Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms	)	CC Docket No. 98-171
	)	
Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990	)	CC Docket No. 90-571
	)	
Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size	)	CC Docket No. 92-237 NSD File No. L-00-72
	)	
Number Resource Optimization	)	CC Docket No. 99-200
	)	
Telephone Number Portability	)	CC Docket No. 95-116
	)	
Truth-in-Billing and Billing Format	)	CC Docket No. 98-170

REPLY COMMENTS OF CONSUMERS UNION, TEXAS OFFICE OF PUBLIC UTILITY COUNSEL, CONSUMER FEDERATION OF AMERICA, APPALACHIAN PEOPLE'S ACTION COALITION, CENTER FOR DIGITAL DEMOCRACY, EDGEMONT NEIGHBORHOOD COALITION, AND MIGRANT LEGAL ACTION PROGRAM

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SUMMARY

Consumers Union, Texas Office of Public Utility Counsel, Consumer Federation of America, Appalachian People's Action Coalition, Center for Digital Democracy, Edgemont Neighborhood Coalition, and Migrant Legal Action Program ("CU *et al.*"), by their attorneys, the Institute for Public Representation ("IPR"), continue to support the interim measures established by the Commission's *Report and Order and Second Further Notice of Proposed Rulemaking* of December 12, 2002 ("*Second Further Notice*"),[1] and believe that if and when the present system is no longer sustainable the Commission should adopt a methodology that assesses all interstate carrier revenue pursuant to the "impossibility exception."

The *Staff Study*[2] recently released by the Commission corroborates the position of CU *et al*. that the connection-based proposals are not in the best interest of consumers. Although the *Staff Study* underestimates the total costs of the proposals by failing to consider their respective administrative costs, the *Staff Study* nevertheless demonstrates that most consumers would not be better off, and would generally be made worse off under the connection-based proposals. Moreover, low-volume consumers that are disproportionately poor or elderly and therefore least able to afford increases in their phone rates would pay substantially more in USF fees under all three proposals. This result cannot be reconciled with the Commission's statutory mandate to ensure that consumers receive "[q]uality service…at just, reasonable, and affordable rates."[3]

Recognizing the drawbacks of these proposals, CU *et al.* and the large majority of commenters have recommended that the Commission retain the present revenue-based system, which the Commission's own *Staff Study* has shown to be sustainable for the foreseeable future.

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[1] *See Federal-State Joint Board on Universal Service*, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24,952 (2002), *as modified by Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order and Second Order on Reconsideration (rel. Mar. 14, 2003) ("*Second Further Notice*").

Concerns over bundling and IP telephony are not significant enough to justify replacing the current assessment system, especially since these problems can be addressed by directly assessing IP telephony and modifying the bundling safe harbor.

If and when the present system is no longer sustainable, the Commission will have authority to implement an all-revenue assessment system that better complies with the Commission's statutory and policy objectives than the connection-based proposals. At such point that bundling and all-distance services make it practicably impossible for a USF assessment methodology to distinguish interstate and intrastate revenue, the Commission will have authority pursuant to the "impossibility exception" to assess all interstate carrier revenue. An all-revenue based system would greatly expand the pool of carriers obligated to contribute to the USF, and would ensure that carrier and consumer USF obligations remained equitably based upon their actual usage of telecommunication services.

[2] *Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, CC Docket No. 96-45, FCC 03-31 (rel. Feb. 26, 2003) ("*Staff Study*").
[3] 47 U.S.C. § 254(b)(1).

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REPLY COMMENTS OF CU *ET AL.*

Consumers Union, Texas Office of Public Utility Counsel, Consumer Federation of America, Appalachian People's Action Coalition, Center for Digital Democracy, Edgemont Neighborhood Coalition, and Migrant Legal Action Program ("CU *et al.*"), by their attorneys, the Institute for Public Representation ("IPR"), hereby submit the following reply comments in response to the Commission's *Second Further Notice*.

In initial comments, CU *et al.* advocated that the Commission retain the present revenue-based assessment system because it will sustain the USF for the foreseeable future and is more equitable towards consumers and carriers than any of the connection-based proposals.[4] CU *et al.* also strongly urged the Commission to reject the three connection-based proposals presented in the *Second Further Notice*, because these proposals would significantly raise phone rates for low-volume, low-income, and elderly users, and would be contrary to the principle that "[q]uality services should be available at just, reasonable, and affordable rates."[5] CU *et al.* also noted that these proposals failed to assess carriers' USF contribution obligations in an "equitable and nondiscriminatory manner" as required by statute.[6]

In these reply comments, CU *et al.* focus on three main points. First, CU *et al.* comment on the *Staff Study* that provides additional evidence that consumers will be hurt by the connection-based proposals. Second, CU *et al.* demonstrate that the revenue-based USF system, as modified by the interim rules, is sustainable, and indicate how concerns about bundling and IP telephony can be addressed without abandoning the present assessment system. Third, CU *et al.* argue that if and when the current assessment system is no longer sustainable, the Commission should implement a methodology that assesses interstate carriers on the basis of total revenue, pursuant to the impossibility exception permitting regulation of intrastate services.

I. THE STAFF STUDY FURTHER CONFIRMS THAT THE PROPOSALS WOULD ADVERSELY AFFECT LOW-VOLUME CONSUMERS

A contribution methodology that required all carriers to pay the same amount of USF fees regardless of their respective revenues would rightly be deemed unjust; so too should a USF assessment system that requires consumers to pay the same USF fees, regardless of their actual

[4] *See* CU *et al.* Comments at 3-4.

interstate calling practices. As CU *et al.* noted in previous comments, the connection-based plans enable telecommunications carriers to assess low-volume consumers the same amount in USF fees as high-volume consumers. This fee increase would be particularly detrimental to low-income and elderly individuals that are disproportionately low-volume consumers.[7] The administrative costs incurred by carriers under each proposal will further raise these consumers' long-distance phone bills.[8] The significant increase in USF burden placed upon these consumers is contrary to the statutory principles of Section 254(b), which require the Commission to base policies for universal service in part upon the goal that "[q]uality services should be available at just, reasonable, and affordable rates."[9]

The *Staff Study* recently released by the Commission corroborates the position of CU *et al.*, demonstrating that low-volume users would pay far more under the three connection-based proposals than under the present assessment system.[10] Indeed, the majority of consumers would not meaningfully benefit from any of the proposals. As the *Staff Study* shows, the average USF-related phone charges for residential users would be significantly higher under Proposal #2 and Proposal #3 than under the present system. Under Proposal #2, the average monthly household USF fee in 2004 would be $3.47,[11] or $1.26 greater than under the present revenue-based assessment system, raising concerns that many consumers will experience a "rate shock." By 2007, the average residential household would pay $3.81 per month in USF fees[12]—$1.43 more than the average household would otherwise pay under the present system. Under Proposal #3, this rate increase would amount to roughly $0.30 per month for the average residential

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[5] 47 U.S.C. § 254(b)(1).
[6] CU *et al.* Comments at 11-14.
[7] CU *et al.* Comments at 5-9.
[8] *Id.* at 9-10.
[9] 47 U.S.C. § 254(b)(1).
[10] *Staff Study* 5-8.
[11] *Id.* at 7.

household,[13] although this estimate does not include the proposal's related administrative costs.[14] According to the *Staff Study*, Proposal #1 would be the only plan that would assess the average residential household at a similar rate as the revenue-based system.

While the average residential customer would be harmed by Proposal #2 and Proposal #3, and would not be greatly benefited by Proposal #1, low-volume consumers would be significantly hurt by each proposal. Under the current revenue-based system, customers pay USF fees proportionate to their contribution to their carriers' interstate revenue.[15] Customers' USF charges therefore vary greatly depending upon their interstate usage patterns. This would not be the case under the three proposals, which would charge consumers a flat-fee for each connection or number they possessed. Thus, low-volume users would pay significantly more under any of these flat-fee proposals than they pay under the present revenue-based system, and would be hurt far more than the "average" residential user.

Although the *Staff Study* corroborates the position of CU *et al.* that the proposals would unjustly raise phone rates of low-volume consumers, CU *et al.* nevertheless believe that the *Staff Study* underestimates the full magnitude of the proposals' costs for carriers and consumers. A major problem with the *Staff Study* is its failure to assess the administrative costs of each proposal. As CU *et al.* noted in previous comments, the three proposals would impose significant USF-related administrative costs upon carriers, and these costs would likely be passed onto these carriers' customers.[16] Although the Commission prohibited carriers in its *Second Further Notice* from including administrative surcharges as part of the "USF" fees that can be

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[12] *Id.*
[13] *Id.* at 5, 8.
[14] Proposal #3 would exempt most interexchange carriers from meaningful USF contribution obligations, leaving local exchange carriers responsible for the vast majority of funds. Because consumers generally have a very limited choice in selecting local exchange carriers, local exchange carriers lack the competitive incentive to keep administrative costs related to USF assessments low. *See* CU *et al.* Comments at 9-10.
[15] *Second Further Notice*, 17 FCC Rcd at 24,978-79.

passed onto customers on the line-item portion of customer bills,[17] it also stated that carriers may still "recover any administrative or other costs they currently recover in a universal service line-item through their customer rates or through another line item."[18]

In estimating the average USF fees paid by customers in 2002 and 2003, the *Staff Study* included the typical "mark-up" that consumers were required to pay by their carriers. Beginning in 2004, however, the *Staff Study* does not include this "mark-up" in USF fees, and reduces its estimates of the USF fees paid by consumers by a proportionate amount.[19] It does not offset this reduction in mark-ups with an estimate of the amount of USF-related administrative costs carriers will henceforth pass onto consumers in the form of a separate line-item or increase in phone rates. Nor does it assess the likely increase in overall administrative costs caused by Proposal #2 and Proposal #3.[20] Because the *Staff Study* does not assess the unique administrative costs associated with each proposal, it underestimates the proposals' total costs to consumers and carriers.

Despite underestimating the proposals' costs, the *Staff Study* nevertheless makes clear that consumers will not benefit from the proposals. Given the sustainability of the present assessment system, and the ability of the Commission to correct its deficiencies without injuring low-volume consumers, the implementation of any connection-based methodology is unwarranted.

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[16] CU *et al.* Comments at 9-10.
[17] *Second Further Notice*, 17 FCC Rcd at 24,954.
[18] *Id.* at 24,974.
[19] *Staff Study* at 5.
[20] Proposal #2 would increase administrative costs for IXCs significantly by requiring them to gather information regarding end-users access connections in order to determine USF contribution rates. CU *et al.* Comments at 9. Proposal #3 would place USF contribution obligations primarily upon LECs, which have the least competitive incentive of any class of carrier for maintaining low administrative costs. *Id.* at 10. These administrative costs are likely to be passed onto consumers.

II. THE INTERIM MEASURES ARE SUFFICIENT AND SHOULD BE GIVEN AN OPPORTUNITY TO WORK

Commenters overwhelmingly favor the present, revenue-based assessment system over any of the proposals presented by the Commission.[21] This broad support strongly suggests that the interim measures taken by the Commission are sufficient to ensure the system's sustainability for the foreseeable future. The interim measures have addressed the need to better account for interstate calling using wireless telephones. To the extent that bundling and IP telephony increase, the revenue-based assessment system can be similarly adjusted to capture these revenues. Accordingly, it is not presently necessary for the Commission to replace the current USF assessment system.

A. THE COMMISSION HAS TAKEN ADEQUATE MEASURES TO ENSURE THE SUSTAINABILITY OF THE PRESENT USF ASSESSMENT SYSTEM

The primary concern for the sustainability of the revenue-based assessment system was the previous inadequacy of wireless carriers' USF contributions.[22] Because wireless revenues have grown at a far faster rate than the revenues of interexchange or local exchange carriers, the previous safe harbor level no longer accurately reflected the significant percentage of wireless revenue deriving from interstate communication. The Commission has sufficiently addressed this concern by raising the wireless safe harbor to better represent the amount of interstate revenue accrued by wireless providers. Several comments, as well as the Commission's own

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[21] A broad and diverse number of commenters favor the revenue-based system over one or more of the alternative proposals including, *inter alia,* CU *et al.*, WebLink Wireless, Inc., Industrial Telecommunications Association, Inc., National Telecommunications Cooperative Association, Fred Williamson & Associates, Inc., Community Action Partnership, National Indian Education Association, American Association of Paging Carrier, Verizon, National Association Of State Utility Consumer Advocates, Nextel, TracFone Wireless, Inc., AT&T Wireless Services, Inc., Arch Wireless Operating Company, Inc., Verizon Wireless, Montana Independent Telecommunications Systems, j2 Global Communications, Inc., Cellular Telecommunications & Internet Association, Telecommuncations Research & Action Center, RAINBOW/ PUSH Coalition, Attorneys for Allied National Paging Association, and Virgin Mobile.

Staff Study, demonstrate that raising the wireless safe harbor from 15 to 28.5% will ensure the sustainability of USF contributions for the foreseeable future.[23]

Nonetheless, commenters in favor of replacing the present USF collection system argue that even with the interim regulations, the USF contribution factor under the revenue-based system will soon increase to unconscionably high levels.[24] As various studies presented in this proceeding indicate, however, these fears are unfounded.[25] Indeed, the Commission's *Staff Study* indicates that the USF contribution factor is expected to rise only to 11.4% by 2007, the final year accounted for in the study.[26] This contribution factor is comparable to what many consumers were already paying prior to the Commission's recent prohibition of carrier "mark-ups" on USF fees passed onto consumers.[27] In 2002, for example, AT&T assessed residential consumers at a rate of 11%, almost 4% higher than the contribution factor established by the Commission.[28] Furthermore, even with this increased contribution factor, most residential customers' USF related fees would still be lower than under the three proposals.[29] Accordingly, the expected increase in the USF contribution factor under the revenue-based system does not warrant abandoning the system for any of the connection-based proposals.

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[22] *See Federal-State Joint Board on Universal Service*, Further Notice of Proposed Rulemaking and Report and Order, 17 FCC Rcd 3752, 3757-58 (2002) ("*Further Notice*").
[23] *See Staff Study* at 5; CU *et al.* Comments, attached Affidavit of Dr. Mark N. Cooper ("*Cooper Study*"); Comments of TracFone Wireless, Inc., attached analysis of Henry B. McFarland, Economists, Inc. ("*McFarland Study*").
[24] *See* AT&T Comments at 20; WorldCom Comments at 6-11.
[25] *See Cooper Study*; *McFarland Study*; *Staff Study* at 5.
[26] *Staff Study* at 5.
[27] *See Second Further Notice*, 17 FCC Rcd at 24,976, n.124. These inflated rates often included hidden administrative surcharges. The prohibition of mark-ups requires carriers to include any administrative costs as either a separate line-item or as an overall increase in phone rates. This "truth in billing" requirement better enables consumers to "shop around" for the truly lowest phone service, and therefore provides carriers with a competitive incentive to keep administrative costs as low as possible. *See* CU *et al.* Comments at 3-4.
[28] *See Second Further Notice*, 17 FCC Rcd at 24,976 n.124.
[29] *See Staff Study* at 5-8 (showing that most consumers would pay significantly more under Proposal #2 and Proposal #3 than under the current system, and that the average residential consumer would a pay comparable amount in USF fees under Proposal #1 as the current system). Moreover, the USF fees assessed on low-volume users would be greater under each proposal than under the current methodology. *See* discussion *infra* Part I.

In the future, assuming that interstate revenues of wireless companies substantially increase, the Commission could again raise the wireless safe harbor, thereby ensuring that these providers will still be required to contribute their fair share into the USF. The Commission could also consider eliminating the wireless safe harbor altogether, because TracFone has demonstrated that wireless carriers can accurately distinguish between interstate and intrastate activity.[30] In sum, the contribution rate will not increase significantly in the foreseeable future and future rate increases can be minimized through modifications of the wireless safe harbor. Scrapping the present revenue-based system for an entirely new and unproven USF assessment system is therefore not warranted.

B. BUNDLING AND IP TELEPHONY DO NOT JUSTIFY THE REPLACEMENT OF THE PRESENT USF ASSESSMENT SYSTEM

The few commenters arguing that the current, revenue-based assessment system is inadequate point to a potential reduction in USF contributions that could be caused by bundling and internet telephony.[31] While the Commission will probably need to reform the USF assessment system eventually to address these developments, these emerging services do not provide compelling reasons to alter the USF assessment system at the present time, let alone replace it with any of the alternative proposals. As the *Staff Study* demonstrates, the bundling of intrastrate and interstrate services is not expected to seriously diminish the USF contribution base or threaten its sustainability in the foreseeable future.[32] Additionally, safe harbor provisions can be used to estimate interstate revenues of bundled services, just as they have been used for wireless providers.

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[30] *See* TracFone Wireless Comments at 15-17.
[31] *See, e.g.,* AT&T Comments at 15-19; SBC and BellSouth Joint Comments at 5-8; Sprint Comments at 5-6; WorldCom Comments at 11-13 (discussing bundling only).

WorldCom argues that safe harbors cannot adequately address bundling services because the safe harbor system established by the Commission gives bundled carriers discretion to determine their respective safe harbor through multiple stand-alone rates, thereby giving these carriers broad discretion to characterize their interstate revenue in a manner that lowers their USF obligations. [33] However, the Commission can address these concerns by enacting more stringent safe harbor regulations that reduce carrier discretion in the characterization of interstate revenue. The safe harbor can be modified as needed to more accurately assess the true amount of interstate revenue attributed to bundled services.

IP telephony is also not expected to seriously affect the USF contribution base of interstate revenue for the foreseeable future. In 2002, internet telephony accounted for only 2.5 million subscribers within the U.S.[34] In contrast, wireless providers had 119 million subscribers only a year earlier.[35] Given its small share of the telecommunications market, IP telephony is not a compelling reason to abandon the present assessment methodology at this point, especially since none of the alternative connection-based proposals would fully address its problems either.[36] However, if IP telephony becomes a problem for USF sustainability, the Commission can address the problem by imposing USF contribution requirements upon the IP telephony industry.

The above-mentioned measures should sufficiently address any concerns over the present USF methodology's sustainability for the foreseeable future. If these measures prove

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[32] *See Staff Study* at 5 (showing that the present system is sustainable at least until 2007, despite certain commenters allegations that bundled services and IP telephony will make the fund unsustainable).
[33] *See, e.g.,* WorldCom Comments at 11-13.
[34] *McFarland Study* at 7 (citing data collected from the National Cable and Telecommunications Association).
[35] *Id.*
[36] Proposals #1 and #2 presently would not cover IP telephony connections. Proposal #3 could only cover those IP telephony services where "a VoIP user wants to have the ability to be *reached from PSTN connections."* AT&T Comments at 19 (emphasis added). Thus, the growing number of computer-to-computer IP telephony connections

inadequate, however, the Commission will have strong grounds to adopt an all-revenue system of assessment for the reasons discussed below.

III. THE COMMISSION CAN RESOLVE FUTURE SUSTAINABILITY CONCERNS BY ADOPTING A METHODOLOGY THAT ASSESSES CARRIERS ON BASIS OF ALL CARRIER REVENUE

As discussed *supra* in Part II, it is likely that the present USF methodology will sustain the USF for the foreseeable future. CU *et al.* nevertheless believe the Commission should consider other methodologies if the present system becomes insufficient in the future. Although telecommunications services such as wireless, bundling, and IP telephony are unlikely to threaten the viability of the current USF assessment system in the short-term,[37] the failure of carriers of these services to clearly distinguish between interstate and intrastate revenue enables them to underreport the interstate revenue they accrue, thereby reducing the USF contribution base. Based on the growing success of these services, it appears likely that future telecommunication services will continue to blur the line differentiating interstate and intrastate telecommunication services.

If this problem becomes significant, the Commission can address it most directly and effectively by assessing interstate carriers on the basis of all revenue, rather than merely interstate revenue. The Commission would have authority to adopt an all-revenue assessment system in response to the impossibility of distinguishing between intrastate and interstate telecommunication services. Moreover, an all-revenue assessment system would have certain advantages over both the present system and all three connection-based proposals. While an all-revenue system is not yet necessary, the Commission should consider its adoption if and when the present USF assessment methodology proves unworkable.

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would remain uncovered under Proposal #3. The connections and numbers-based proposals would therefore be ill-

A. THE COMMISSION HAS AUTHORITY TO ASSESS ALL CARRIER REVENUE PURSUANT TO THE IMPOSSIBILITY EXCEPTION

Although section 2(b) of the 1934 Communications Act generally denies the Commission authority over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio,"[38] the courts have recognized that the Commission's absence of authority over intrastate matters is not absolute. The 1934 Act was enacted at a time when interstate and intrastate telecommunication services were readily distinguishable;[39] since that time, the line between intra and interstate services has blurred considerably. When it is not possible to effectively distinguish between the two, courts have upheld the Commission's regulation of intrastate services pursuant to the "impossibility exception."

1. Courts Have Long Recognized That the Impossibility Exception Enables the Commission to Regulate Interstate Activity.

The "impossibility exception" was first established in *North Carolina Utility Commission v. FCC* (*NCUC I*).[40] In *NCUC I*, the Commission sought to preempt states' restrictions on customer premises equipment (CPE) that was hooked into the public network for both intrastate and interstate use.[41] The states prohibited the equipment unless it was used solely for interstate communication. Even though CPE was used 97% of the time for intrastate calls,[42] the Fourth

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suited towards handling this new technology as it becomes more common.

[37] *See Staff Study* at 5; *McFarland Study.*

[38] 47 U.S.C. § 152(b).

[39] *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 360 (1986) ("*Louisiana PSC*") (noting that the Act sought to "divide the world of domestic telephone service neatly into two hemispheres—one comprised of interstate service, over which the FCC would have plenary authority, and the other made up of intrastate service, over which the states would retain exclusive jurisdiction").

[40] *North Carolina Util. Comm'n v. FCC*, 537 F.2d 787, 793 (4th Cir. 1976) ("*NCUC I*").

[41] *Id.* at 790.

[42] *Id.* at 796 (Widener, J., concurring and dissenting).

Circuit sustained the preemption.[43] The impossibility exception was again used in *North Carolina Utility Commission v. FCC* (*NCUC II*),[44] where the court found that separating CPE equipment used for local communication was "a practical and economic impossibility."[45] In *Louisiana PSC*, the Supreme Court endorsed the impossibility exception, finding that federal preemption of state regulations was permissible if separating the intrastate and interstate components of the FCC regulation was impossible.[46]

The D.C. Circuit subsequently relied upon the impossibility exception in *Illinois Bell Telephone Company v. FCC* (*Illinois Bell*).[47] In that case, five Bell operating companies (BOCs) objected to the Commission's requirement that they allow independent CPE vendors to market their equipment alongside the BOCs' network services. The regulation allowed the independent vendors to market their CPE jointly with Centrex, an electronic switching service for large organizations sold and administered by local phone companies, enabling everyone in the market to offer "one-stop shopping."[48] The Commission also preempted states from imposing their own structural separation requirements on BOCs' marketing of CPE,[49] finding that "there [was] no practical way to divide the subject matter of [the Commission's] regulatory program into separate interstate and intrastate components."[50]

The court held that the Commission's regulations were valid. It noted that when the intrastate and interstate components are inseparable, the Communications Act "sanctions federal

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[43] *Id.* at 793.
[44] *North Carolina Util. Comm'n v. FCC*, 552 F.2d 1036, 1043 (4th Cir. 1977) ("*NCUC II*").
[45] *Id.* at 1043.
[46] *Louisiana PSC*, 476 U.S. at 376 n.4 (citing *NCUC I*and *NCUC II*). In that case, Court found that section 2(b) barred federal preemption of state depreciation practices in setting rates for a plant providing both intrastate and interstate service. The Court found that since it was possible to determine what percentage of plant use was intrastate and interstate, the Commission and the state could each apply its depreciation plan based on this proportion. *Id.* at 376.
[47] *Illinois Bell Tel. Co. v. FCC*, 883 F.2d 104, 113 (D.C. Cir. 1989) ("*Illinois Bell*").
[48] *Furnishing of Customer Premises Equipment by the Bell Operating Companies and the Independent Telephone Companies*, Report and Order, 2 FCC Rcd 143, 156 (1986) ("*BOC Report and Order*").

regulation of the *entire subject matter* . . . if necessary to fulfill a valid federal regulatory objective."[51] Despite the BOCs' contention that Centrex was an intrastate-only service, the court found that Centrex supports both intrastate and interstate communications, and its users pay interstate access charges.[52] Furthermore, the FCC regulations governing the marketing of Centrex and other network services could not be severed into "discrete interstate and intrastate components."[53] The court recognized that the Commission had a legitimate objective—promoting competition in the CPE market—and that its regulations were legitimately promoting this goal.[54] Although the impossibility exception is typically used in cases where there is inconsistent state policy, the D.C. Circuit noted that it is not limited to preemption of local regulation.[55]

2. The Impossibility Exception Can Be Applied to USF Assessment of Carriers.

Section 254 of the Communications Act grants the Commission authority to ensure that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute…to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service…."[56] The FCC interpreted this provision to provide it with jurisdiction over both the intrastate and interstate revenues of interstate

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[49] *Illinois Bell*, 883 F.2d at 108.
[50] *BOC Report and Order*, 2 FCC Rcd at 160.
[51] *Illinois Bell*, 883 F.2d at 114-15 (emphasis added).
[52] *Id.* at 114.
[53] *Id.* at 115.
[54] *Id*.
[55] The court noted that Federal regulation of the "entire subject matter" which "*may* include preemption of inconsistent state regulation." *Id.* (emphasis added). In another FCC preemption case, the D.C. Circuit note that "[t]he Louisiana [PSC] Court implicitly recognized, however, that the FCC may regulate the subject matter and, *if necessary*, preempt conflicting state rules where the FCC cannot 'separate the interstate and intrastate components of [its] asserted . . . regulation.'" *Public Util. Commission of Tex. v. FCC*, 886 F.2d 1325, 1331 (D.C. Cir. 1989) (quoting *Louisiana PSC*, 476 U.S. at 375 n.4) (emphasis added).
[56] 47 U.S.C. § 254 (c).

carriers, [57] and it accordingly established a methodology that assessed both sources of revenue to ensure universal service for schools and libraries.[58] However, in *Texas Office of Public Utilities* (*TOPUC*), the Fifth Circuit found that the express language of Section 254 did not provide the Commission with sufficient authority to override the Communication Act's general prohibition on regulation of intrastate services.[59] Noting that the Commission "has no other basis to assert jurisdiction,"[60] the court found that the Commission lacked the authority to assess intrastate telecommunications revenue to sustain the universal service fund.[61]

The court did not consider whether it was impossible for the Commission to separate interstate and intrastate revenue, and if such impossibility would permit the Commission to assess both sources of revenue.[62] Indeed, the Commission never suggested this argument since interstate and intrastate revenue was for the most part easily distinguishable at the time *TOPUC* was decided.[63] New telecommunication services have emerged since *TOPUC*, however, that will make it increasingly difficult for the Commission to distinguish between intrastate and interstate communication. At such point as these services can no longer be readily distinguishable, the premise underlying the *TOPUC* court's conclusion that the FCC lacked authority to assess intrastate revenue will no longer be accurate.

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[57] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, 15544 (1996), *modified on recon*., 11 FCC Rcd 13042 (1996), *vacated in part*, *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev'd. sub nom. Iowa Utils. Bd.*, 525 U.S. 366 (1999).
[58] *See Federal-State Joint Board on Universal Service*, CC Docket No.96-45, Report and Order, 12 FCC Rcd 8776, 8797 (1997).
[59] *Tex. Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 423 (5th Cir. 1999) ("*TOPUC*").
[60] *Id.* at 448.
[61] *Id.* at 423.
[62] While the decision determined that the Commission was not authorized to have control over both interstate and intrastate USF services, it did not address the impossibility of assessing only interstate revenue from carriers that do not distinguish long-distance revenue from local. The impossibility exception is only brought up in connection with the Commission's preemption of state "no disconnect" rules. *Id.* .at 421-22.
[63] The Commission argued that assessment of intrastate revenue for USF purposes was not expressly prohibited by 2(b) of the Communications Act, and Section 254 unambiguously authorized it to assess intrastate revenue. *Id.* at 446-48.

While the *TOPUC* court made clear that the Commission lacks express statutory authority to assess intrastate services, the Commission nevertheless retains jurisdiction under the impossibility exception to assess any telecommunication service that could potentially be used for interstate communication. The *Illinois Bell* case, in particular, provides the Commission with sufficient grounds to employ the doctrine of impossibility and assess all carrier revenue, rather than only that revenue clearly derived from interstate activities. The Centrex system in *Illinois Bell* was labeled "purely" intrastate by the BOCs, because the costs associated with marketing were attributed to local billings and assigned exclusively to intrastate operations.[64] The court, however, agreed with the Commission that the service allowed access to interstate communication and therefore was both intrastate and interstate in nature.[65] In fact, the D.C. Circuit stated that even if Centrex was a purely intrastate service, the Commission would still have the jurisdictional authority to regulate its marketing if it was sold with interstate services since "the marketing realities might themselves create inseparability."[66]

Similar marketing realities seem to be emerging in phone service that may eventually make interstate and intrastate service inseparable. Under the calling plans marketed by many wireless carriers, as well as bundled plans offered by carriers such as MCI, all calls are treated the same regardless of whether they are intrastate or interstate.[67] It is not possible to distinguish how much of these carriers' revenue is from local or long-distance calling since the service is marketed and sold in an all-inclusive package.

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[64] *Illinois Bell*, 883 F.2d at 113-14.
[65] *Id.*
[66] *Id.* at 113 n.7.
[67] Under MCI's Neighborhood Plan, for example, customers can make unlimited local and long-distance calls and receive a variety of additional features like call waiting and caller ID for a flat fee of $49.99-$69.99. *See* The Neighborhood Home Page, *at* http://www.theneighborhood.com/res_local_service/jsps/default.jsp (last visited Apr. 17, 2003).

When and if a substantial portion of telecommunication revenue is derived from services where it is impossible to distinguish between interstate and intrastate revenue, it would be appropriate for the Commission to assess carriers' USF contributions on the basis of their total revenues. In this case, unlike many other impossibility exception cases examined by the courts, the FCC would not need to preempt any state regulation. Thus, we believe that even if challenged, a court would uphold the FCC's assessment of total revenue under the "impossibility exception."

B. STATUTORY OBJECTIVES WILL BE PROMOTED BY ASSESSING ALL CARRIER REVENUE

If, in the future, it becomes impossible to feasibly separate interstate and intrastate revenues for the purposes of assessment, not only will the FCC have authority to assess all carrier revenue, but the adoption of an all-revenue methodology will also be preferable to the present USF assessment system and the three alternative proposals. An all-revenue methodology will better accomplish Congress's goal in enacting the Telecommunications Act of ensuring a "specific, predictable, and sufficient" mechanism for advancing universal service, and will impose more equitable USF obligations upon carriers and consumers.

1. An All-Revenue Assessment System Provides a Specific, Predictable, and Sufficient Mechanism for Universal Service.

Under the Telecommunications Act, "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[68] An all-revenue assessment system best accomplishes these objectives. As discussed in our initial comments, the three connection-based proposals have serious lapses in coverage, inhibiting their

[68] 47 U.S.C. § 254(b)(5).

ability to ensure that the universal service is sufficiently funded, because they provide lesser contribution obligations upon those carriers not directly providing connections to end users.[69]

In contrast, an all-revenue based system would require proportionate USF contributions from all interstate carriers. An all-revenue system would add more than $180 billion to the USF contribution base—more than doubling the amount of revenue that could be assessed to support the USF under the present system.[70] By spreading the USF contribution among the largest number of carriers, the all-revenue plan would also ensure that the USF contribution rate for each carrier would remain low.

An all-revenue based system would also ensure that the universal service support mechanism is predictable. All telecommunication service providers will be able to accurately determine their USF contribution amount, including providers that offer bundled or all-distance services. In contrast, the ability of the connection-based proposals to incorporate new technologies also cannot be guaranteed. As IP telephony demonstrates, new technologies may not rely on traditional "connections" or the North American Numbering Plan to connect their users, and connection-based plans will have to be continuously modified to accommodate these services. An all-revenue system can easily incorporate these technologies without modification, thereby providing a more predictable form of USF assessment.

Because an all-revenue plan assesses all interstate carriers based on total revenues, it is also a "specific" mechanism for determining carriers' universal service assessment. As interstate and intrastate communications become indistinguishable, it will be easier to determine

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[69] *See* CU *et al.* Comments at 11-15.
[70] FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Telecommunications Industry Revenues* Table One (March 2003),*available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/subs1102.pdf. In 2001, service revenues reported as interstate or international revenue amounted to approximately 119 billion dollars. Service revenues reported as intrastate included approximately 183 billion dollars. *Id.*

carriers' total revenue than to separate out their interstate revenue, or to determine the number of connections or phone numbers the carriers are serving at any given month.

2. Assessing All Revenue Creates An Equitable and Nondiscriminatory Support Mechanism.

Another principle under the Telecommunications Act is that "all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."[71] As CU *et al.* showed it their comments, the connection-based proposals do not comply with this statutory mandate, because each proposal takes no account of actual interstate activity in its assessment of carriers, and would either exempt certain carriers from meaningful USF contribution or would use fundamentally different assessment methodologies to assess carriers with similar activity.[72]

An all-revenue methodology is a more equitable and nondiscriminatory system of assessment. It ensures that all carriers contribute to universal service through the same assessment system, and reduces carriers' incentive to misreport interstate revenue and intrastate revenue, since both sources of revenue will be assessed equally. Under an all-revenue system, carriers with high levels of telecommunications activity could not avoid meaningful USF obligations simply because they did not provide direct connections to end users, as would happen under the connection-based proposals.

3. An All-Revenue Plan Is Competitively Neutral.

The Commission has recognized that "universal service support mechanisms and rules [should] neither unfairly advantage nor disadvantage one provider over another, and neither

[71] 47 U.S.C. § 254(b)(4). *See also* 47 U.S.C. § 254(d) (requiring that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis [to the USF]…").
[72] CU *et al.* Comments at 12-14.

unfairly favor nor disfavor one technology over another."[73] The connection-based proposals do not advance this principle to the same degree as an all-revenue system. The connection-based proposals compel certain carriers to pay higher USF fees than other carriers with similar telecommunications activity,[74] thus providing certain carriers a competitive edge over others. These plans would also hinder the competitiveness of low-volume carriers, which would pay a greater portion of revenue to the USF than high-volume carriers under a connection-based methodology and be forced to raise their rates dramatically.[75]

An all-revenue based system avoids these problems. No service would be competitively advantaged or disadvantaged from an all-revenue methodology. An all-revenue system would not distinguish between bundled and unbundled services; wireline and wireless services; and interexchange and local exchange carriers providing interstate telecommunication services. Every interstate carrier would be assessed in the same manner and be required to contribute the same percentage of revenue towards the USF, thereby guaranteeing that no carrier or technology would be competitively disadvantaged through USF obligations.

4. An All-Revenue System Would Help Ensure that Quality Service Was Available at Just, Reasonable, and Affordable Rates.

A system that assesses both interstate and intrastate revenue would further the Commission's goal of ensuring that "[q]uality services should be available at just, reasonable,

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[73] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8801 (1997), as corrected by *Federal-State Joint Board* on Universal Service, Erratum, CC Docket No. 96-45, FCC 97-157 (rel. June 4, 1997), and Erratum, 13 FCC Rcd 24493 (1997*), aff'd in part, rev'd in part, remanded in part sub nom*, *TOPUC*, 183 F.3d 393 (5th Cir. 1999), *cert. denied*, 530 U.S. 1210 (2000).
[74] CU *et al.* Comments at 11-15.
[75] TracFone, for example, has estimated that its USF contribution obligations would increase by 488% if the Commission replaced the revenue-based USF assessment system with a connection-based system, requiring a considerable increase in its customers' phone rates. *See* TracFone Comments, CC Docket No. 96-45, filed April 22, 2002, at 6. This estimate was based upon the optimistic assumption that carriers would be charged a flat $1.00 fee for every residential line served under a connection-based approach.

and affordable rates."[76] Under the connection-based proposals, consumers would be charged the same USF fee for each connection or phone number regardless of their actual usage of telecommunications services. As a result, these proposals would harm low-volume users, who would have to pay higher USF fees than under the present revenue-based system or an all-revenue based system.[77] An all-revenue based system is preferable for consumers, because telecommunication users' USF fees would be proportionate to their usage of telecommunication services.

Moreover, an all-revenue based assessment system would likely reduce overall consumer costs by lowering administrative costs passed onto consumers. The connection-based proposals would require many customers to pay significant administrative costs related to USF assessment.[78] An all-revenue system, in contrast, would have quite low administrative costs, because carriers could determine their USF obligations on the basis of total revenue more easily than on the basis of either a fluctuating number of connections served or any other contribution requirements the proposals mandate. Accordingly, USF-related fees consumers pay will likely be lower under an all-revenue system than under the connection-based proposals.

CONCLUSION

The Commission has not been presented with compelling justification to alter the present USF assessment system, which has been shown to be sustainable for the foreseeable future. Given that the connection-based proposals presented for comment would unjustly harm low-volume users and possibly make the long-distance phone service unaffordable for low-income and elderly persons, the Commission should not adopt a connection-based USF assessment

[76] 47 U.S.C. § 254(b)(1).
[77] *See* CU *et al.* Comments at 4-10; *Staff Study* at 5-8 (comparing average residential USF fees under the present system and the three proposals).
[78] *See* CU *et al.* Comments at 9-10.

system. If and when the present USF system is no longer sustainable, the Commission should assess all interstate and intrastate revenue, a policy that would ensure the long-term viability of the USF while ensuring equity among both customers and carriers.

Respectfully Submitted,

___/s/____________________

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