

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)
)
Universal Service Contribution Methodology) WC Dkt. No. 06-122
)
)

**COMMENTS OF THE
OFFICE OF ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION,
ON THE NOTICE OF PROPOSED RULEMAKING
AND INITIAL REGULATORY FLEXIBILITY ANALYSIS**

The Office of Advocacy of the U. S. Small Business Administration (“Advocacy”) submits these Comments to the Federal Communications Commission (“FCC” or “Commission”) regarding the Report and Order and Notice of Proposed Rulemaking (“NPRM”) in the above-captioned proceeding.¹ The FCC is seeking comment on interim modifications² for assessing contributions to the Universal Service Fund (“USF” or “Fund”), which were adopted concurrently with the proposed rule. In that interim modification, the FCC raised the interim wireless safe harbor rate³ from 28.5 percent to 37.1 percent, and extended Universal Service obligations to interconnected Voice over Internet Protocol (“VoIP”) services.⁴

Advocacy is concerned that the imposition of regulatory burdens on a nascent industry with many, very small businesses in an extremely short period of time will have a significant

¹ *Report and Order and Notice of Proposed Rulemaking*, WC Dkt. No. 06-122, FCC 06-94 (rel. June 27, 2006).

² Concurrent with the NPRM, the Commission issued a final rule that adopted the interim modifications to the Universal Service contribution methodology which are now being considered for comment in the NPRM. Advocacy filed a letter on June 16, 2006, advising the FCC against adopting a rule until after it had provided notice and comment. The FCC disagreed with Advocacy's stance and adopted the interim modifications. NPRM at Appendix E, para. 6.

³ Contributions to the USF are based on interstate revenue on telecommunications services. Providers of telecommunications services may contribute based on actual interstate revenue, a traffic study analyzing the provider's traffic, or the safe harbor rate.

⁴ NPRM at para. 2.

economic impact. To assist the FCC in its analysis, Advocacy has solicited input from a variety of small entities and prepared these comments reviewing the impacts and available alternatives.

1. Advocacy Background.

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the Small Business Administration (“SBA”), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. Section 612 of the Regulatory Flexibility Act (“RFA”) requires Advocacy to monitor agency compliance with the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996.⁵

Congress crafted the RFA to ensure that, while accomplishing their intended purposes, regulations did not unduly inhibit the ability of small entities to compete, innovate, or to comply with the regulation.⁶ To this end, the RFA requires agencies to analyze the economic impact of draft regulations when there is likely to be a significant economic impact on a substantial number of small entities, and to consider regulatory alternatives that will achieve the agency’s goal while minimizing the burden on small entities.⁷

On August 13, 2002, President George W. Bush signed Executive Order 13272 requiring federal agencies to implement policies protecting small entities when writing new rules and regulations.⁸ This Executive Order highlights the President’s goal of giving small business owners a voice in the complex and confusing federal regulatory process by directing agencies to work closely with the Office of Advocacy and properly consider the impact of their regulations

⁵ Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

⁶ Pub. L. 96-354, FINDINGS AND PURPOSES, SEC. 2 (a)(4)-(5), 126 CONG. REC. S299 (1980).

⁷ See generally, Office of Advocacy, U.S. Small Business Administration, *A Guide for Federal Agencies: How to Comply with the Regulatory Flexibility Act* (2003), available at <http://www.sba.gov/advo/laws/rfaguide.pdf>.

⁸ Exec. Order. No. 13272 at § 1, 67 Fed. Reg. 53,461 (2002).

on small entities. Executive Order 13272 also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion accompanying the final rule's publication in the *Federal Register*, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁹

2. Significant Regulatory Burdens on Small Business in the Proposed Rule.

Advocacy held a roundtable on August 3, 2006, to discuss upcoming telecommunications issues of importance to small businesses, including the NPRM.¹⁰ Advocacy asked the participants to discuss the economic impacts of the proposal and available alternatives that would minimize that impact. Advocacy's comments are based upon the discussions at this roundtable and additional outreach to small businesses.

Advocacy believes that small wireless carriers are likely to use the safe harbor, so an increase in the wireless safe harbor rate will fall mainly on them. Roundtable participants reported that 65 percent of wireless carriers currently use traffic studies, which show that on average 23 percent of wireless traffic is long distance. The increase in the safe harbor rate to 37.1 percent likely will encourage small wireless carriers to use traffic studies because the increase in the rate exceeds the administrative costs of the traffic study. If the average traffic study for a wireless carrier's interstate traffic remains at 23 percent, then contributions to the USF will remain constant, while the regulatory costs for small wireless carriers will increase since they will be doing traffic studies instead of relying on the safe harbor.

Interconnected VoIP providers face a much greater regulatory impact as they are being

⁹ *Id.* at § 3(c).

¹⁰ Participants in Advocacy's Roundtable included: the Cellular Telephone Industry Association, CompTel, Council Tree, COVAD, National Telecommunications Cooperative Association, USA Datanet, National Federation of Independent Business, and the Voice on the Net Coalition.

required to contribute to the USF for the first time. Advocacy estimates there are 200 interconnected VoIP providers.¹¹ Of these 200, various analyst reports estimate that seven companies control more than 94 percent of the market, and the remaining 193 companies are likely to be small businesses that collectively serve less than 200,000 customers.¹²

Advocacy's outreach to small interconnected VoIP providers shows that the rule is already having a significant economic impact. These small providers did not object to contributing to the USF. Instead, their focus was on the administrative costs of doing so. These companies have not had to contribute to the USF before, and they are unfamiliar with the recordkeeping and paperwork required. Forms 499-Q and Forms 499-A involve significant reporting requirements, which fall heavily on small businesses.¹³ One small VoIP provider had 60 percent of its staff working on the form for two weeks. Advocacy believes that because of the small number of customers per company and the nascence of the industry, many small VoIP providers are facing similar burdens associated with the administrative costs of estimating and collecting the contributions.

Small interconnected VoIP providers have trouble identifying their telecommunications revenue for Form 499-Q and Form 499-A because they provide integrated services to customers for a flat fee. They have not set up their accounting systems to differentiate telecommunications services revenue from information service or customer premises equipment revenue. To

¹¹ Advocacy bases this estimate on the more than 200 interconnected VoIP have filed letters with the FCC describing their compliance with the Commission's E911 requirements. See generally, letters filled in response to E911 Requirements for IP-Enabled Service, *First Report and Order and Notice of Proposed Rulemaking*, WC Docket No. 05-196 (June 3, 2005).

¹² Infonetics Research, 3 Providers Dominate VoIP Subscriber Share; 24M Subscribers Expected by 2008 <<http://www.infonetics.com/resources/purple.shtml?ms05.vip.2.nr.shtml>>; Cable Digital News, North American MSOs Top 1 Million Mark for VoIP Subs <<http://www.cabledatcomnews.com/sep05/sep05-2.html>>

¹³ See generally, W. Mark Crain, *The Impact of Regulatory Costs on Small Firms* (September 2005) <<http://www.sba.gov/advo/research/rs264tot.pdf>> (In the face of higher costs of federal regulations, the research shows that small businesses continue to bear a disproportionate share of the Federal regulatory burden.)

measure these revenues requires significant changes to their accounting systems.

Form 499-Q and Form 499-A both require contributors to provide estimates of anticipating interstate telecommunication revenue. As an emerging industry VoIP is growing by leaps and bounds; the FCC estimated that the number of VoIP providers has grown from 150,000 thousand at the end of 2003 to 4.2 million at the end of 2005.¹⁴ When the industry is in this much flux, predicting future revenues for small interconnected VoIP providers is difficult because they are rolling out their services, their sale numbers are erratic, and they have limited historical experience on which to base future revenues. Predicting future revenues in this environment is difficult and involves substantial guesswork.

Once the interconnected VoIP provider has identified its telecommunications service revenue, the FCC has offered small interconnected VoIP providers three choices: contribute based on actual interstate telecommunications revenue, conduct a traffic study, or use a safe harbor rate of 64.9 percent of its total revenue.¹⁵ As the FCC stated in an earlier order and this rulemaking, it is difficult for interconnected VoIP providers to determine their actual interstate revenue.¹⁶ Traffic studies may be an attractive option, but the Commission placed an additional requirement on interconnected VoIP providers that their traffic studies must be pre-approved by the Commission.¹⁷ The Commission provided no timeframe as to when the FCC would approve a submitted traffic study. Since small interconnected VoIP providers had to start contributing by August 1, 2006, there was no opportunity to get a traffic study approved beforehand. This leaves

¹⁴ NPRM at para. 3.

¹⁵ *Id.* at para. 52.

¹⁶ *Id.* at para. 42; *See Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, Memorandum Opinion and Order*, WC Docket No. 03-211, para.2 (2004).

¹⁷ *Id.* at para 57. The Commission cites concerns with using traffic studies for estimating wireless interstate traffic. The FCC required wireless carriers to submit their traffic reports to the Commission and the Universal Service Administrative Company but did not require them to get their studies approved. Interconnected VoIP providers are required to get pre-approval or "risk extending the problems we have identified with the use of traffic studies by wireless carrier to a new technology."

small interconnected VoIP with the option of a 64.9 percent safe harbor rate, which is significantly higher than any other industry class.

The FCC required compliance with its new Universal Service contributions requirements less than a month after the rule was published in the *Federal Register*.¹⁸ This brief period to come into compliance increases the regulatory burden on small businesses. They have small staffs and do not have the institutional knowledge to comply rapidly with Federal regulations. At our roundtable, Advocacy heard one report that a small VoIP provider could not even finalize the contract to hire a company to perform the accounting necessary for compliance with the interim modifications in the time provided. Advocacy anticipates that many other small businesses are in similar situations.

3. Possible Alternatives that Could Minimize the Impact on Small Businesses.

In the initial regulatory flexibility analysis (“IRFA”), the FCC asked small entities to submit alternatives that would minimize the impact while ensuring stability and sufficiency of the USF.¹⁹ After speaking with small businesses through individual outreach and at our roundtables, Advocacy recommends that the Commission consider the following alternatives in addition to those proposed by the FCC.

Safe Harbor. Both small wireless and small interconnected VoIP providers are supportive of a safe harbor and urged that it be retained. The safe harbor is an administrative convenience that minimizes reporting requirements. The reservations about the safe harbor centered around the rates, which the small businesses believed are too high and not reflective of their traffic patterns. They recommended that the FCC consider re-evaluating the safe harbor rates, using the traffic studies or actual interstate traffic revenues as a guide.

¹⁸ The Report and Order was published in the *Federal Register* on July 6, 2006. Form 499-Q was due August 1, 2006.

¹⁹ *Id.* at Appendix F, para. 14.

Traffic Studies. Traffic studies have the potential to minimize the burdens on small businesses. But first the FCC should remove the pre-approval requirement for interconnected VoIP providers. If the FCC does not take that step, the Commission should specify a timeframe within which it will respond to a traffic study request. Small businesses at our roundtable discouraged the idea of the FCC setting specific requirements for the traffic study. Broad guidelines are best, and the FCC can use enforcement procedures if a particular traffic study is not sufficient.

Penalties for Estimates. Because small interconnected VoIP providers do not have historical data to project revenues for the coming quarter, the FCC could remove the fine for small providers who estimate incorrectly on their revenue projections for their first year or two of contributing to the USF. This would recognize the growing nature of these companies and not penalize them for falling short or exceeding predictions. The small businesses would still need to meet their contribution obligations to the USF when their actual numbers come out, so the Fund would not be destabilized.

Reporting Requirements. Advocacy also recommends that the Commission look at Form 499-A and 499-Q to see if they can be simplified or shortened. Advocacy applauds the FCC's decision to excuse small interconnected VoIP providers from the historical reporting requirements of Form 499-Q²⁰ and encourages the FCC to continue to look for means to minimize the paperwork burdens.

De Minimis Contributions. The Commission currently excuses contributors to the USF if the amount they contribute is considered *de minimis*, which is currently set at \$10,000.²¹ The FCC should consider if this is the appropriate amount or whether the *de minimis* threshold has

²⁰ *Wireline Competition Bureau Streamlines Reporting Requirements for Interconnected VoIP Providers and Announces OMB Approval of New FCC Forms 499-A and 499-Q*, DA 06-1528 (Released July 27, 2006).

²¹ 47 CFR § 54.708 (2005).

increased with inflation and other factors.

Contribution Methodology. Some participants in Advocacy's roundtable supported a numbers-based contribution methodology for contribution to Universal Service. Under this system, interstate telecommunications providers would contribute an amount determined by the total number of telephone numbers used by the provider. The principle advantage to small providers is ease in administrative use. The paperwork would be reduced to reporting the number of telephone numbers use. There would no longer be any accounting complications for what is interstate telecommunications revenue, and the safe harbor would no longer be needed. In addition, the contribution would be a predictable factor that small businesses could plan for. USF contributions would remain the same, but the administrative cost reductions would result in minimizing economic burdens.

4. Conclusion.

Advocacy urges the FCC to consider the comments from small entities and consider the regulatory impact of the Universal Service Methodology. Additional alternatives may be received through small business comments on the IRFA and the NPRM. Advocacy recommends that the FCC analyze the alternatives recommended above and other significant alternatives presented by commenters to reduce the impact on small businesses.

The Office of Advocacy is available to assist the Commission in its outreach to small business or in its consideration of the impact upon them. For additional information or assistance, please contact me or Eric Menge of my staff at (202) 205-6533 or eric.menge@sba.gov.

Respectfully submitted,

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Certificate of Service

I, Eric E. Menge, an attorney with the Office of Advocacy, U.S. Small Business Administration, certify that I have, on this August 8, 2006, caused to be mailed, first-class, postage prepaid, a copy of the foregoing Comments to the following:

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