless phones.

Reform Proposals

In light of these and other factors, parties have proposed a range of reforms.

Several IXCs for some time have argued that, if the Commission assesses contributions based on revenues, we should use current or projected revenues, rather than historical revenues. Making such a change would eliminate the six-month lag and the competitive distortions associated with it. Some would further reduce competitive imbalances by increasing the wireless safe harbor. These changes would introduce a more level playing field. But eliminating the six-month lag and leveling the playing field would do nothing to halt the overall decline in interstate minutes and the corresponding rise in the contribution factor. Thus, even if AT&T were able to reduce its line item to a level closer to the contribution factor, and Bell companies and wireless carriers were forced to increase their line items, the contribution factor still would rise above 9% sometime next year.

Because of this fact, and because of the issues presented by bundled service offerings, a coalition of IXCs and business users has developed a proposal to switch to a flat, connection-based charge in lieu of a revenue-based approach. Residential customers would pay $1 per physical connection to a public network, whether wireline or wireless. Paging customers would pay $.25. Business customers would pay charges based on capacity, so a T-1 line would have a certain charge, as would a DS-3 and so forth.

The Commission sought comment on this proposal in our February further notice, and the June public forum focused primarily on this proposal and an alternative offered by BellSouth and SBC and another alternative offered by Sprint.

The potential benefits of the Coalition proposal include the following.

- It would provide a stable funding source, because the number of connections is more stable than revenues. This plan also might broaden the base of universal service support, because the number of connections is increasing, even as revenues are declining

- A flat $1 fee would be less confusing for consumers than a fluctuating, revenue-based charge.

- The Coalition plan would eliminate the competitive disparities associated with the current system and eliminate the need to separate out interstate telecommunications service revenues.

At the same time, some parties have raised significant objections:

- Many parties have objected to the fact that the proposal would dramatically reduce the contributions paid by IXCs, since IXCs' only end-user connections are special access circuits (leaving aside the lines they serve as CLECs). Commenters contend that this reduction in IXCs' contribution burden violates section 254(d), which requires that *every* telecommunications carrier shall contribute to the support mechanisms on an equitable and nondiscriminatory basis. Some parties also argue that the Coalition proposal is inconsistent with the 5th Circuit's decision barring the

Commission from assessing contributions based on intrastate rates.

- Wireless carriers in particular object to this plan, because they would bear a far greater share of the support burden if it were adopted. Incumbent LECs would pay more than they currently do, but the increase would not be dramatic because SLC increases and long-distance entry are already increasing their average contribution under the revenue-based methodology to a point close to $1 per customer. CLECs, however, which often do not charge SLCs, would pay much more under this proposal.

- Some consumer groups have argued that the proposal would harm low-volume users, many of whom may be low-income consumers. Others have argued that there is no clear correlation between low-volume users and low-income consumers; indeed many people who make very few long distance calls are relatively affluent consumers who are using cell phones.

Based on these concerns, BellSouth and SBC proposed an alternative connection-based approach. Their plan would require consumers to pay a flat charge to every carrier with a qualifying service connection, including IXCs. Connection charges would be higher for high-bandwidth services, as under the Coalition proposal. "Occasional use" carriers, such as calling card providers, would continue to contribute based on end-user revenues.

Sprint also proposed a variation on the Coalition proposal. Sprint's plan would be almost exactly the same, except the line charge for wireless customers would be based on the current relative contribution of the wireless industry. In other words, if consumers paid $1 for each wireline connection, they would pay approximately $.46 for a wireless connection.

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Commission staff are hard at work formulating a recommendation in this proceeding, and we welcome the views not only of the state members of the Joint Board, but also of individual state commissions.

I would be happy to answer any questions if we have time.