

Written Statement

Of

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Good morning Chairman Upton, Ranking Member Markey and members of the Subcommittee. Thank you for the opportunity to speak about the universal service high-cost program.

As you know, in Section 254 of the Communications Act of 1934, Congress directed the Commission to promote universal service to ensure that all Americans have access to affordable, quality telecommunications services. In particular, in section 254, Congress articulated a national goal that consumers in all regions of the nation, including consumers in rural, insular, and high-cost areas, as well as low-income consumers, should have access to telecommunications services at rates that are affordable and reasonably comparable to those provided to consumers in more urban areas. Section 254 further provides that federal universal service support mechanisms should be specific, predictable, and sufficient to preserve universal service. Today, I will provide a brief overview of the Commission's actions implementing the universal service high-cost support program in response to section 254 of the Act and pending proceedings at the Commission examining ways to improve the high-cost program.

In implementing the universal high-cost support program, the Commission has proceeded in stages to consider which universal service support mechanism is appropriate for a particular carrier. Specifically, the Commission has taken into consideration the differences between large, price-cap regulated non-rural carriers and small, rate-of-return regulated rural carriers in establishing its high-cost programs. Universal service support is provided today to defray both the intrastate and interstate network costs through the following mechanisms: high-cost loop support; local switching support, high-cost non-rural support, interstate access support, and interstate common line support.

Consistent with section 254 of the Act, the rural and non-rural support mechanisms support the intrastate network costs of carriers to ensure those in high-cost and rural areas have access to telecommunications services at rates that are affordable and reasonably comparable to urban areas. Although incumbent local exchange carriers may qualify as rural carriers based on other criteria (*e.g.*, less than 15 percent of the incumbent's lines are in communities of more than 50,000), a carrier generally is eligible for high-cost loop support if it serves less than 100,000 lines in a service area. Non-rural carriers generally are those that serve more than 100,000 lines in a service area.

The rural high-cost loop support mechanism, which was last modified by the Commission in 2001, provides support to carriers for their embedded intrastate network costs to rural incumbent local exchange carriers in service areas where the cost to provide service exceeds 115 percent of the national average cost per-line. The Commission has recognized that rural carriers serve more sparsely populated areas, serve fewer subscribers, and do not typically benefit from economies of scale and scope. In addition to high-cost loop support, carriers with 50,000 or fewer access lines are also eligible to receive local switching support which provides intrastate support for switching costs. In 2005, approximately \$1.2 billion was distributed in rural high-cost loop support and \$445 million was distributed in local switching support.

The non-rural high-cost support mechanism was established by the Commission in 1999 to support intrastate network costs for non-rural carriers based on forward-looking economic costs. The non-rural mechanism determines the amount of federal high-cost support to be provided to non-rural carriers by comparing the statewide average non-rural, forward-looking cost per line to a nationwide cost benchmark. Federal support is provided to non-rural carriers in states with costs that exceed the benchmark, which currently is set at two standard deviations

above the average, or approximately 131 percent of the national average cost per line. In 2005, approximately \$292 million was distributed in non-rural high-cost support.

The interstate access support and interstate common line support mechanisms provide support to offset the interstate portion of carriers' networks, for which the FCC has primary responsibility for regulating rates and cost recovery. Each of these explicit universal service support mechanisms replaced implicit subsidies in the interstate access rate structure.

Additionally, these mechanisms enable carriers to provide telecommunications services to consumers while charging Subscriber Line Charges at capped rates.

Consistent with Congress' directive that universal service support be explicit, in July 2000, the Commission adopted the interstate access support mechanism to provide explicit universal service support to price-cap carriers to replace \$650 million annually in implicit subsidies that were eliminated from the access charge rate structure. The precise amount of interstate access support provided each year may vary, but is targeted to \$650 million for all carriers, both incumbents and competitors. In 2005, approximately \$691 million was distributed in interstate access support.

The interstate common line support mechanism, which was implemented beginning July 1, 2002, provides explicit universal service support to rate-of-return carriers in exchange for removing implicit subsidies from access charges. Each rate-of-return carrier receives enough support to ensure that it can recover its interstate loop costs while charging Subscriber Line Charges no higher than the cap, which is \$6.50 for residential customers and \$9.20 for multi-line business customers. In 2005, approximately \$1.18 billion was distributed in interstate common line support.

The Commission has initiated proceedings to consider potential reform of the program. For example, in the Commission's *Rural Review Proceeding*, the issue of whether to continue to distinguish the receipt of high-cost support based on carrier size or type is being contemplated or whether other factors should be considered such as geography of a service area, or the type of carrier receiving support. Currently, the Federal State Joint Board on Universal Service, a group of FCC commissioners, state utility commissioners and a consumer advocate representative, is considering these issues. The Joint Board will provide a recommendation to the Commission concerning any rural high-cost support modification. The Commission will carefully consider the Joint Board's recommendations as it contemplates changes to the high-cost program in this proceeding.

In addition, in response to the United States Court of Appeals for the Tenth Circuit's remand, the Commission is reviewing its rules relating to the high-cost universal service support mechanism for non-rural carriers. Specifically, the Commission sought comment on: (1) how the Commission should define the statutory term "sufficient" to take into account all the principles enumerated in section 254; (2) how the Commission should define "reasonably comparable" under section 254, consistent with its concurrent duties to preserve and advance universal service; and (3) how, in light of the interpretation of the key statutory terms, the Commission should modify the high-cost funding mechanism for non-rural carriers. The Commission further sought comment on whether it should adopt a non-rural insular universal service mechanism.

The Commission is also considering how to improve the universal service high-cost program in other ways. For example, the Commission has a pending proceeding examining ways to improve administration and oversight of the Universal Service Fund (USF) in order to

improve the operation of the program for its beneficiaries and contributors and to enhance program integrity and protect against waste, fraud, abuse. The Commission is also examining whether to establish more aggressive sanctions and debarment procedures in all the USF programs, including the high-cost program. Moreover, the Commission is considering ways to modify the high-cost program's reporting requirements, strengthen its audit processes, and establish additional criteria for recovering funds that were disbursed or used incorrectly.

Again, thank you for the opportunity to discuss universal service high-cost issues with you today. I look forward to working with this Subcommittee, other Members of Congress, Chairman Martin and the Commission as further reform to the high-cost program is considered.