Item 46 (11396)

State of California **Public Utilities Commission**
San Francisco

M E M O R A N D U M

Date : June 15, 2012

To : The Commission
(Meeting of June 21, 2012)

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Subject: **Filing of Comments in Response to FCC's Further Notice of Proposed Rulemaking (FNPRM) Regarding Universal Service Fund Contribution Methodology**

RECOMMENDATION: The CPUC should file comments before the Federal Communications Commission (FCC) in response to its *Further Notice of Proposed Rulemaking* (*FNPRM*) for Universal Service Contribution Methodology.[1] The FCC seeks comment on proposals to reform and modernize how federal Universal Service Fund (USF) contributions are assessed and recovered. This action is the FCC's next step in its "ongoing efforts to modernize its universal service programs to efficiently bring the benefits of 21st century broadband networks, and the economic growth, jobs and opportunities they provide, to all Americans."[2]

The CPUC should make the following recommendations. First, the FCC should broaden the contribution base to include all services that touch the PSTN, as the State Members of the Federal-State Joint Board on Universal Service (State Members of the Joint Board) have proposed. In the alternative, the base of contributors should be broadened to include at the least text messaging service, one-way VoIP service, and broadband Internet access services. Second, the CPUC should support a reformed revenue-based contribution system as the most effective way to assess contributions. Third, the CPUC should urge the FCC to lower the costs and improve the administration of the contribution system by calculating the adjustment of the contribution factor over a period of two quarters and moving to a six-month or annual contribution assessment. Finally, the CPUC should urge the FCC to prohibit all contributors from assessing contributions on Lifeline services.

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[1] In the Matter of Universal Service Contribution Methodology, A National Broadband Plan For Our Future, WC Docket No. 06-122, GN Docket No. 09-51 (FCC 12-46), Further Notice of Proposed Rulemaking; rel. April 30, 2012. (FNPRM).

[2] *Id.*, at para. 1.

Comments are due July 9, 2012.

BACKGROUND: The current federal Universal Service Fund provides subsidies to telecommunications service providers for the interstate portion of high cost support, lifeline discounts, services to schools and libraries, and services to rural health care providers. The support for services to schools, libraries and rural health care providers includes support for certain broadband services. In November 2011, the FCC implemented the Connect America Fund, expanding the high cost support program to include broadband Internet access service. In January 2012, the FCC established a Broadband Adoption Pilot Program for broadband Internet access service under the Lifeline program.

Since passage of the Federal Telecommunications Act of 1996, the FCC has assessed contributions based on end-user revenues. Under this system, contributions are assessed based on a contributor's "projected collected interstate and international end-user telecommunications revenues, net of projected contributions." In determining what revenues should be assessed and how contributors must report those revenues, the FCC requires contributors to distinguish revenues in three ways.

First, contributors are required to allocate between revenues derived from either "telecommunications services" or certain provisions of "telecommunications" (whether offered on a common carrier or private carrier basis), and revenues derived from "information services" or consumer premises equipment (CPE). Second, a contributor also must apportion its telecommunications revenues between two categories: (1) revenues derived from sales by one carrier or provider to another carrier or provider that is expected to contribute, known as "carrier's carrier" or wholesale revenues; and (2) revenues derived from sales to all other entities, known as "end-user" or retail revenues.[3] Third, once the above determinations are made, contributors must determine how much of their end-user telecommunications revenues are derived from the provision of intrastate, interstate, and international services.[4] The FCC has established safe harbors for allocating revenues for wireless and interconnected VoIP service providers to use if they so choose.

The Universal Service Administrative Company (USAC) is the entity responsible for administering the federal universal service support mechanisms. Contributors report their revenues to USAC on a quarterly and an annual basis.[5] USAC reports the total quarterly contribution base to the FCC, projects the quarterly expenses for the universal service support mechanisms, and submits its projections to the FCC. The FCC uses the ratio of projected expenses to the projected contribution base to establish the quarterly contribution factor. USAC then bills contributors for their universal service contributions based on this factor.[6]

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[3] *Id.*, at para. 11.

[4] *Id.*, at para. 12.

[5] *Id.*, at para 14. Pursuant to the Commission's rules, contributors report their revenues by filing Telecommunications Reporting Worksheets quarterly (FCC Form 499-Q) and annually (FCC Form 499-A) with USAC.

[6] *Id.*, at para. 15.

The FCC states that since 1996 "network convergence and technological innovation have transformed the telecommunications industry."[7] Noting dramatic changes in the telecommunications marketplace, with increased usage of mobile devices, and shifting market shares among cable, VoIP, traditional wireline and bundled broadband service, the FCC remarked on commensurate shifts in funding for universal service:

> These changes to the marketplace also have led to a decline in the contribution base at the same time that the communications market has grown. Due in part to the introduction of new services into the marketplace, total revenues reported to the [FCC] by communications firms grew from $335 billion in 2000 to more than $444 billion in 2010. Demand for universal service support also increased, from $4.5 billion in 2000 to $8.1 billion in 2011. … [D]uring this period, the revenue base for universal service contributions remained relatively stable from 2004 (approximately $75.8 billion) to 2008 (approximately $74.9 billion), but has fallen since 2008, declining to approximately $67 billion in 2011…[R]eported toll revenue (*i.e.*, long-distance voice revenue), which historically comprised the largest share of the contribution base, has steadily declined over the last decade…. Meanwhile, reported mobile revenue, which typically is a combination of interstate and intrastate revenues, has increased significantly.[8]

DISCUSSION: In this *FNPRM*, the FCC seeks comments on proposals to reform and modernize how USF contributions are assessed and recovered in light of this transformation in the "telecommunications ecosystem" since 1996. It requires that any revision to the contributions methodology should promote efficiency, fairness, and sustainability of the USF programs.[9]

Specifically, the FCC seeks comment on the following issues:

- Who Should Contribute to the USF
- How Contributions Should Be Assessed
- How the Administration of the Contribution System Can Be Improved
- How Should Universal Service Contributions from Consumers Be Recovered

Staff recommendations on these four issues are discussed below.

1. Who should contribute to the USF

The FCC seeks comment clarifying or modifying the Commission's rules on which services and service providers must contribute to the USF in order to reduce uncertainty, minimize competitive distortions, and ensure the sustainability of the Fund. In particular, it seeks comment on two alternative approaches: (1) using its permissive authority, and/or other tools to clarify or modify on a service-by-service basis whether particular services or providers are required to contribute to the

[7] *Id*., at para.18.

[8] *Id*., at paras. 18-20.

[9] *Id.*,at para. 5.

Fund; or (2) adopting a more general definition of contributing interstate telecommunications providers that could be more future proof as the marketplace continues to evolve.

The State Members of the Joint Board have proposed that the FCC broaden the contributions base to include "all services that touch the public communications network."[10] Under this definition, "public communications network" would be defined as the "interconnected communications network that uses public rights of way or licensed frequencies for wireless communications."[11] This would include broadband and services closely associated with the delivery of broadband, including DSL, cable and wireless broadband.[12] This method could result in services, such as ISP services, that are traditionally bundled with broadband services also being surcharged.[13] However, pure content delivered by non-telecommunications carriers would not be required to contribute.[14]

Staff recommends the Commission support the State Members' approach to broadening the contribution base. This definition would allow the FCC to include others services in the future without continually updating a list of specific services subject to assessment. Furthermore, this approach would allow the FCC to make specific exclusions in the future if it finds that it is in the public interest to do so.

In the alternative, if the FCC chooses to modify the contribution obligations by specific services, the Commission should recommend that text messaging providers, one-way VoIP providers, and broadband internet access service providers be required to contribute to the fund. It would be in the public interest to include these services because a significant amount of communications is now traveling through these mediums rather than traditional voice telephony. Including these services would reduce market distortions and would bring the contribution factor down significantly. Regarding addition of broadband Internet access service, although wireline broadband Internet access service was classified in 2002 as an information service, the FCC recognized that such a service also includes a provision of telecommunications.[15] The FCC's proposed rule intends to only include those "entities that provide transmission to their users, whether using their own facilities or by utilizing transmission service purchased from other entities."[16] This proposal would be consistent with past FCC precedent where it "exercised its permissive authority to extend USF contribution requirements to providers of telecommunications that are competing directly with common carriers."[17]

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[10]. Comments of State Members of Universal Service Joint Board, WC Docket No. 10-90 *et al* (filed May 2, 2011) at 118.

[11]. *Id.*

[12]. *Id.*

[13] *Id.*

[14] *Id*.

[15] *FNPRM* at para.66.

[16] *Id.*, at para.76.

[17] *Id*.

Although some commenters have raised concerns that requiring broadband internet access providers to contribute to the fund could deter adoption, staff notes that the inclusion of more services and service providers into the fund would result in a reduction of the percentage contribution required from each subscriber, particularly since the FCC does not intend for the dollar amount of the total fund to grow. State Members of the Joint Board have opined that expanding the revenue base to include broadband could reduce the contribution rate to as little as 2%.[18]

2. How should contributions be assessed

The FCC explores four options for reforming the current contributions system in order to simplify the process. This section of the *FNPRM* focuses on the question of how contributions should be calculated, whether based on revenues, connections, numbers, or a hybrid system. Staff recommends that the Commission urge the FCC to continue to use a revenues based system but reform the current system by broadening the contribution base, as discussed above, and by improving the administration of the current system. We believe this would be preferable to creating an entirely new contribution scheme that is based on technologies and services that are continuously evolving. In order to provide additional context for Staff's recommendation, the four options are discussed further below.

a) Revenue-based system

Many proponents for a different regime reason that a revenue based system is not sustainable because of the steady increase in the contribution factor. However, besides increased spending pressures, this increase is caused, in part, by the growth of competing technologies that are not currently contributing to the fund. Changing the definition of what technologies must contribute or in the alternative, adding services that are the largest service providers of competing technologies, will help toward alleviating this problem.

Moreover, a revenue based system is more equitable because the greater burden is put on those who use the most services. According to Keep USF Fair Coalition, which represents myriad consumer advocacy groups, a change to a numbers or connections based contribution methodology would place the most negative impact on low income, seniors, disabled and rural Americans. The Coalition performed a usage study showing that households making less than $10,000 per year use long distance services about half as much as those making more than $70,000 per year.[19]

b) Numbers-based system

The FCC proposes that under a numbers-based system, providers would be assessed based on their telephone number inventory. Each carrier would be assessed a standard monthly amount per "assessable" number ($1/ month), with potentially higher and lower tiers for certain categories of

[18] *Id.*, at para.69.

[19] *Letter from Maureen A. Thompson, Executive Director, Keep USF Fair Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, (filed Mar. 27, 2006).*

numbers based on how these numbers are categorized. The monthly assessment per number would be calculated by applying a formula based on the USF demand requirement and the relevant count of numbers.

At first blush, the numbers-based assessment seems attractive, but it is problematic. The FCC already has created six categories of numbers that carriers must report to the FCC semi-annually. The FCC has proposed that carriers pay their contribution on "assessable" numbers, which is not an existing category of numbers. The FCC's proposed definition would limit "assessable" numbers to those assigned to end users for certain specified purposes, thus potentially leaving millions of numbers out of the calculation for universal service assessment. In addition, a numbers only methodology would not encompass wireline broadband.

Further, a numbers-based system could disproportionately affect both vulnerable populations and small users of interstate telecommunications who have many numbers, but low usage. This would include government agencies, military bases, universities and hospitals. According to the Association for Information Communications Technology Professionals in Higher Education, universities often have a large amount of numbers that are not often in use and even when in use, are not often used for interstate telecommunications.[20] Thus, under a numbers based system, they could see their contributions increase significantly.

c) Connections-based system

Under a connections-based system, providers would be assessed based on the number of connections to a communications network provided to customers. Providers would contribute a set amount per connection, regardless of the revenues derived from that connection. This method has several problems. First as the FCC notes, unlike revenues, "connection" is not a universally-recognized or tracked unit, and the FCC would need to create a definition of "connection" for purposes of moving to a new connections-based contribution methodology. The definition of an assessable "connection" is therefore integral to any connections-based proposal. Yet, defining connections could be problematic because connections can be defined based on facilities or services. In addition, a connections-based system may result in collection from non-interstate revenues which would violate the Communications Act.

Moreover, many of the connections-based proposals call for the implementation of tiers which would be based on either connection speed or capacities for enterprise consumers. This method would ensure that a greater burden is placed on enterprises, which account for more usage than residential consumers. However, this proposal raises many issues. Initially, it may be difficult to even determine whether a connection should be assessed as a residential connection or a business connection. Even establishing a standard method for determining speeds for broadband connections in order to impose a contribution may be problematic due to the variability in actual measured speeds as well as advertised speeds. Furthermore, a higher pricing bracket based on faster speeds or greater capacity has the potential to stifle innovation. XO Communications, a provider of telecommunications services for enterprises, also argues that connection speed correlates to the

[20] Letter from Patricia Todus, President, ACUTA, & Mark Luker, Vice President, EDUCAUSE, CC Docket No. 96-45, (filed May 31, 2006).

amount of bandwidth that may be available for usage.[21] Therefore, many customers purchase excess speed for backup or future growth.[22] Discouraging this practice could lead to poor network management issues.[23]

d) Hybrid numbers/connections-based system

The last alternative proposed by the FCC is a hybrid numbers- connections-based system. This proposal would require consumer numbers to be assessed based on a numbers-based methodology and business lines would be assessed on a connections-based methodology. Another alternative would assess providers a flat fee for each assessable telephone number and assess services not associated with a telephone number as a connection. However, this option poses all of the same concerns as each system individually, and also would place a greater burden on providers who would have to track both numbers and connections in order to make contributions.

3. Improving the administration of the system

The FCC seeks comment on potential rule changes that would reduce the costs associated with complying with contribution obligations and promote the transparency and clarity of the contribution system. The CPUC should recommend that the quarterly contribution factor be revised so that it is calculated on either a six-month interval or annually. This reform would increase the predictability of the contribution factor and help reduce the cost of administering the USF.

According to Chart 8 in the *FNPRM*, the historical data shows that if the adjustment to the contribution factor were calculated over a period of two quarters, the fluctuation of the contribution factor would be reduced by 32%.[24]

4. Recovery of Universal Service Contributions from Consumers.

Finally, the FCC seeks comment on whether it could promote fairness and transparency by modifying the methods by which providers recover the costs of universal service contributions from consumers. In particular, it seeks comment on whether to require additional information on customer bills about contributions, whether to limit the flexibility of contributors to pass through contribution costs as a separately stated line item on customer bills, and whether to extend to non-incumbent eligible telecommunications carriers (ETCs) existing rules that preclude incumbent carriers from recovering from their Lifeline subscribers universal service contributions for Lifeline offerings.

Staff recommends that the Commission support transparency by continuing the requirement for information on customer bills about contributions. Further, the Commission should support

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[21] Letter from Brad E. Mutschelknaus, Counsel, XO Communications, LLC to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, (filed Sept. 17, 2010).

[22] *Id.*

[23] *Id.*

[24] *Id.*, at paras.357-358.

extending to non-incumbent ETCs the FCC's rules precluding incumbent carriers from recovering from their Lifeline subscribers universal service contributions for Lifeline offerings.

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