

Congress of the United States
Washington, DC 20515

April 2, 2007

The Honorable Kevin J. Martin
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Dear Chairman Martin:

I am writing with respect to implementation of certain universal service provisions of the Telecommunications Act of 1996 (the "1996 Act"). At the outset, let me state that I remain fully committed to ensuring that basic telephone service remains affordable for consumers in all parts of the country. I also believe that the E-rate program, for which I was the primary House sponsor, has been highly successful in bringing affordable telecommunications service and Internet access to America's K-12 schools and public libraries.

I am concerned, however, that rules adopted several years ago by the Commission to implement the 1996 Act's universal service provisions seem less focused on the best interests of consumers than on ensuring the financial well-being of particular companies operating in certain geographic markets. As you know, the central purpose of the universal service provisions of the 1996 Act is to benefit consumers, not telecommunications carriers. In addition, competition was an overarching goal of the legislation. Congress anticipated that competition would promote consumer welfare, even in many high cost areas where universal service support was needed to keep rates affordable, by lowering the cost of universal service as providers competed for the universal service subsidy. Further, advances in technology were expected to make networks deliver supported services more efficiently, not in a more costly manner. As the House and Senate reports on the 1996 Act stated, respectively:

"...as the current system of internal and external subsidies is replaced by a system consisting primarily of external subsidies, the total amount of subsidies collected from low-cost customers and passed on to high-cost customers would not change significantly. Over time, [the Congressional Budget Office] expects that the operating costs of telephone companies would tend to fall as a result of competitive pressures and the total amount of subsidies necessary would decline."¹

¹ House Report No. 104-204 (I) (1995).

“...competition and new technologies will greatly reduce the actual cost of providing universal service over time, thus reducing or eliminating the need for universal service support mechanisms as actual costs drop to a level that is at or below the affordable rate for such service in an area...”²

Yet rather than enabling the beneficial forces of technology, innovation, and competition to reduce the amount of high cost universal service support, the Commission’s implementation of the 1996 Act appears to have allowed a certain class of carriers to use high cost support as a shield against the positive effects of competition. The net result is a universal service fund that has grown, not shrunk, from \$1.8 billion in 1997 to \$7.2 billion in 2007.³ This explosive growth is largely attributed to an expansion of the high cost program, which unlike the other federal funding mechanisms for the “E-rate” and rural health care, is not subject to a cap.

This has placed an increasing financial burden on consumers because Federal universal service support, which subsidizes the high cost fund, is funded through contributions paid by consumers nationwide. In addition, the burgeoning cost of the high cost program, in particular, may undercut the ability of the Commission to ensure that universal service evolves efficiently over time (as the law anticipated) and encompasses affordable broadband service.

The House Subcommittee on Telecommunications and the Internet will examine various public policy proposals this year with the goal of developing a blueprint for achieving affordable broadband service to all Americans. Universal service may prove to be an important element of any such comprehensive plan. Therefore, as we analyze current universal service support mechanisms and proposals to adjust them, I am eager to get your thoughts on how to modernize the system. Such modernization should occur in a manner that reduces unnecessary growth in the universal service fund and ensures long-term stability. As a general matter, I believe consumer contributions to universal service must produce quantifiable, social, and economic benefits in terms of affordable service, enhanced networks, and a robust, competitive marketplace. Any modernization plan also should be consistent with Congress’ belief that universal service would evolve over time as technologies change, as well as with the larger, pro-competitive framework that Congress established in the 1996 Act.

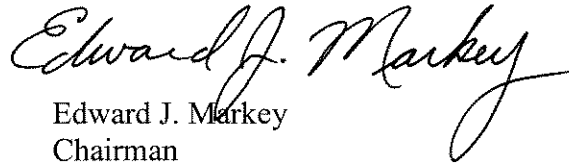
² Senate Report No. 104-23.

³ Testimony of Billy Jack Gregg, Director, Consumer Advocate Division, Public Service Commission of West Virginia, Before the Communications Subcommittee of the Senate Commerce, Science, and Transportation Committee, March 1, 2007.

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Please respond to the following questions by May 4, 2007. If you have any questions regarding this matter, please feel free to call me or have your staff contact Maureen Flood or Colin Crowell at (202) 226-2424. Thank you in advance for your time and attention in responding to this request.

Sincerely,

A handwritten signature in black ink that reads "Edward J. Markey". The signature is written in a cursive style with a large, sweeping flourish at the end.

Edward J. Markey
Chairman
House Subcommittee on
Telecommunications and the Internet

Questions for Chairman Kevin J. Martin

Universal Service Contribution Factor

Background. As the universal service fund has grown, the universal service contribution factor has steadily climbed as well. This is of significant concern because these contributions are routinely passed on to consumers in the form of higher fees on their telephone bills.

On March 2, the Universal Service Administrative Company (“USAC”) filed its universal service fund contribution base information for Second Quarter 2007. USAC has collected \$18.014 billion. This amount is approximately \$500 million less than the First Quarter 2007 revenue base of \$18.55 billion. Thus, while the First Quarter 2007 contribution factor was 9.7 percent, the Commission recently announced that the Second Quarter 2007 Contribution Factor climbed to 11.7 percent. This is the highest contribution factor in history.

- (1) Please identify what you believe to be the root cause for this significant increase in the contribution factor.
- (2) What impact did the Commission’s designation of Digital Subscriber Line Service as an “information service” have on the contribution base? What would be the impact on the overall contribution base if all broadband Internet access services were required to contribute, regardless of their designation as “information services”?
- (3) Does the Commission plan to take any action to broaden the contribution base to reduce the contribution factor and the corresponding burden placed on consumers? If so, please describe the planned action and the timeframe in which the Commission intends to act.

Distribution of Universal Service Support

Background. The Commission’s initial implementation of the 1996 Act adapted universal service to a competitive environment. The Commission’s early framework was both competitively and technologically neutral, in that it made universal service support “portable.” In other words, to the extent that a competitor captured a customer formerly served by an incumbent carrier, the competitor would “win” the universal service support allocated to that customer’s line. The Commission even added a rule, 54.307(a)(4), (the “portability rule”), which expressly stated, “the amount of universal service support provided to such incumbent local exchange carrier shall be reduced by an amount equal to the amount provided to such competitive eligible telecommunications carrier.”⁴ (The

⁴ *Federal-State Joint Board on Universal Service*, Fourth Order on Reconsideration, 13 FCC Rcd 5318, 5367 (1997).

Fifth Circuit Court of Appeals upheld this approach. *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 621 (5th Cir. 2000).)

However, in a November 1999 Order, the Commission, with no apparent discussion on the record, summarily deleted the portability language from its regulations.⁵ In its place, the Commission made an about-face and adopted a new rule stating, "... a competitive eligible telecommunications carrier receives support for each line it serves based on the support the incumbent local exchange carrier would receive for supporting the line."

The net effect of this abrupt policy change was profound. Rather than making universal service a "zero sum game" in competitive markets, universal service became a support system in which "everyone wins" and everybody gets paid. As a result, incumbents today retain universal service support for lines they lose to a competitor, while the competitor also receives support, resulting in double payments.

Moreover, when the Commission deleted the portability rule, it also abandoned its rulemaking to define "captured and new lines," which could have placed important restrictions on the distribution of universal service support among competing carriers. The Federal-State Joint Board on Universal Service (the "Joint Board") tried to remedy this problem by recommending that support be limited to a single "primary line" for each consumer in 2004,⁶ but a restriction attached in the U.S. Senate to the Commission's appropriations measure effectively prohibited the Commission from implementing this policy when that bill was approved by Congress.⁷ As a result of "captured and new lines" remaining effectively undefined, the subsidies generated by the Commission's universal service rules now support multiple wireless networks providing services that for many consumers are effectively a complement, not a substitute, to the service already offered by the subsidized wireline incumbent local exchange carrier.

(1) Mr. Billy Jack Gregg, Director of the West Virginia Consumer Advocate Division and a member of the Joint Board, stated in his recent testimony before the Senate Commerce, Science, and Transportation Committee that the Commission's failure to implement the original version of the portability rule (54.307(a)(4)), and adequately define "captured and new lines," is estimated to have added more than \$1 billion to the Universal Service Fund since 2003. Do you agree? Please explain your answer.

(2) Is the Commission currently reviewing whether it would be meritorious to resurrect the original version of the portability rule (54.307(a)(4)), which would eliminate an incumbent local exchange carrier's universal service support when it loses a customer to a competitor? Likewise, is the Commission reconsidering the merits of defining

⁵ *Federal-State Joint Board on Universal Service*, Ninth Report and Order, 14 FCC Rcd 20432, 20503-05 (1999).

⁶ *Federal-State Joint Board on Universal Service*, Recommended Decision, 19 FCC Rcd 10812, 10837-42 (2004).

⁷ Consolidated Appropriations Act, 2005, Pub. L. No. 108-447, § 634, 118 Stat 2809 (2004) (*2005 Consolidated Appropriations Act*).

“captured and new lines”? If not, why not, particularly given that the original version of rule 54.307(a)(4) was previously considered and adopted by the Commission?

(3) Would you support implementation of the primary line restriction recommended by the Joint Board in 2004 if Congress lifted the prohibition on this policy? Please explain your answer.

(4) Why does the high cost program provide support that enables each customer in a high cost area to get multiple subsidized landlines and mobile phones, but Lifeline and Link-up customers elsewhere must choose and only are permitted to obtain support for a single landline or mobile phone? In other words, if mobility is so important, and customers in high cost areas may have a subsidized landline and a mobile phone, don't low-income customers outside high cost areas deserve the same policy?

(5) Given the rise of Voice over Internet Protocol (“VoIP”) services, do you believe universal service should provide subsidies for the deployment of broadband service, or should it remain limited to funding voice-grade access?

(6) If universal service has a role to play in making broadband more accessible and affordable, do you believe that this should be the case solely for consumers in high cost areas? Should low-income consumers benefit from the same policy?

Reverse Auctions

In a February 20 speech to the Joint Board, you expressed enthusiasm for the use of “reverse auctions” as a means to stem the growth of the Federal Universal Service Fund. However, you expressly rejected any reverse auction that would provide support to multiple “winners” serving consumers in the same geographic area on the basis that “[u]niversal service is not about competition.” While I do not take a position on the merits of reverse auctions at this time, I am intrigued by the idea and want to better understand your criticism of a reverse auction that distributes support to more than one winner for a particular high cost area.

(1) Would you still consider it “subsidizing competition” if the Commission implemented its original policies regarding portability and “captured and new” lines, thereby permitting multiple carriers to “win” universal service support when they serve customers in the same high cost areas without enlarging the overall subsidy funding? Wouldn't this reflect a policy of “creating competition for subsidy” rather than the current policy of dual or multiple subsidizations? Please explain your answer.

(2) As you know, Section 214(e) of the 1996 Act states that a State commission or the FCC “shall” designate more than one “eligible telecommunications carrier” (ETC) in a non-rural market and “may” designate more than one ETC in a rural market. Only ETCs are eligible to receive Federal universal service support. Since Section 214(e) expressly permits designation of multiple ETCs in non-rural markets, would a policy to implement

a reverse auction that distributed support to a single “winner” run afoul of this provision in the statute? Please explain your answer.

(3) In addition, while the statute provides a State commission or the FCC with some discretion to designate more than one ETC in rural markets, do you believe a blanket prohibition on the distribution of universal service support to more than one ETC effectively eliminates this discretion altogether? Please explain your answer.

(4) What do you believe are the implications on competitive choice for rural consumers if only one carrier can win a subsidy to serve consumers in a high cost area?

(5) Under the statute, State commissions are the primary authorities for granting ETC designations (Section 214(e)(2)), whereas the FCC only designates ETCs where the relevant State commission lacks authority (Section 214(e)(6)). Since the only benefit conferred by an ETC designation is the ability to receive universal service support, doesn't a Federal restriction that limits universal service support to a single ETC effectively preempt a State commission's express authority under the statute to designate multiple ETCs? Similarly, wouldn't prohibiting State commissions from designating new ETCs also preempt the State commissions' express authority under the statute? Please explain your answer.

(6) Does your reverse auction proposal encompass “bids” that offer a more robust package of services, including affordable broadband access to the Internet, in addition to bids for subsidy offering to provide the most affordable voice-grade service? Would you favor including such attributes in a reverse auction mechanism?

I also note that in your recent testimony before the Telecommunications and Internet Subcommittee, you stated your intention to ask the Joint Board to impose a temporary cap on the high cost program.

(7) Will you ask the Joint Board to place a “cap” or a “freeze” on the high cost program in its entirety, or on some portion of the program, such as the funding provided to a certain class of telecommunications carriers?

(8) If you cap or freeze the high cost support received by some carriers, but not others, how will this be consistent with the Commission's long-standing commitment to competitively neutral universal service policies? If the cap or freeze is not competitively neutral, how will it preserve the beneficial forces of competition, which Congress intended would reduce the size of the high cost program over time?

E-Rate

(1) Do you support a permanent exemption for universal service from the Anti-Deficiency Act (ADA)? Has the Commission approached the Office of Management and Budget about re-interpreting the ADA to exempt universal service? If so, what is the status of that process?

(2) I applaud your efforts to reduce the backlog in the appeals process for E-rate funding. However, one possible repercussion of this recent action may be confusion among applicants and USAC as to what is now permissible under the program. What actions does the Commission intend to take to ensure no such confusion arises and what recommendations would you make generally to improve the appeals process?

(3) Do you support ensuring that the most financially-strapped school districts continue to obtain the highest E-rate subsidy? Do you support making certain telecommunications services available for financially strapped entities for free? Would you support bringing the highest bandwidth services to the most financially-strapped school districts by making their subsidized level conducive for deployment to such school classrooms?

(4) Do you support lifting the cap on the E-rate program, which is currently set at \$2.25 billion per year?

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