

Testimony of

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Before

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I. INTRODUCTION

Good morning, Chairman Inouye, Senator Burns, and Members of the Subcommittee.

My name is Dorothy T. Attwood, and I am the Chief of the Wireline Competition Bureau at the Federal Communications Commission. I appreciate the opportunity to appear before you today to discuss universal service.

Universal service is a cherished principle. I am sure that all of us on this panel and everyone on this Subcommittee recognizes the importance of maintaining universal service support and achieving the goals of ensuring affordable and ubiquitous telecommunications service. Universal service ensures that consumers living in rural, insular and high cost areas have access to telecommunications services. Universal service ensures that millions of school children and library patrons, including those in many of the nation's poorest and most isolated communities, obtain access to modern telecommunications and information services for educational purposes. Through universal service, rural health care providers can provide access to high-quality medical service in rural America. Universal service also increases the availability of telecommunications services in underserved areas such as Indian tribal lands. In short, universal service ensures the delivery of telecommunications to all Americans.

II. BACKGROUND

In the Telecommunications Act of 1996, Congress directed the Commission to ensure the affordability and availability of telecommunications for all Americans. Congress mandated that

the implicit subsidies that ensured universal service in a monopoly environment be replaced with explicit, predictable, and sufficient support mechanisms. The task Congress set out for us was a monumental one, requiring a massive overhaul of the existing universal service system so that it would be sustainable in an increasingly competitive marketplace.

The Commission's initial implementation of the universal service provisions of the 1996 Act is now complete. Starting with the First Universal Service Order in 1997, the Commission created an equitable and non-discriminatory assessment methodology for contribution to universal service, and implemented the statutory mandate to provide support to schools, libraries, and rural health care providers. The Commission removed implicit support from access charges and created explicit interstate support mechanisms in two proceedings in 2000 and 2001. The Commission also reformed intrastate high cost support for all carriers, creating separate mechanisms for non-rural and rural carriers in 1999 and 2001, respectively. In undertaking these reforms, the Commission recognized the differences between the larger price cap carriers, and the rate of return carriers that typically operate in rural areas, and it proceeded in a staged fashion to minimize disruption to the smaller rural carriers.

In implementing the statutory mandate, the Commission has made certain policy choices. First, contributions to support universal service are based on interstate telecommunications service revenues. Second, we have disparate high cost support systems for rural and non-rural carriers. Third, high cost support for competitors is based on the costs of incumbents. As the marketplace evolves, each of these policy choices brings new complexities.

III. CHANGING CONDITIONS FOR UNIVERSAL SERVICE

The preservation and advancement of universal service—the goals of which remain paramount—presents significant prospective challenges. Though the Commission has done much work implementing the 1996 Act, more work needs to be done in the future.

As Congress has recognized, universal service policy cannot remain static. The Commission must reexamine its regulatory framework in light of the changing and maturing nature of the telecommunications market as a whole. The foundation of universal service needs to be refined to account for advances in technology, shifting consumer preferences, and the realities of a competitive market environment.

In doing so, first, and foremost, the Commission is guided by the principles in the 1996 Act, informed by what we know about the telecommunications market today.

Interstate revenues are decreasing. Although traditional long distance revenues grew consistently between 1984 and 1997, they are now in a period of steady decline. A variety of factors are responsible. First, new carriers are entering the long distance market, bringing aggressive price competition that benefits consumers, but also drives down overall interstate revenues.

Second, wireless substitution is increasing. Consumers are substituting new mobile services for traditional wireline services such as payphones and second lines to the home. A

small but growing number of customers have substituted mobile wireless for their primary residential lines. Many consumers now use their wireless service rather than traditional wireline interexchange service to make long distance calls. According to one report, 16 percent of customers now make most of their long distance calls using mobile services, which may skew the balance of universal service contributions.

And third, companies are marketing innovative bundled packages of service that blur service category lines. For example, carriers increasingly are bundling services together in creative ways, including offering flat-rate packages that include both local and long distance services. Carriers also are offering bundled packages of telecommunications services and customer premises equipment and packages with telecommunications and information services, like broadband Internet access.

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

The Commission is up to this task. The realities of the maturing telecommunications market require us to consider how, for instance, we can ensure that the collection of funds to support universal service does not favor one class of carriers or one technological platform over

another. As a related matter, the Commission must consider how to maintain universal service as traditional communications services migrate toward delivery over convergent broadband platforms. In this changing environment, the Commission also needs to refine its thinking on how to provide sufficient support to eligible providers in order to ensure nationwide access to quality services in rural areas at rates comparable to those in urban areas. Inasmuch as these are significant challenges, the changed landscape does afford the Commission the opportunity to promote universal service objectives in economically sound ways.

Again, the Commission is guided above all by the statutory text. The paradigm we are developing rests on a few core concepts.

First, the competitive telecommunications market requires a more sophisticated targeting of universal service support than in a monopoly environment. This support needs to be sufficient, but not excessive.

In addition, universal service policy should not encourage inefficient investment or preclude innovation. In other words, the Commission must be cognizant of the market distorting effects of universal service support and target support in a manner that reduces the impact of this distortion.

Finally, universal service must be maintained as technology and markets evolve. The Commission's framework must be flexible so it can accommodate legal, technological, and market developments that we cannot even foresee.

IV. A NEW PHASE IN UNIVERSAL SERVICE POLICY

In sum, the Commission is entering a new stage in the development of universal service policy. With implementation of the 1996 Act complete, the Commission's current task is to reexamine and reassess the foundation it has built in order to ensure the preservation and advancement of universal service in the modern telecommunications marketplace. Throughout this endeavor, we seek to work closely and collaboratively with our state colleagues and industry stakeholders.

The Commission already has begun to take on these issues in a new set of foundation proceedings. By examining universal service issues in these vehicles and others that will be introduced before the end of the year, the Commission will incorporate its understanding of the evolving market in an updated framework consistent with the basic principles in the 1996 Act.

In May 2001, the Commission began a proceeding to revisit its universal service contribution methodology. This system has two distinct but related components: the assessment of contributions on telecommunications providers and the recovery of contribution payments by providers from their customers. Contributors are assessed on the basis of their interstate and international end-user telecommunications revenues, based on a percentage or "contribution

factor" that is calculated every quarter. Because interstate revenues are declining, the contribution factor—which carriers typically pass along as a line item on consumer bills—has increased over time. Consumers understandably are frustrated with these growing charges.

The Commission must work to ensure that our contribution system is both equitable and non-discriminatory. To this end, in February 2002, the Commission requested comment in a Further Notice on a specific industry proposal to replace the existing, revenue-based assessment mechanism with one based on the number and capacity of connections provided to a public network, and refreshed the record on other proposals. We have received a voluminous record, and will be holding a public forum to further develop the record on these pending proposals later this week.

The Commission intends to adopt a new foundation for contribution methodology before the end of this year. In the interim, the Commission has acted to stabilize the contribution factor for consumers by using unused funds from the schools and libraries program to decrease the upward pressure on consumer line items caused by declining interstate revenues.

In February 2002, the Commission also initiated a foundation proceeding concerning universal service and broadband technology. Universal service has historically been based on the assumption that consumers use the network for traditional voice-related services and that those voice services are provided over circuit-switched networks. As traditional services migrate to broadband platforms, the Commission must assess the implications for funding universal

service and determine how to sustain universal service in an evolving telecommunications market. At the same time, the Commission must seek to avoid policies that may skew the marketplace or overburden new service providers. Thus, the proceeding seeks to answer the fundamental question: in an evolving telecommunications marketplace, should facilities-based broadband Internet access providers be required to contribute to support universal service?

In addition, the Commission has underway foundation proceedings to streamline and strengthen the universal service support mechanisms for schools and libraries and rural health care. As with other areas of universal service policy, the Commission seeks to ensure the continued efficient and effective implementation of Congress's goals as established in the statute, while taking into account the evolving nature of the telecommunications market.

Finally, the Commission also intends to initiate other proceedings later this year that will examine other critical universal service issues. In particular, the Commission intends to begin a foundation proceeding to take a look again at the nature and level of support for competitive industry providers, whose costs may differ from those of incumbent carriers. As part of its comprehensive high cost review, the Commission also intends to begin the complex process of examining the disparate rural and non-rural support mechanisms, so that we can ensure our universal service framework is resilient over time.

I would like to thank you, Mr. Chairman, for the opportunity to appear before you today. I look forward to working with you and other Members of this Subcommittee on these important universal service policy issues. I would be pleased to answer any questions you might have.