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Universal Service: Problems, Solutions, and Responsive Policies

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Universal Service: Problems, Solutions, and Responsive Policies

By Allen S. Hammond, IV*

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I. THE IMPORTANCE OF UNIVERSAL SERVICE

Affordable access to telecommunications networks is extremely important to all Americans.¹ The federal universal service policy is critical

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1. “The federal government’s commitment to universal service is grounded in our belief that basic telecommunication services should be available to all Americans at rates that are affordable and relatively uniform.” *The Future of Universal Service: Ensuring the Sufficiency and Stability of the Fund: Hearing Before the Communications Subcomm. of the Senate Commerce, Science, and Transportation Comm.*, 107th Cong. (2002) [hereinafter *2002 Universal Service Hearing*] (statement of Sen. Daniel K. Inouye). “[A]dditional users of the telephone network create benefits for everyone—the marginal user as well as everyone already on the network. Indeed, this powerful theory underlies our universal service policies and has served our country very well.” *Cell Phone Number Privacy: Hearing Before the Senate Comm. on Commerce, Science, and Transportation*, 108th Cong. (2004) (statement of Ms. Kathleen Pierz).

The most straightforward example of a product that possesses network effects is a communications network such as a phone system or a fax machine: with only one user, it is basically worthless, but as more people come to own phones/faxes, the value of the system, and the consumer demand associated with it, increases significantly. . . . In the case where the product in question is a communications network, the value associated with the growth of the network can be classified as direct: the more people that become part of the network, the more people one can

to ensuring affordable access for low income Americans and those living in rural and high cost areas, and on tribal lands.² Consequently the nation's commitment to preserving universal service has been longstanding and continues to this day.³

II. PROBLEMS WITH UNIVERSAL SERVICE

Recently, many have begun to question whether the current version of the federal universal service program can be sustained.⁴ Indeed, some

communicate with, and hence, the more valuable the network is to a given user.

Alan E. Wiseman, Federal Trade Comm'n, *Economic Perspectives on the Internet*, FTC Policy Papers 52 (2000), available at <http://www.ftc.gov/be/hilites/economicissues.pdf> (last visited Feb. 23, 2005). See also Rauf Gonenc, Maria Maher, & Giuseppe Nicoletti, Organisation for Economic Co-operation and Development, *The Implementation And The Effects Of Regulatory Reform: Past Experience And Current Issues* 11 (2001), available at <http://www.oecd.org/dataoecd/15/9/1885290.pdf> (last visited Feb. 23, 2005).

"[T]here can be no denying the critical role that universal service plays in ensuring the future of our integrated network, a network that has been proven to be crucial and critical to the national and economic security of this country." *The Future Of Universal Service: Hearing Before the Communications Subcomm. Of The Senate Comm. On Commerce, Science And Transportation*, 108th Cong. (2003) (testimony of Robert Orent).

2. *2002 Universal Service Hearing*, *supra* note 1 (statement of Sen. Daniel K. Inouye).

As each of us can attest, access to adequate telecommunication services is essential to modern day social and economic commerce. These challenges are acutely felt by millions of Americans in remote areas who rely on telephone and Internet connections to contact families and friends, to benefit from expanded job opportunities offered by telecommunications, to access educational information from remote libraries, to maintain critical contacts with health and emergency service personnel. Yet, beyond these specific uses, as telecommunication services reach more and more individuals, all Americans benefit from the network effects of a ubiquitous communications network.

Id.

3. *Id.*

The goal of providing high quality telecommunication services to all Americans at affordable rates is a cherished principle in U.S. telecommunications policies and one of the cornerstones of the Telecommunications Act of 1996. From Alaska to Alabama, from Montana to Mississippi, universal service funding has guaranteed citizens the ability to communicate at reasonable rates across the country.

The Future Of Universal Service: Hearing Before the Communications Subcomm. of the Senate Comm. on Commerce, Science and Transportation, 108th Cong. (2003) [hereinafter *Apr. 2003 Universal Service Hearing*] (testimony of Kathleen Q. Abernathy, Comm'r, FCC).

4. *Apr. 2003 Universal Service Hearing*, *supra* note 3 (statement of Matthew Dosch, VP, External Affairs, Comporium Comms.).

This statutory combination of universal service support as a local telephone competition facilitation device, coupled with the limitation on universal service support contributions to only narrowly based interstate revenues, places extreme pressure on these federal universal support mechanisms. . . . [T]hese two factors alone will render the existing federal mechanisms unsustainable, in that demands for universal service support funds are increasing far more rapidly than interstate revenues are growing. Over the next five years, USTA estimates that demands for

observers insist that federal and state⁵ universal service policies are in imminent danger of demise unless appropriate action is taken.⁶ A declining supply of revenues from which the fees⁷ are collected and an increasing demand for the fees that remain are identified as the immediate problems.⁸

universal service support will increase substantially, from \$7.4 billion to \$11.9 billion, while the interstate service revenue funding base remains flat at best.

Id.

5. *Cal. Puc Staff Warns VoIP Could Take 400m From Cal. Universal Service In 2008*, 22 STATE TEL. REG. REP. 15, July 30, 2004. This article states in relevant part:

VoIP could drain Cal[ifornia]'s universal service coffers of 400 million in 2008 as it grabs 43% of the state's voice business, predicted the staff of the Cal[ifornia] PUC. The so-called High Cost Funds A & B—to promote service in high-cost areas through subsidies to SBC, Verizon and 17 small companies—are expected to lose 114-253 million, said Jack Leutza, the PUC's Telecom Div[ision] dir[ector]. . . . It's a "big concern" to the PUC that "universal service funding will not be able to be provided," either from older providers whose conventional circuit-switched service is severely eroded or from VoIP providers if they are exempted from the requirement, he said.

Some question whether VoIP is the current cause of the universal service crisis. It is argued that "local exchange carriers 16 million access lines have been lost in the past 4 years, costing the [universal service] fund approximately \$7 billion in revenue." Patrick Ross, *VoIP Said to Press Reform of Universal Service*, COMM. DAILY, Aug. 25, 2004. Half of the losses are said to be the result of "homes abandoning 2nd [wire]lines acquired for dial-up Internet access in favor of broadband, and the other 8 million" are due to homes canceling wireline access and replacing it with cell phones as their home phone." *Id.* "[E]ven with VoIP's rapid growth," the argument goes, "it would be several years before it could equal the impact on the fund of those developments caused." *Id.* "Nothing about VoIP threatens universal service. The real threat is the shrinking base of interstate revenues that support the system today." *Regulatory Aspects of Voice over Internet Protocol: Hearing Before the Commercial and Administrative Law Subcomm. of the House Judiciary Comm.*, 108th Cong. (2004) [hereinafter *VoIP Regulatory Hearing*] (testimony of John Langhauser).

6. *2002 Universal Service Hearing*, *supra* note 1 (statement of Sen. Byron Dorgan). The Senator stated:

[W]e're in a situation where slowly but surely, relentlessly, over time this universal service fund has been neglected and chopped away at and we will not long have a universal service fund that works, relevant to the philosophy that we have embraced for many decades and especially relevant to what is in Section 254 in the act. . . . I think the commission has a lot to answer for, with respect to what's gone on in recent years on universal service.

See also Apr. 2003 Universal Service Hearing, *supra* note 3 (testimony of Jack H. Rhyner).

7. *Future of Universal Service: Hearing Before the Telecomm. and Internet Subcomm. of the House Energy and Commerce Comm.*, 108th Cong. (2003) [hereinafter *Sept. 2003 Universal Service Hearing*] (statement of Kathleen Q. Abernathy, Comm'r, FCC). The Commissioner stated:

The Commission collects funds for the various universal service support programs pursuant to section 254(d) of the Communications Act. Service providers must pay a percentage of their revenues from interstate end-user telecommunications services to the Universal Service Fund. This percentage fee, called the contribution factor, changes on a quarterly basis depending on the demand for funding and the base of reported revenues. The current contribution factor is 9.5 percent.

8. *2002 Universal Service Hearing*, *supra* note 1 (testimony of Dorothy Attwood).

On the supply side, the method by which universal service has been funded through fees collected from the revenues of local and long distance wireline and wireless carriers, is being undermined in part by wireless competition,⁹ the growing use of email,¹⁰ and all distance service bundling.¹¹ The near term future of universal service is believed to be threatened by the growing adoption of VoIP as an alternative to wireline services.

On the demand side, increasing requirements on the high cost fund by telecommunications carriers¹² and continuing requirements for funding of social inclusion subsidies for indigent, school-age, and rural Americans combine to place increasing strain on the funding process.¹³

Dorothy Atwood stated in relevant part:

These changes, price competition, technological substitution and the development of service bundles are precisely the kind of developments that Congress sought to stimulate when it passed the 1996 act. They are good things. Nonetheless, they strain traditional regulatory distinctions. They present challenges to our current universal service framework and they require us to consider difficult questions.

9. Jim Blaszak, *You Can Do Something About The Growing Universal Service Burden: With New Regulations Coming, Businesses Must Make Their Concerns Known To The FCC*, BUS. COMM. REV., July 1, 2004, at 52. Stating in relevant part:

[T]he carriers' interstate revenues, against which an FCC-prescribed factor is applied to obtain universal service subsidies, have been dropping since 2000. The revenue drop is attributable to two main factors: Consumers now often use wireless service plans and email instead of traditional long distance service; and long distance service rates have fallen.

10. *Id.*

11. *Sept. 2003 Universal Service Hearing*, *supra* note 7 (statement of Kathleen Q. Abernathy, Comm'r, FCC). The Commissioner stated in relevant part:

For years, wireless carriers have offered buckets of any-distance minutes at flat rates, and now wireline carriers are offering packages including local and long distance for a single price. In addition, many carriers offer business customers bundles that include local and long distance voice services, Internet access, and customer premises equipment. Such bundling has been a boon for consumers but has made it difficult to isolate revenues from interstate telecommunications services.

12. Jim Blaszak, *You Can Do Something About The Growing Universal Service Burden: With New Regulations Coming, Businesses Must Make Their Concerns Known To The FCC*, BUS. COMM. REV., July 1, 2004, at 48. Stating in relevant part:

[T]he funding requirements for universal service have soared as rural local exchange carriers have claimed more and more subsidies. In 1999, the high-cost component of the universal service fund was about \$1.7 billion and the entire Universal Service Fund was \$3.9 billion. For 2004, the high-cost component of the Universal Service Fund . . . is forecast to be at about \$3.6 billion and the entire Universal Service Fund may top \$6.5 billion. . . . Virtually all the growth in universal service subsidies over the last four to five years has gone to local exchange carriers. With influential elected officials proclaiming the need for virtually ubiquitous availability of broadband service, the high-cost component of the Universal Service Fund probably will continue to grow at an alarming rate.

13. *Sept. 2003 Universal Service Hearing*, *supra* note 7 (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n). Billy Jack Gregg

III. PROBLEMATIC POLICIES

In addition to the strain caused by market competition and social need, however, there are federal and state procompetition policies that cause substantial damage to the viability of universal service programs.¹⁴

A policy of regulatory forbearance¹⁵ has been used to increase competition for wireline voice services by exempting cable and VoIP services, and partially exempting wireless services, from paying universal service fees. This policy is said to be partly responsible for the rapid growth of wireless and broadband as well as the recent investment in VoIP. Yet, the policy has also resulted in an erosion of the subscriber base of traditional incumbent wireline providers who pay the bulk of the fees from which universal service funds are derived.

The continuation of the regulatory forbearance policy has long term implications for the survival of universal service. The pursuit of such a policy could result in the exemption of all broadband providers from legacy Title II (telecommunications) and Title VI (cable) regulations,¹⁶ as well as

stated:

[T]he introduction of the schools and libraries fund and increases in the high-cost fund have driven the overall size of the fund. As a result, the fund has tripled, rising from approximately \$1.8 billion in 1997 to approximately \$6.2 billion [in 2003]. So long as interstate revenues grew at a reasonable rate, the ultimate impact of fund growth on the USF assessment rate and customers' bills was fairly moderate. However, beginning in 2000 interstate revenue growth began to flatten out, and during 2002 started to decline. The result has been a steep escalation in the assessment rate, from 5.7% in the fourth quarter of 2000 to 9.5% in the third quarter of 2003.

14. *2002 Universal Service Hearing*, *supra* note 1 (comment of Senator Byron Dorgan).

The Senator stated:

[F]or a long period of time, my concern [has been] that the FCC has used whatever discretion it has to shrink rather than expand the [universal service contribution] base. And the result is I think [the FCC has] precious little opportunity to provide universal service funds support for advanced services. In fact, I wonder whether we will be providing the kind of universal service support that we expect for basic telephone services.

15. IP-Enabled Services, *Notice of Proposed Rulemaking*, 19 F.C.C.R. 4863, 4893, para. 42 (2004), available at <http://hraunfoss.fcc.gov/edocs-public/attachmatch/FCC-04-28A1.pdf> (last visited Feb. 23, 2005). The Commission has the ability "to forbear from enforcing its own regulations or the requirements of the statute if enforcement is not necessary to protect consumers, ensure against unjust, unreasonable or unreasonably discriminatory practices, or protect the public interest." *Voice over Internet Protocol: Hearing Before the Telecomm. and the Internet Subcomm. of the House Comm. on Energy and Commerce*, 108th Cong. (2004) (statement of Jeffrey J. Carlisle, Sr. Deputy Chief, Wireline Competition Bureau, FCC).

16. See Charles A. Zielinski, *Barriers to Entry: The Fight Against Power-Line Communications*, PUB. UTILS. FORTNIGHTLY, Dec. 2004, 19, at 20 n.6 (discussing *Brand X Internet Servs. v. FCC*, 345 F.3d 1120 (9th Cir. 2003)). See also Cable Modem Case Could Spur Huge Changes, TELECOM POLICY REPORT, Dec. 10, 2003 (stating that because of the decision in *Brand X*, cable modem service was in part a "telecommunications service"

the preemption of state regulation by defining the providers as Title I information services. It is argued that this policy would protect fledgling broadband enterprises from costly and sometimes conflicting regulation. However, the policy also could eviscerate the universal service program as wireline carriers join their cable and wireless counterparts in the election to provide voice and other services as information service providers and avoid universal service obligations altogether.

In addition, federal and state governments have sought to increase competition for rural carriers by allowing states to certify more carriers as eligible for federal high cost area subsidies.¹⁷ The expectation has been that competition will result in lower prices for rural telecommunications services. The policy has resulted in a substantial increase in the demand for universal service funding at a time when revenues coming into the fund are decreasing. Simultaneously, the policy is said to undermine the ability of the rural incumbent wireline carrier¹⁸ to compete because, while it must serve the entire area of license, the newly certified wireless and local exchange carriers are free to serve only the more lucrative portions of the service areas.¹⁹

subject to common carrier regulation, overruling an FCC determination that cable modem was a non-common carrier "information service." The FCC may have to forbear from regulation to exempt cable modem and other broadband "telecommunications service" from common carrier obligations).

17. *Sept. 2003 Universal Service Hearing*, *supra* note 7 (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n). Billy Jack Gregg stated:

[S]ince states have no responsibility for funding the federal USF, and under current rules additional ETCs mean more federal USF money coming into the state, it is very difficult for states to find that it is not in the public interest to designate additional ETCs in rural areas. This is true regardless of the cost to serve any particular area.

18. "Rural telcos today obtain a surprisingly large 40 percent of their revenues from universal service payments. Loss of these subsidies would thus have a devastating impact on these carriers and their customers." David Passmore, *Taxing VOIP: Consider the Alternative*, *BUS. COMM. REV.*, Oct. 1, 2004, at 14.

19. *Apr. 2003 Universal Service Hearing*, *supra* note 3 (statement of Matthew Dosch, VP, External Affairs, Comporium Comms.).

The policy of using universal service support as a means to promote competition has proven to be an expensive failure. This artificial approach simply adds to the cost of the universal service program. States should make reasoned public interest findings before designating additional ETCs, with full consideration of an equality of obligations on carriers and equality of expectations of all of the consumers in the subject service area. A recipient should be required to serve an entire high cost area - not just the least costly part, as is often the case today.

IV. PROPOSED SOLUTIONS

Current proposals to address the universal service crisis focus on modifying the contribution process (supply side) and/or managing the funding process (demand side).²⁰ Efforts to modify and better manage the contribution process include: establishing (or repealing) an appropriate safe harbor for wireless providers;²¹ eliminating the lag time between the reporting of revenues and the recovery of contribution costs; prohibiting the marking up of contribution costs on consumer bills;²² choosing an

20. *Encouraging Capital Formation In The Telecommunications Sector: Hearing Before the House Subcomm. on Domestic Monetary Policy, Technology and Economic Growth of the House Committee on Financial Services, Federal Document Clearing House, 107th Cong. (2002)* (statement of Blair Levin, Managing Dir. and Telecomm. and Media Regulatory Analyst, Legg Mason Wood Walker, Inc).

A necessary component to any such rationalization would be universal service reform. Obviously, there needs to be a restructuring of the method for distributing funds for universal service to make sure that the vast majority of Americans, including in high-cost rural areas, stay connected, as they are today. There needs to be a simpler way to determine where subsidies need to go, and in what amounts. There are clearly parts of the country where subsidies (whether implicit or explicit) can be reduced and rates increased without any reduction in subscribers. This would create a better business investment climate in these markets, with the business case structured less by regulation and more by market forces.

There also needs to be a simpler and more sustainable way to collect the funds. The FCC is currently reviewing whether to replace the current method of collecting a percentage of each carrier's net interstate and international telecom services billings with an assessment on connections to the network. Without commenting on a number of details that need to be thought through, I would note it is likely that such a system will become even more important in the future. We believe that service providers will increasingly bundle numerous products. Assessments applied against a service will be difficult to account for and will create incentives to engage in accounting manipulations that ultimately hurt the market. Assessments applied against a connection, on the other hand will give the market the kind of transparency that leads to more efficient markets and an improved investment climate.

Id.

21. *Compare Sept. 2003 Universal Service Hearing, supra* note 7 (statement of Kathleen Q. Abernathy, Comm'r, FCC) (discussing the pro safe harbor proposal), *with id.* (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n) (discussing the proposal for repeal of the safe harbor policy).

22. *Sept. 2003 Universal Service Hearing, supra* note 7 (statement of Kathleen Q. Abernathy, Comm'r, FCC). The Commissioner stated:

In December 2002, the Commission adopted a number of measures to stabilize the universal service contribution factor in an effort to mitigate the growing funding burden on consumers. For example, the Commission increased from 15% to 28.5% the safe harbor that wireless carriers may use to determine the interstate percentage of their revenues. The Commission also eliminated the lag between the reporting of revenues and the recovery of contribution costs, which lessened the competitive disadvantages facing long distance carriers with sharply declining

alternative contribution methodology;²³ amending §254 to allow federal access to intrastate revenues;²⁴ and applying the same universal service

revenues. And the Commission prohibited mark-ups of contribution costs on customers' bills to ensure that carriers cannot profit from inflated line charges.

23. Commissioner Abernathy stated:

The Commission has sought comment on alternative methodologies based (in whole or in part) on end-user connections or assigned telephone numbers, because such approaches arguably would create a more sustainable model for funding universal service in the future. The number of end-user connections has been more stable than the pool of interstate revenues, and connection-based charges can be adjusted based on the capacity of each connection to ensure an equitable distribution of the funding burden among business and residential customers. Moreover, proponents of a contribution methodology based on telephone numbers (with connection-based charges for high-capacity business lines) argue that it would not only be more stable but also promote number conservation.

Id.

The proposals before the FCC have been criticized, however.

While these connection-based or numbers-based proposals do enlarge the base of the USF, and minimize problems with classification of services or revenues as information services, they do have several flaws: (1) each proposal radically shifts the funding of the USF among industry groups; (2) each proposal appears to exempt pure providers of interstate long distance from making any contribution to the fund in contravention of the plain wording of Section 254(d); (3) each proposal requires capacity-based connection equivalents for high-capacity customers; and (4) each proposal shifts responsibility for payment of USF charges from high-use to low-use customers.

Sept. 2003 Universal Service Hearing, supra note 7 (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n).

Finally, it has been proposed that the FCC "continue to base 50% of the universal service assessment on interstate revenues, and assess the remaining 50% on end-user connections to the public switched network." *Id.* It is argued that the hybrid contribution approach would not require a statutory amendment and would ensure that all providers of interstate services would continue to contribute to support universal service. In addition, it would mitigate most regressive impacts on low-usage customers. *Id.* While such a solution may hold promise but only to the extent that the implementation of such a methodology does not adversely impact low income urban and rural end-users. One way to avoid such a result would be to exempt low income end users from the universal service assessment. At least one observer has suggested that those favoring the phone numbers assessment approach would exempt low income end users from paying any universal service charges. Jim Blaszk, *You Can Do Something About The Growing Universal Service Burden: With New Regulations Coming, Businesses Must Make Their Concerns Known To The FCC*, BUS. COMM. REV., July 1, 2004, at 52.

24. *Sept. 2003 Universal Service Hearing, supra* note 7 (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n). Billy Jack Gregg stated:

The contribution base problem stems in large part from the wording of the Act itself. Section 254(b)(4) states that: "All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." However, Section 254(d) states: "Every telecommunications carrier that provides interstate telecommunications services shall contribute on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service." In other words, even though the principle set forth

obligations to all carriers, service providers, and competitors.²⁵

in the Act is that all telecommunications providers should contribute to the fund, and even though the fund benefits all areas of the country, Section 254(d) limits the obligation to support the fund to a subset of telecommunications carriers - providers of interstate telecommunications services.

While Commissioner Abernathy remarked:

[A]mend section 254 to provide the FCC with authority to assess intrastate revenues, in addition to interstate revenues. A total revenue assessment would be far lower and more stable than one based solely on interstate revenues, and, just as importantly, it would prevent carriers from avoiding their contribution obligations by allocating revenues to the intrastate jurisdiction.

Sept. 2003 Universal Service Hearing, supra note 7 (statement of Kathleen Q. Abernathy, Comm'r, FCC).

25. Commissioner Abernathy stated:

[T]he Commission also has sought comment, in the Wireline Broadband NPRM, on whether all facilities-based providers of broadband services should be subject to the same contribution obligations. While a total-revenue methodology or one based on end-user connections or telephone numbers would address problems arising from the blurring of the line between interstate and intrastate telecommunications services, such changes would not necessarily broaden the contribution base to include all broadband transmission services and new services such as VoIP. The Commission accordingly sought comment on whether or not to change the contribution pool to include new services that currently are not assessed. Regardless of whether such services are classified as telecommunications services or information services, section 254 gives the FCC permissive authority to assess contributions on "telecommunications," which underlies both types of services.

Id.

Several alternative methods have been considered as a means of stabilizing the USF contribution base. For instance, the current USF system could be retained, but the safe harbor restrictions that reduce the existing interstate revenue contribution base would be removed. Alternatively, restrictions limiting the contributions from broadband providers could be removed. Currently DSL broadband providers must pay into the fund but their cable modem competitors do not. This restriction is inequitable. *Sept. 2003 Universal Service Hearing, supra* note 7 (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n). *See also Voice over Internet Protocol: Hearing Before the Subcomm. on Telecomm. and the Internet of the House Energy and Commerce Comm.*, 108th Cong. (2004) [hereinafter *VoIP Hearing*] (statement of Margaret H. Greene, Pres. Regulatory & External Affairs, BellSouth Corporation).

As communications migrate to broadband, the old world base of universal service funds-local and long distance wireline is shrinking. And increasingly, alternate technologies, like cable modem and VoIP, offer directly competitive services while being exempt from the social responsibilities attendant to universal service. Like so many other aspects of our current regulatory scheme for telecommunications, this puts the historic providers of universal service, those living with the legacy of using wireline revenue flows to subsidize social goals, at a competitive disadvantage in a robustly competitive marketplace. This situation cannot exist without serious detriment to the regulated carriers and it must be fixed. . . . Fixing this competitive/social policy mismatch means, for the issue of universal service, ensuring neutrality on both sides of the equation. Parity of obligation must exist between those who offer functionally equivalent telecommunications services. If broadband connections are to be assessed, as DSL is today, then functional equivalents, like cable modem service, must pay.

Proposals to better manage the funding process include: reducing the number of rural carriers certified as Eligible Telecom Carriers (“ETCs”);²⁶

Id.

[A]ll carriers, regardless of regulatory classification, should be required to contribute to the USF. [T]he Commission [should]...expand the list of USF contributors to include cable, wireless and satellite broadband Internet access service providers and facilities-based and nonfacilities based VoIP and IP-enabled service providers. . . . “No carrier should receive a free pass on access charges. . . .Simply because VoIP providers use an IP-network platform to provide voice communications, the Commission should not grant [them] most favored nation status. . . This will only create an unfair competitive advantage in favor of VoIP and IP- enabled service providers in the highly competitive voice communications market.” [G]iven that the “vast majority” of U.S. consumers were still using PSTN telephone service and about 75% of U.S. households [don’t] have access to broadband, a “significant number” of VoIP calls would terminate on the PSTN “for many years to come. . . It may take a decade or more before 90% of all American households have access and subscribe to broadband, therefore the interaction between VoIP services and the PSTN will continue well into the future.

Commenters At FCC Split On States’ Role In VoIP Regulation, STATE TELEPHONE REGULATION REPORT, June 4, 2004.

26. An officer of BellSouth Corp. stated:

The primary driver inflating the costs associated with Universal Service are provisions of the 1996 Act that open up support to multiple providers in the same service area that successfully secure status at the state level as ETCs. For incumbents to gain universal service support, they must thoroughly document the costs of their telecom infrastructure, promise to deliver a specified list of services, and most importantly, continue to fulfill the regulatory, public safety, and national security expectations and obligations of state and federal officials. So while incumbent providers have access to a cost-recovery mechanism, non facilities-based providers are offered what amounts to a windfall. They get the money, regardless of whether they are truly fulfilling the obligation of being a critical infrastructure provider, and potentially the sole critical infrastructure provider, in a particular area. This perpetuates a fundamental disparity rampant throughout today’s outdated system of wireline regulation: rewarding those who fail to assume the full obligations of a true carrier of last resort and punishing those that actually carry out the Fund’s initial purpose of delivering the infrastructure that ensures reliable, affordable access to basic services in every community across the country.

Apr. 2003 Universal Service Hearing , supra note 3 (statement of Matthew Dosch, VP, External Affairs, Comporium Comms.). See also VoIP Hearing, supra note 25 (statement of Margaret H. Greene, Pres. Regulatory & External Affairs, BellSouth Corporation).

On the distribution side, USTA believes this rise in demand on the Fund is unwise, unnecessary and unsustainable. Discipline must be brought to bear around distribution of the Fund. This can be accomplished by implementing some specific principles governing eligibility to draw from the Fund. Specifically, USTA asserts that the federal Fund should be asked to support only one ETC in each high-cost area. That ensures universal service. States that wish to subsidize competitors by designating additional providers should be permitted to do so, provided they pay the additional cost, so the Fund is not destabilized for the entire nation. Again, basic connectivity is the goal of universal service.

Id.

bolstering the effectiveness of Linkup and Lifeline;²⁷ and eliminating red tape while insuring the integrity of the schools, libraries, and rural health care support programs.²⁸ Many of these proposed solutions, while important, seem more akin to rearranging the deck chairs on the Titanic. As many observers have realized, the universal service system needs a more fundamental revision.

V. FORBEARANCE, COMPETITION, INFORMATION SERVICES AND ARBITRAGE

While reform of the telecommunications universal service policy is clearly warranted, ignoring the impact of IP-enabled intermodal competition is counterproductive. In an era of IP-enabled convergence, ultimately, proposals and policies that solely focus on one technology platform will be less successful. Too often they will serve as an opportunity for regulatory arbitrage by firms seeking an advantage through exemption. The advent of IP-enabled broadband telecommunications, cable, and wireless platforms offering bundled voice, video, and data services provides a critical opportunity to harmonize a fundamental public interest goal across platforms. As the IP-enabled network platforms evolve and compete, how should the public goal of universal service be met?

VI. EQUITABLE CONTRIBUTIONS FROM ALL PLATFORMS

One of the more realistic proposals is to require that IP-enabled network providers pay into the universal service fund. The proposal, if

27. "A separate component of the federal universal service program is the low-income support mechanism, Lifeline/LinkUp. These programs provide funding that enables low-income consumers to receive discounts on monthly service and installation charges. An additional layer of discounts is available for eligible consumers living on Indian tribal lands." *Universal Service: Hearing Before the Senate Comm. on Commerce, Science, and Transportation*, 108th Cong. (2003) (statement of Hon. Michael K. Powell, Chairman, FCC).

[O]f the \$673 million paid out for low-income support in 2002, almost half went to one state, California. This is not to disparage California's low-income program, but to point out that low-income support funds are distributed very unevenly throughout the nation. There are also overall fund size implications from this skewed distribution. If every state's program was as successful as California's, the size of the low-income support fund would more than double to \$1.5 billion.

Sept. 2003 Universal Service Hearing, *supra* note 7 (statement of Billy Jack Gregg, Dir. of the W. Va. Consumer Advocate Div., Public Service Comm'n).

28. [T]he Schools and Libraries support mechanism [E-Rate] and the support mechanism for rural health care facilities provide additional support that enables these institutions to receive discounts on basic and advanced telecommunications services (as well as internal connections in the E-Rate program). *Sept. 2003 Universal Service Hearing*, *supra* note 7 (statement of Kathleen Q. Abernathy, Comm'r, FCC).

adopted, would be technology-neutral,²⁹ less susceptible to regulatory arbitrage, and subscriber-friendly.³⁰ In doing so, the government would have to require that the fees be paid not on the application or service,³¹ but on the connection, regardless of platform.³² These fees would be used to subsidize indigent, inner-city, and rural American, as well as tribal land, broadband Internet access.³³ At the same time, efforts should be undertaken

29. *VoIP Regulatory Hearing*, *supra* note 5 (testimony of Stephen M. Cordi).

Voice over IP is an exciting new technology. It's always tempting to want to nurture a new product, but in doing so you must not forget existing and competing products. One of the primary goals of tax policy is to treat similar taxpayers and similar goods and services in a similar fashion. Government should not choose the winners and losers in the marketplace through tax policy.

Id.

30. Mark Rockwell, *Regulators Hone In On USF*, WIRELESS WEEK, Oct. 15, 2003, at 14.

Universal service contributions are made through interstate carrier contributions and show up on long distance bills as a separately listed universal service fee. . . . [A]nalytists say, consumers will see an increasing tax on their telephone bills, which could result in political problems for Congress. The trick, they say, to preserving the program is to find ways to avoid increasing the contribution notices on consumers' bill, perhaps spreading the contribution over more types of carriers.

Id.

31. "Voice is becoming little more than one application of many over a multi-use digital broadband network. . . . Indeed, the majority of Voice over IP applications, including voice instant messaging and talking to players of live interactive games like Xbox look nothing at all like traditional telephone service." *VoIP Regulatory Hearing*, *supra* note 5 (testimony of Robert Pepper).

32. Passmore, *supra* note 18, at 14.

The biggest problem with all schemes for taxing VOIP is that they involve taxing the use of an application that runs over broadband networks. What's so special about VOIP that it-but not email, Web surfing, streaming video, file sharing, telemetry, or other types of communications-should be taxed? There has to be a better way to generate telecom fees, and there is. . . . Stop taxing applications like voice and instead tax access to the broadband "plumbing" that can carry any and all communications. But wouldn't this be a form of "Internet taxation?" It sure is, but if it were properly seen as a replacement for declining circuit-switched voice-related tax revenues, rather than as an opportunity for governments to increase taxes, it might become acceptable. . . . A tax on broadband Internet access would be application- and technology-independent, and if simply added to everyone's broadband Internet access "phone bill," could be fair and enforceable. One might argue that 802.11 or 802.16 wireless broadband systems operated independently of carriers or any enterprise private network could avoid the tax, but most of these networks would need to connect somewhere to a real facilities-based ISP, where they would be taxed on their access links.

Id.

33. Passmore also wrote:

Think about it this way: Taxing VoIP in order to fund more rural circuit-switched voice service is analogous to taxing automobiles to fund more horse-and-buggy trails. Instead, why not tax everyone's broadband service to subsidize poor and rural broadband Internet access and VoIP—a definition of universal service much more appropriate to the 21st century? With the obsolescence of circuit-switched

to manage demands on the fund by refining the ETC process and improving both the eligibility criteria for Lifeline and LinkUp and the disbursement requirements for schools, libraries, and rural health care funds.

This universal service policy should be part of a more comprehensive strategy that has the following components: IP-enabled network providers should pay access charges consistent with whatever intercarrier compensation scheme is ultimately adopted; the public-switched network must continue to be supported to allow continuing innovation and evolution; the definition of basic service must incorporate affordable access to broadband for all Americans; and all network platform providers (telecommunications, cable, wireless, satellite, powerline) must contribute to the universal service fund.³⁴

Both the FCC, through its open proceedings on universal service, intercarrier compensation, and regulation of IP-enabled networks,³⁵ and Congress, through its anticipated consideration of VoIP³⁶ and revision of

voice, some rural telcos are already using universal service monies to deploy voice via broadband Internet access and VoIP.

Id.

34. *VoIP Hearing, supra* note 25 (testimony of Michael Jensen, CEO, Great Plains Comms.).

VoIP and other IP-enabled service providers should be required to pay access charges, regardless of their regulatory classification as an information or a telecommunications service. Next the underlying network upon which all calls, including VoIP, are carried must continue to be supported to enable the deployment of both existing and new technologies and to uphold the doctrine of universal service.

Also, the definition of universal service must evolve to include broadband services so that all Americans have access to them. Further, the universal service contribution base should be expanded to include cable, wireless and satellite broadband Internet access service providers and VoIP and other IP-enabled service providers, since those providers benefit from that national network.

35. Barrie Tabin Berger, *Internet Telephony-Friend or Foe?*, *GOV'T FIN. REV.*, Oct. 1, 2004, at 60.

On March 10, 2004, the FCC initiated a Notice of Proposed Rulemaking soliciting comments on the appropriate regulatory treatment of Internet services, including VoIP. In the notice, the FCC stated its preference that Internet services continue to be subject to minimal regulation. The FCC also noted that the methods used to implement certain policy goals, such as public safety, E-911, universal service, law enforcement access, consumer protections, and disability access, may change as communications migrate to Internet-enabled services.

Id.

36. *Id.*

S. 2281/H.R. 4129, the VoIP Regulatory Freedom Act of 2004, would have preempted any federal, state, or local regulation of VoIP services. As originally introduced, both bills imposed sweeping preemptions of essential and long-standing state and local regulatory authority. The House bill, H.R. 4129, permanently preempts state and local taxing authority as well as state and local

the Telecommunications Act of 1996, have an opportunity to address the issue of universal service in the context of intermodal competition in an evolving, IP-enabled network market environment. Hopefully, they will embrace the opportunity and establish a technologically agnostic, inclusive national universal service policy that will last.

authority to regulate in the areas of franchising, zoning, E-911 services, wiretapping, criminal and consumer protection, and the collection of access fees and funds for universal service.

Id.