

## *FCC Activity in the Wireline World*

**Remarks of Commissioner Kathleen Q. Abernathy**

**NECA Expo 2002**

**Las Vegas, NV - September 17, 2002**

As prepared for delivery.

Thank you very much for inviting me to discuss rural telecom issues with you. Rural telcos grew out of the American can-do spirit - the idea that we can pull together and provide critical services to all Americans. So, I want to thank you for your commitment to providing service at the highest level of quality, and for making the national policy goal of universal service a reality. I look forward to hearing more about your views on FCC policy.

What I thought I would do today is discuss some of the major policy initiatives underway at the FCC, focusing on how they might affect rural telephone companies and rural consumers. In addition, I'll discuss some of the proceedings that grab fewer headlines but are of critical importance to rural carriers. And finally, I'll close with a few thoughts about how the FCC can better position itself to face the regulatory challenges associated with a more complex environment.

### **1. Universal Service Initiatives**

Let me begin with our universal service initiatives. I can't think of any other area of policy that has such a profound impact on rural telephone companies and their customers.

#### *a. Contribution Methodology*

As many of you know, FCC staff are hard at work on a proceeding to reform the methodology for contributing to the federal universal service support mechanisms.

Under the current contribution rules, virtually all 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. The current contribution factor is approximately 7.3%. It would have been much higher ? over 9% ? but the Commission this year used surplus funds from the Schools and Libraries program to stabilize the factor through the second quarter of next year.

Telecom carriers currently contribute about \$5.4 billion per year to support the various universal service programs. Of that amount, interexchange carriers account for 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.

Many parties have asked the FCC to revise our contribution rules, for a number of reasons. First, interstate revenues, after many years of growth, are now in decline. Together with the steady increase in the demand for support, the decline in revenues is pushing the contribution factor higher and higher. As NECA pointed out in a recent study, the factor could exceed 11% in just four years. Such a high factor imposes significant costs on consumers.

Another challenge to the sustainability of the current system is the increasing prevalence of bundled service packages. As carriers combine local and long distance services for a single price,

it is increasingly difficult to separate out revenues from interstate services. By the same token, as carriers offer packages including telecom services, information services, and CPE, it is difficult to separate out revenues from the telecommunications service portion.

Finally, the six-month lag between the reporting of revenues and the assessment of contributions poses problems for long-distance carriers with declining revenues. These carriers are forced to charge their current customer base significantly more than the contribution factor just to recoup their costs.

One proposal under consideration by the Commission would shift from using historical revenues to projected revenues to calculate contributions. Such a shift would eliminate the six-month lag and therefore correct the competitive disparity affecting carriers with declining revenues. Parties also have argued that the Commission should adjust the 15% safe harbor for determining the interstate portion of wireless revenues. Such measures, if adopted, would help level the playing field by making sure that all classes of carriers contribute on an equitable basis.

But such measures would *not* address the overall increase in the contribution factor. A number of carriers and customer groups therefore have proposed that the Commission abandon the revenue-based contribution methodology and replace it with a connection-based approach. There are many varieties of connection-based approaches. Some propose contributions only by carriers with physical connections to end users – that is, local exchange carriers, wireless carriers, and IXCs that provide private line services. Under the proposal advanced by one coalition, for example, residential customers would pay \$1 for each physical connection to a wireline or wireless carrier, and business customers would pay charges based on the capacity of their circuits. Other proposals would require contributions by all carriers that have

service relationships with consumers, not just those with physical connections and that would generate greater contributions by the IXC.

The Commission, in conjunction with the state members of the Joint Board, held a public forum on these issues in June, and we anticipate completing our proceeding in November. I encourage you to contact my staff and the other commissioners' offices in coming weeks, because we would very much like to hear your perspectives. We are truly looking at all our options. We have also been fortunate to have the state members of the USF Joint Board formally weigh in and they are supporting a contribution approach.

*b. Other Universal Service Issues*

In addition to the Contribution Methodology proceeding the Commission has a number of other proceedings underway regarding universal service.

- The Joint Board is completing its work on a Recommended Decision regarding the administration of *non-rural* high-cost support, in response to a remand from the Tenth Circuit Court of Appeals. This Recommended Decision will address, among other things, how the FCC can ensure sufficient support for the nonrural carriers. At the same time, the court told the FCC it must induce states to do their part to preserve and advance universal service.
- The Joint Board also is considering changes to the Commission's low-income programs, Lifeline and Linkup. We've sought comment on how to improve the programs to ensure we are accurately targeting the

support.

- And there is a future proceeding that I believe will be of great interest to rural telephone companies. We will examine our rules for distributing support to competitive eligible telecommunications carriers, including wireless carriers. Rural LECs have long objected to the policy of providing identical support to competitive ETCs based on the ILEC's costs, which may be higher than a wireless carrier's costs. This is a complex issue and there is no easy answer, but nevertheless, we must ask hard questions. In my view, this rulemaking also should address whether universal service funds should continue to support multiple lines per customer, or perhaps only a single line. I have long supported launching such a proceeding, and I hope that we are able to complete work on a Notice of Proposed Rulemaking later this year.

## **2. Broadband and Competition Policy Proceedings**

Other major proceedings on the Commission's near-term agenda include our rulemaking on the classification of broadband Internet access service, our Triennial UNE Review proceeding, and our Performance Metrics proceedings. It would take the rest of the day to do justice to all the issues at stake in those rulemakings, but let me try to summarize them very briefly.

The Wireline Broadband Classification proceeding is focused on the appropriate statutory classification of broadband Internet access services such as DSL Internet access. The Commission has tentatively proposed an information service classification under Title I. Such a classification could have a number of consequences, and one of the issues I have asked my staff to focus on in particular is the impact on rural carriers. For example, I

understand that the classification of broadband Internet services has a significant impact on rate-of-return carriers' allocation and recovery of costs. I intend to examine those issues in detail before we make any final decision in the classification proceeding.

Then there is the Triennial UNE Review proceeding, which concerns the list of elements that must be unbundled at TELRIC rates under section 251(c) of the Act. Much of the debate has focused on two issues: the appropriate treatment of facilities used to provide broadband services, and the future of the UNE-Platform service offering. Commission staff are examining the record and will be developing recommendations this fall. In the meantime, the lobbying is hot and heavy.

Another proceeding involves the Performance Metrics. We are considering whether to impose national standards for the provisioning of UNEs and special access circuits. Competitive carriers have proposed a number of national metrics concerning ordering, provisioning, maintenance and repair, and other functions, and the Commission is evaluating those proposals.

### **3. Miscellaneous Issues**

We also have some other pending proceedings that are likely of interest.

#### *a. Bankruptcy-related issues*

An issue that has been on everyone's mind deals with carrier bankruptcies, and their effect on the incumbent LECs. WorldCom's bankruptcy has left many rural companies exposed to significant losses. In turn, carriers have been seeking tariff revisions that would provide greater protection in the event of future bankruptcies. For example, some carriers have proposed

advance payment requirements and security deposits where access customers' credit ratings fall below investment grade.

The Commission is taking a serious look at these proposals in several contexts. First, we are evaluating tariffs that have been filed by a number of different carriers. Second, we are considering a petition for declaratory ruling filed by Verizon. And third, the Commission, along with the Justice Department, is participating in bankruptcies proceedings. Our paramount goal in bankruptcy situations is to protect consumers from service terminations. But we are looking to accomplish that goal in a manner that balances incumbent LECs' legitimate interest in ensuring payment for all services rendered. The Commission hopes to provide guidance on these issues in the near future.

*b. All or Nothing Rule*

When the Commission adopted the MAG Plan, it sought comment on a number of issues, such as transitioning from rate-of-return regulation to incentive regulation. While that is an important long-term issue, of more immediate interest is the proposal to modify the Commission's "all or nothing" rule, which requires carriers to elect price cap or rate-of-return regulation on a uniform basis across all of their study areas. I am eager to explore whether there are viable alternatives to this rule, because many carriers have demonstrated that it can impose harsh results.

*c. Separate Affiliate Requirements*

Finally, one proceeding that has not received a great deal of attention in Washington, but which I am sure is important to this audience, concerns structural separation requirements for independent LECs' long-distance affiliates. The Commission is considering eliminating those requirements in a pending rulemaking. I believe that there is much to be said for allowing

carriers to take advantage of economies of scale and scope ? for example by joint ownership of switching facilities. Structural safeguards impose significant burdens and costs, and the Commission's non-structural safeguards have generally been effective in protecting competition and consumers. I am therefore interested in exploring the elimination of structural separation requirements and look forward to completing that proceeding as expeditiously as possible.

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The last topic I would like to discuss is how to ensure that the FCC, as a government agency, is ready to take on the regulatory challenges that flow from a more competitive market. How do we harness the chaos?

After a long period of stability in the 50s, 60s, and 70s, the role of the FCC has undergone a tremendous amount of change - particularly in the last 10-15 years. Our licensees have changed tremendously both in number and character. Twenty years ago, the federally regulated providers were a fairly discrete group: broadcasters (3 networks), wireline telephony (1 for all distances), wireless (effectively 0), cable (large numbers regulated at local and state level), satellite (INTELSAT). Today that landscape is vastly different: broadcasters (7 networks), wireline (RBOCS- 4, large IXC's - 3, CLECs), wireless (6 national mobile, dozens smaller/niche mobile, fixed, unlicensed), large cable players with broadband, satellite (DBS - 2, DARS - 2, MSS - 2 plus INTELSAT etc.) As a result, the consumer and licensee experiences have also changed dramatically. In 1982, most consumers received at most two communications bills (telephone and cable (33% penetration)). Today that number is at least five (local and long distance, wireless, cable or DBS (penetration of approximately 86%), an ISP and maybe more (additional landlines, wireless phones, DARS). Similarly, a provider entering the market faces a vastly more



complex world than it would have faced in 1982. For example, a new wireless provider in 1982 would have needed to interconnect with AT&T only. Today a new wireless provider needs to have a way to exchange traffic with dozens of local, long distance and other wireless providers. Thus, two sets of relationships - consumer/provider and provider/provider - that are essential to the FCC's regulatory function have become dramatically more complex and contentious and show no signs of becoming less so.

Faced with this increasingly complex and contentious set of relationships, what is a modern regulator and regulatory agency to do to prevent harm and resolve disputes? I have identified four roles that I believe are critical.

## ROLE I - TRUST COMPETITIVE MARKETS

The best protection against harm to consumers and providers is a fully competitive market - not present in 1982, but increasingly present today. Regulators' goal is to allow markets to work - and in this way maximize efficiency and further the public interest.

Regulator Role: Exercise restraint and let competition operate.

## ROLE II - FACILITATE PARTY TO PARTY ENGAGEMENT

The best way to solve any problems that arise in any relationship is directly between the parties involved. Effectiveness of this approach, however, depends on parties' abilities to (1) identify one another and (2) clearly understand their respective rights. Government has a limited but critical role to play in both these areas. One of the reasons that I spend so much time on consumer issues - including education efforts, like my Focus on Consumer Concerns - is the significant role government can play in educating parties about their respective rights. This education

ultimately lessens the need for government to intervene via Stage III or IV.

Regulator Role: Educate consumers, facilitate interaction between private actors.

### ROLE III - REGULATORY ROLE IN DISPUTE RESOLUTION

When markets and private direct negotiation/dispute resolution fail, then regulatory enforcement becomes critical. At that point government should intervene to enforce rights provided by the statute or FCC rules. Role is not limited to federal authority - there is a significant role for states and localities.

Regulator Role: Prompt and stringent enforcement of rules, data collection.

### ROLE IV - IMPOSITION OF REGULATORY RULES

In 1982, this role was the main tool in government's arsenal to protect consumers and competitors. Today, other equally effective tools are available. Nonetheless, general rulemaking authority serves as a final bulwark against consumer or competitor harm.

Our responsibility is to draft clear rules that will withstand judicial scrutiny.

As I said previously, all four roles for government exist in a competitive environment. Each market we regulate falls in a different place on the competitive continuum - so they each require a different mix of the four roles. For example, the wireless industry likely best reflects the competitive market where Role I - the trust in market forces - is the most effective. Over time, as other communications markets hopefully become more

competitive, I believe the FCC should appropriately migrate towards that regulatory role. Roles I and II were largely absent in 1982 from both the consumer and the service provider perspective, but they are increasingly present today and will become more important tomorrow. That means the FCC must continually refine our mission at the Commission and allocate resources differently so that we can best respond to changed conditions.

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I hope this provides a good sense of our mission and the issues we are working on, even if I was only able to provide a brief overview of what we have pending. And I also want to emphasize that in all of these proceedings, I am mindful of the unique role of rural telephone companies and the fact that one-size-fits-all solutions are seldom appropriate. I am pleased that we have taken into account the uniqueness of rural carriers when we have adopted rules regarding universal service, accounting requirements, and many other matters. I will work hard to ensure that we continue to do so.

I would be happy to take questions if we have time.