

THE FUTURE OF UNIVERSAL SERVICE

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

OCTOBER 30, 2003

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ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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THE FUTURE OF UNIVERSAL SERVICE

THURSDAY, OCTOBER 30, 2003

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m. in room SR-253, Russell Senate Office Building, Hon. Conrad Burns, presiding.

OPENING STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. Good morning. Today we'll hear testimony about the Universal Service Program which is an extremely high priority.

The Committee faces the stark reality that Universal Service is in grave and immediate danger. The size of the fund has exploded upward from \$1 billion in 1996 to \$6.3 billion in 2003. Interstate revenues have plunged dramatically, however, from over \$20 billion a quarter to only \$17 billion a quarter, so we've got a drastic drop.

The FCC has dealt with this decline by simply increasing the contribution rate assessed to providers of interstate telecommunications services from 3.9 percent in 1998, to 7.3 percent in the second quarter of 2002, to the current rate of 9.2 percent. Simply put, this trend is unsustainable.

To address the crisis facing Universal Service, Senator Dorgan and I have recently hosted two very informative Universal Service summits in which we heard from a broad cross-section of the parties interested in Universal Service and its reform. The summit provided an outstanding opportunity for a frank and open exchange with good give and take, and they were candid, and I felt all the stakeholders were at the table.

To the extent that it's possible to boil down what we heard at the session and put it into a simple message, it is this. The status quo system is fundamentally broken, and without reform the Universal Service system is in peril. Having identified the problem and the urgent need to resolve it, the question is what we do to replace the current assessment mechanism.

At the summit, participants suggested that we move to a system based on total revenues, to a system based on connections, to a system based on assigned working telephone numbers. The Federal-State Joint Board unanimously recommended a solution to us, with the legislation granting the Commission authority to include intra-state revenue in its fund support base. I understand that Chairman Powell strongly supports this move, which would provide for the near-term stabilization of the fund, but I'm not going to put words in his mouth.

To this end, I've been working on draft legislation with my colleagues that would grant the Commission the authority while ensuring that it move forward and complete an overall plan within the next 6 months. In my view, the touchstones for reform must include competitive and technological neutrality, predictability, and sustainability.

I understand that the Commission's agenda over the next year has been crowded with vital issues, which have deservedly occupied a great deal of its time and resources; however, Universal Service reform needs the same attention that has been devoted to crafting items in those other important proceedings.

Finally, we need to ensure that any solutions which ultimately range from the decisions surrounding Universal Service reform bear in mind that the ever-changing technology landscape changes every day. The devices that our citizens use to communicate with one another today may not be the instruments of tomorrow. In this context, the shift to new technology, such as Voice over Internet Protocol is particularly critical.

Clearly, the Members of this Committee care a great deal about Universal Service and will do everything it takes to ensure its viability. Rural America can afford no less.

And I welcome the Chairman here today, and I look forward to his testimony. And now, Senator Stevens, the Chair recognizes you.

**STATEMENT OF HON. TED STEVENS,
U.S. SENATOR FROM ALASKA**

Senator STEVENS. Thank you very much, Mr. Chairman. I hope not to carry forward your prediction.

[Laughter.]

Senator STEVENS. We've got to go to a vote on the floor now, and as soon as that's over I will have to go back to the appropriations process. I do have, as you know, a great interest in the subject of Universal Service. And working with my staff, we've developed a set of principles we believe are important to us, as Alaskans. So I just thought I'd like to put that in the record, particularly while the Chairman is here, and it'll be short. So I hope we'll be able to hear the Chairman's comments.

I believe we should direct the FCC to conduct a rulemaking to require all users of public telephone switched networks, long distance, local companies, cellular, satellite, cable, Blackberry, Voice over Internet, to contribute to the Universal Service Fund in some manner and authorize the FCC to consider interstate revenues, telephone numbers, and individual identifiers in a way that will provide competitive neutrality.

We should direct the FCC to develop a national standard for determining who is an eligible telecommunication carrier, with specific timelines. We should allow cell phone companies who would pay more into the system with either an interstate revenue or a telephone number system, to get additional price support to expand cell phone towers into rural areas. Allow cable and high-speed Internet providers as well as Blackberry-type networks, who would be paying in, to receive support for expanding their high-speed networks into rural America. Direct the FCC to develop a procedure to be used by the states to begin reining in the Universal Service

Fund in any market with two or more carriers. The Universal Service Fund should be limited overall, or new carriers could be denied entry. Require new eligible telecommunications carriers to qualify for high-cost support when the loop is over \$24 in cost, based upon their own cost, not derivatively through incumbents' costs.

Those are very basic, but we're getting down to the point where we're going to have to make some basic decisions. I believe the Universal Service Fund cannot continue much longer with one major portion of the industry paying in and so many receiving funds out or finding ways to avoid being included in the future. There seems to me to be too much attention given to how to avoid paying Universal Service Funds, rather than how to make it a universal system that's fair and competitively neutral for all.

I look forward to being with you.

Senator BURNS. Thank you, Mr. Chairman. I appreciate that. And your suggestions are well taken as we work on this fund.

Senator Dorgan?

**STATEMENT OF HON. BYRON L. DORGAN,
U.S. SENATOR FROM NORTH DAKOTA**

Senator DORGAN. Mr. Chairman, thank you very much. Chairman Powell, thank you for being here today.

Mr. Chairman, I have worked with you and the Senator from Alaska, Senator Stevens, on this issue. The issue of Universal Service is very, very important to rural areas of the country, to rural states especially. When we wrote the legislation in 1996, we created a Universal Service that we said, at that point, would provide comparable service at affordable and comparable rates.

Now, after 7 years of neglect—and I go back all the way to the FCC at the start of the development of the new law and the administration of the new law—the Universal Service Program is in significant trouble. We find that the contribution base is in decline, the industry is in the midst of a digital transformation, and that transformation is challenging regulatory rules and challenging, in many ways, the way we think about all of this. But while I think this migration to digital has been a great success for consumers, as new forms of communications—cell phones, e-mail, instant messaging, voice over the Internet—are invented and popularized, they present some real new challenges for us, as well.

And I agree with you, Mr. Chairman, that we should not stunt the growth of progress in the migration to the advanced networks from the circuit-switched networks. I don't think we ought to try to stunt the growth of that, but we have to embrace the change and be flexible about how we deal with it. But none of that, in my judgment, means that we should ignore, or can ignore, the issues of Universal Service, because Universal Service is central to the question of whether we have a system of communications in this country that provides opportunities to all.

The fact that there is a telephone in Regent, North Dakota, my little hometown, makes Donald Trump's telephone more valuable. Doesn't mean he's ever going to call Regent, but it means that his telephone instrument on his desk in New York City is made more valuable because someone in Cutbank, Montana, has a telephone

that he can call if he wants to. That's the universality of service that all of us care a great deal about.

Now, I will not repeat what my colleague from Alaska said. I don't know what my colleague from Montana said. I could hardly even guess, as a matter of fact.

[Laughter.]

Senator DORGAN. At least sometimes you can hardly guess. But I suspect both of them have covered, in some detail, the need to broaden the base. I know I heard my colleague from Alaska say that.

We need to find a mechanism to broaden the base so that we have the resources necessary to have a Universal Service system that works. And does that mean finding a new collection mechanism? Does it mean doing as the Joint Board has suggested, including intrastate revenues in the contribution base? Is that enough? Or should the contribution base be broadened to include services like DSL, cable modems, VoIP?

We really need, finally, to put all the spotlights on the same spot here and get an answer. We just can't any longer linger for 12 months, or 24 or 36 months, and keep watching this problem grow larger and see that solutions are not coming.

So, Mr. Chairman, you have, I think, a significant burden here, as well. We do, in Congress. We need, together, to solve this problem, and I hope that a year from now, or 2 years from now, we're not here still talking about this problem. I think we will have taken whatever decisive action is necessary to fix that which is wrong, and we know that this fund is in decline, we know that that can't continue, and we know that we have to put these pieces together and make it work.

Once again, just finally, I'm pleased that Senator Burns, Senator Stevens, and I have held two gatherings, summit gatherings, with stakeholders in all of this, and I think it's been a great exchange of information. I'm very pleased by the leadership of my colleagues, and I look forward to the rest of this hearing.

Senator BURNS. Well, Senator Dorgan, I want to thank you. I think you and Senator Stevens, in those summits, I think we come out of there with a very good exchange of information. And really, under those circumstances, wish it could have been a broader representation of the Senate. But, nonetheless, I think they were very good.

Senator Brownback?

**STATEMENT OF HON. SAM BROWNBACK,
U.S. SENATOR FROM KANSAS**

Senator BROWNBACK. Thanks, Mr. Chairman, and thank you for holding the hearing. And, Chairman Powell, good to see you. I enjoyed visiting with you on the phone yesterday. I suppose in the future we'll visit over the Internet with the way things are converging and taking place.

I just want to add my voice to the chorus. I agree with the things that I've heard said here today. The Universal Service Fund is very important to my state, but we're seeing explicit and implicit portions of it are under tremendous strain, a shrinking pool of resources, increase in demand. We're seeing the convergence in inter-

platform competition that was promised by the Telecom Act of 1996 that a lot of people think has been a long time in coming, but we're seeing it, and we're now dealing with the impacts of that. This is one of the areas that we're going to have to deal with.

I do look forward to working with the Chairman, Chairman Stevens and Senator Dorgan and others, in earnest on discovering and implementing reform on the Universal Service Fund, including contribution and distribution methodologies and ways of ensuring competition and Universal Service are no longer at odds with each other. And I think we're really going to have to look at that comprehensive reform that others have already spoken about, and I look forward to joining in that effort.

Thanks, Mr. Chairman.

Senator BURNS. Thank you, Senator Brownback.

Senator Sununu?

**STATEMENT OF HON. JOHN E. SUNUNU,
U.S. SENATOR FROM NEW HAMPSHIRE**

Senator SUNUNU. Thank you, Mr. Chairman. And welcome, Chairman Powell.

I'm interested in this issue, obviously, because it has a big impact on the future of the telecommunications industry, but I'm also trying to ensure that, as we look at the issue, we approach it from a sense of consistency and fairness, not just in an arbitrary way that's driven by our desire to get our hands on more revenue.

The phrase was used that "the fund is in decline." I don't necessarily agree with that. Certainly the revenue base, the size of the revenue base, may be in decline, and the rate of assessment may be increasing, but, you know, I think the phrase "the fund is out of control" is maybe more appropriate.

In an age where the cost of transmitting data and the cost of service and the cost of bandwidth is declining at a significant rate, the cost of the fund has increased 300 percent in just 6 years. Now, that may well be partly due to the way that the legislation was written, the number of mandates that we've put onto the fund, and I think that's what we need to look at. We shouldn't just be approaching this from a sense of, "We need more money. We wrote a lot of regulations requirements mandates into the law that are costing a lot of money, so let's find a way to increase the taxes on telecommunication." I think that could well be counterproductive if you broaden the base, but in the long run leave all the mandates, all the requirements in place, all the complexity in place, and do nothing to rationalize the system, then you may well be hurting those people in rural parts of the country that are trying to get access to modern services.

So I think we need to look at the Universal Service Program, first, from the perspective of what are we trying to accomplish, and ask the question of whether legislation that was written only 8 years ago is really appropriate for the telecommunications industry and the goals of the fund five or 10 years from now, because times certainly are a-changing.

Thank you, Mr. Chairman.

Senator BURNS. I don't think there's anybody on this Committee that doesn't understand that we have to take a look at the fund

itself and how it makes disbursements, along with the running base.

Chairman Powell, thank you for coming this morning, and we look forward to your testimony.

**STATEMENT OF HON. MICHAEL K. POWELL, CHAIRMAN,
FEDERAL COMMUNICATIONS COMMISSION**

Mr. POWELL. Thank you, Senator, in your capacity as the Chair. I'm pleased to be here with you. Senators, it's always a pleasure to be here on this important topic.

Providing high quality telecommunications services to all Americans at affordable rate is unquestionably a cornerstone of the Telecom Act. The act directed the FCC to advance two critical objectives, to open local markets to competition and to preserve and advance universal service.

To promote these dual goals, the FCC is currently reexamining virtually every aspect of the Universal Service Program to ensure that the program is administered efficiently and remains sustainable as it confronts widespread marketplace and technological developments that have occurred since the Commission first adopted its rules.

We are in the throes of major changes in communications. And as I've discussed with this Committee before, the telecom industry has embarked on a great digital migration. Traditional telecommunications services are migrating from old circuit-switched networks to new and advanced Internet protocol networks. The demand pull of consumer choice and technological push of network innovation mean that this migration is inevitable. Indeed, regulators cannot stop it, nor should we want to, for it promises new competitive choices and spellbinding innovation for consumers. Our efforts to reform the Nation's Universal Service Program must embrace change and provide sufficient forward-looking flexibility to ensure that supported services remain affordable and ubiquitous.

Digital migration should not be seen as a threat to our universal service objectives, but an opportunity. Indeed, the fact that schools and libraries program has succeeded in connecting 99 percent of public schools is an example of universal success in the digital age.

And there is good news among the many challenges for advancing our goals of ubiquity and affordability. As Senator Sununu mentioned, new technology can reduce the cost of providing supported services, particularly in the higher cost areas of our country. The introduction of technologically advanced lower-cost networks also can have a disciplining effect on the high cost of the fund over time, thereby limiting the burden on our policies that it places on consumers.

Deployment of network infrastructure to high-cost areas directly benefits consumers. And as many of you are aware, a high-quality network can serve as the basis for economic development and job creation in rural America.

However, as we progress further in our digital journey, we will have to confront significant challenges, both in the short and long term. Fully recognizing this challenge, the FCC is currently examining every aspect of the Universal Service Program to ensure that

it is administered effectively and remains sustainable as major marketplace and technological developments take root.

At the center of the effort, as I have mentioned, are the goals of ubiquity and affordability. And to advance those goals, we must do a number of critical things.

First, we must reform the FCC's contribution methodology for collecting Universal Service funds to address changes in the market and to ensure a more stable funding base. Several trends have put pressure on the contribution factor. Interstate revenues have been flat or in decline since 1999 as a result of price competition, bundled packages, and technology substitution. Moreover, expanding the base to include interstate revenues may, indeed, be needed to stem the declining tide.

Second, we must control the growth of the Universal Service Fund, mindful that consumers ultimately are the ones that pay for achieving our Universal Service objectives. Particularly, we need a more rational method of distributing Universal Service support that promotes competition, but preserves the fund. To this end, the Joint Board will very soon make recommendations to the Commission on ETC eligibility and portability, two of the objectives that I think Senator Stevens mentioned in his principles at the outset.

Third, we must improve the administration of our vast and sometimes unnecessarily technical rules in many of our programs. Clarifying and simplifying eligibility criteria in the schools and libraries program, Rural Healthcare Program, and low-income programs has been a priority. Indeed, at our next meeting, in November, we will present to the Commission an item that will advance the important homeland security and public safety interests of rural America by unlocking funds that Congress has designated for rural healthcare providers.

And, finally, we must continue to diligently enforce the Universal Service rules that are currently on the books if we are to sustain Universal Service in a digital age, as well as maintain the accountability of these programs. Our recent enforcement activities are designed to ensure that every responsible entity pays their fair share. And today I'm actually quite happy to announce that because of stepped-up enforcement efforts at the Commission, the contribution factor for the first quarter of next year is likely to drop below 9 percent, as opposed to increase to near 10 percent, as was once feared.

But to get things right, unquestionably this has to be a joint effort, a joint effort of Congress, the FCC, and state commissions. Recently, Senator Burns, in partnership with Senators Stevens and Dorgan, have hosted a second industry summit on Universal Service in an attempt to find consensus on the critical question of which contribution methodology will best support the statutory goals. The summits, which have been very well attended, play a critical role in informing the debate and reaching fair and equitable solutions. And I really want to thank the Senators for their leadership on this issue, and look forward to partnering with them as we solve these problems.

I thank you for very much for your indulgence this morning, and I look forward to your questions.

[The prepared statement of Mr. Powell follows:]

PREPARED STATEMENT OF HON. MICHAEL K. POWELL, CHAIRMAN,
FEDERAL COMMUNICATIONS COMMISSION

Summary

Providing high-quality telecommunications services to all Americans at affordable rates is a cornerstone of the Telecommunications Act. The 1996 Act directed the FCC to advance two key objectives—opening local markets to competition and preserving and advancing universal service. To promote these dual goals, the FCC is currently reexamining nearly every aspect of the program, to ensure that the program is administered efficiently and remains sustainable as it confronts widespread marketplace and technological developments that have occurred since the Commission first adopted its rules.

We are in the throes of major changes in communications. As I have discussed with this Committee before, the telecommunications industry has embarked on a great Digital Migration. Traditional telecommunications services are migrating from old circuit-switched networks to new and advanced Internet protocol networks. The demand pull of consumer choice and technological push of network innovation mean that this migration is inevitable. Indeed, regulators cannot stop it, nor should we want to for it promises new competitive choices and spell-binding innovation for consumers. Our efforts to reform the Nation's universal service programs must embrace change and provide sufficient, forward-looking flexibility to ensure that supported services remain affordable and ubiquitous.

Digital migration should not be seen as a threat to our universal service objectives, but an opportunity. Indeed, the fact that our Schools and Libraries program has succeeded in connecting 99 percent of public schools to the Internet is an example of universal service success in the Digital Age. And there is good news, among the challenges, for advancing our goals of ubiquity and affordability. New technology can reduce the costs of providing supported services, particularly in the higher-cost areas of our country. The introduction of technologically advanced, lower-costs networks also can have a disciplining effect on the high-cost fund over time, thereby limiting the burden our policies place on consumers. Deployment of network infrastructure to high-cost areas directly benefits consumers, and as many of you are aware, a high-quality network can serve as the basis for economic development and job creation in rural America.

However, as we progress further in our digital journey, we will have to confront some significant challenges in the short and long term. Fully recognizing this challenge, the FCC is currently reexamining nearly every aspect of the universal service program to ensure that the program is administered effectively and that it remains sustainable as major marketplace and technological developments take root.

At the center of our efforts to reform universal service are the goals of ubiquity and affordability. To advance these goals, we must do a number of critical things.

First, we must reform the FCC's contribution methodology for collecting Universal Service Funds to address changes in the market and to ensure a more stable funding base. Several trends have put pressure on the contribution factor: Interstate revenues have been flat or in decline since 1999 as a result of price competition, bundled packages and technology substitution. Moreover, expanding the base to include intra-state revenues may be needed to stem the declining tide.

Second, we must control the growth of the Universal Service Fund, mindful that consumers ultimately pay for achieving our universal service objectives. Particularly, we need a more rational method of distributing universal service support that promotes competition, but preserves the fund. To this end, the Joint Board will soon make recommendations to the Commission on ETC eligibility and portability.

Third, we must improve the administration of our vast and sometimes unnecessarily technical rules in our programs. Clarifying and simplifying our eligibility criteria in the Schools and Libraries program, Rural Health Care program and low income programs has been a priority. Indeed, at our November meeting, I will present to the Commission an item that will advance the important homeland security and public health interests of rural America by unlocking the funds that Congress designated for rural health care providers.

And, finally, we must continue to diligently enforce the universal service rules that are currently on the books if we are to sustain universal service in a digital age, as well as maintain the accountability of these programs. Our recent enforcement activities are designed to ensure that every responsible entity pays their fair share. I am happy to announce that because of our stepped up enforcement efforts, the contribution factor for the first quarter of next year likely will drop below 9 percent, as opposed to increase to 10 percent as was feared.

To get things right, this must be a joint effort of Congress, the FCC and the State Commissions. Recently, Senator Burns, in partnership with Senator Stevens and

Dorgan, hosted a second industry summit on universal service in an attempt to find consensus on the critical question of which contribution methodology will best support the statutory goals. The summits, which have been very well attended, play an important role in informing the debate and reaching fair and equitable solutions, and I thank the Senators for their leadership on this issue.

Thank you and I look forward to your questions.

Good morning, Mr. Chairman and distinguished members of the Committee. It is my pleasure to come before you today to discuss the Federal Communications Commission's (the "FCC" or the "Commission") efforts to preserve and advance universal service.

Introduction

Providing high-quality telecommunications services to all Americans at affordable rates is a long-held telecommunications policy goal and a cornerstone of the Telecommunications Act of 1996 (the "1996 Act"). The 1996 Act directed the FCC to further two key objectives—opening local markets to competition and preserving and advancing universal service in high-cost areas. Section 254 of the 1996 Act represents this country's shared social policy of ensuring ubiquitous and affordable service. Seven years after the passage of the 1996 Act, the Commission remains committed to furthering both these goals.

We are in the throes of major changes in communications. As I have discussed with this Committee before, the telecommunications industry is immersed in a great Digital Migration. Traditional telecommunications services are migrating from old circuit-switched networks to new and advanced Internet protocol networks. The demand pull of consumer choice and technological push of network innovation mean that this migration is inevitable. Indeed, regulators cannot stop it, nor should we want to for it promises new competitive choices and spell-binding innovation for consumers. Our efforts to reform the Nation's universal service programs must embrace change and provide sufficient, forward-looking flexibility to ensure that supported services remain affordable and ubiquitous.

Too often regulators and carriers alike try to conform the new to the old, whether for competitive reasons or simply because it is familiar. In cooperation with our state colleagues, we must evolve our universal service programs to be in sync with the exciting, and unstoppable, changes in the competitive digital communications landscape.

Digital migration should not be seen as a threat to our universal service objectives, but an opportunity. There is good news, among the challenges, for advancing our goals of ubiquity and affordability. New technology can reduce the costs of providing supported services, particularly in the higher-cost areas of our country. The introduction of technologically advanced, lower-costs networks also can have a disciplining effect on the high-cost fund over time, thereby limiting the burden our policies place on consumers. Deployment of network infrastructure to high-cost areas directly benefits consumers, and as many of you are aware, a high-quality network can serve as the basis for economic development and job creation, two things that are sorely needed in rural America.

However, as we progress further in our digital journey, we will have to confront some significant challenges in the short and long term. Fully recognizing this challenge, the FCC is currently reexamining nearly every aspect of the universal service program, not only to ensure that the program is administered as efficiently and effectively as possible and that the overall program remains sustainable, but also in response to widespread marketplace and technological developments that have occurred since the Commission first adopted its rules.

At the center of our efforts to reform universal service are the goals of affordability, ubiquity and sufficiency. To meet these goals, we must do a number of critical things:

- First reform the FCC's contribution methodology for collecting Universal Service Funds to address changes in the market.
- We must control the growth of the Universal Service Fund, mindful that consumers ultimately pay for achieving our universal service objectives.
- We need a more rational method of distributing universal service support to promote competition, but preserve the fund.
- We must streamline the administration of our vast and sometimes unnecessarily technical rules in this area.

- And, finally, we must continue to diligently enforce the universal service rules that are currently on the books if we are to sustain universal service in a digital age.

To get things right, this must be a joint effort of Congress, the FCC and the State Commissions. Recently, Senator Burns, in partnership with Senators Stevens and Dorgan, hosted a second industry summit on universal service in an attempt to find consensus on the critical question of which contribution methodology will best support the statutory goals. The summits, which have been very well attended, play an important role in informing the debate and reaching fair and equitable solutions, and I thank the Senators for their leadership on this issue.

II. Background on Current Universal Service Programs

As always, the Commission's work in the universal service arena is guided by the public interest and the principles set out by Congress in the 1996 Act. Section 254 of the 1996 Act directs the Commission to base universal service policies on several fundamental principles, including: (1) promoting the availability of quality services at just, reasonable, and affordable rates; (2) increasing access to advanced telecommunications and information services throughout the Nation; and (3) providing comparable access to telecommunications services to all consumers, including those in low income, rural, insular, and high-cost areas. In addition, the 1996 Act expanded the scope of universal service by directing the Commission to establish support mechanisms for schools and libraries and for rural health care facilities for advanced services.

In its present form, universal service consists of several programs which provided some \$5.96 billion in support in 2002 and are projected to provide some \$6.34 billion in support in 2003. The largest part of the fund goes to support service in high-cost areas. The monopoly environment once enabled regulators to promote universal service by building implicit subsidies into local and long distance rate structures. In a competitive environment, however, these implicit subsidies cannot be sustained, since the monopoly era rates that provided surplus funds—such as business rates in urban areas—are undercut by new entrants and are driven towards a cost-based level. In the 1996 Act, Congress directed the FCC to adopt explicit support mechanisms that would be sufficient to ensure that rates remain affordable and reasonably comparable throughout the Nation.

High-cost Programs

Accordingly, the FCC's high-cost mechanisms provide support to eligible telecommunications carriers for a portion of the costs of providing telephone service in rural and high-cost areas where such services otherwise might be prohibitively expensive. In 2002, approximately \$2.9 billion in high-cost support was provided to approximately 1,500 carriers in all 50 states, American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands. In 2002, Alaska, Wyoming, Montana, and North Dakota were among the top five states, in terms of amount of Federal high-cost support per line received.

Schools and Libraries Program

The schools and libraries program, or the E-Rate program, provides discounts to eligible schools and libraries for telecommunications services, internal connections, and Internet access. The program provides up to \$2.25 billion in annual support and has enabled millions of school children and library patrons to gain access to advanced telecommunications services, internal connections, and Internet services. As a direct result of the e-rate program, 99 percent of America's schools are connected to the Internet.

Lifeline and LinkUp

Other components, the Federal Lifeline and LinkUp programs, provide discounts off monthly service charges and connection fees to ensure that low-income consumers have access to basic telephone service. This year, these programs will provide approximately \$691 million in support.

Rural Health Care

And finally, the rural health care mechanism provides support to rural health care providers. While, as many of you are aware, participation in the rural health care mechanism has fallen short of the \$400 million annual program cap, I am pleased to report that the Commission will be considering a variety of measures designed to strengthen this program at the FCC's November Open Meeting. In addition, I am going to be joined by members of Congress next week to tour a major rural health care facility to see how we can continue to improve this program.

The Commission is constantly striving to ensure that the Federal universal service programs remain effective in a changing telecommunications marketplace. Indeed, we are currently engaged in proceedings regarding nearly every aspect of the universal service program, from contribution to distribution, to ensure that each component is administered as efficiently and effectively as possible and that the overall program remains sound. As the Commission engages in our ongoing review, our commitment remains steadfast to improve and strengthen all of our support mechanisms for the benefit of all consumers—especially consumers in high-cost areas, individuals with low incomes, and patrons of schools, libraries, and rural health care facilities. I will begin by discussing one of our biggest challenges—a re-examination of how we collect the monies used to support universal service.

III. Ongoing Challenges and Proceedings

Contribution Methodology

Our first task in the area of universal service reform must be in the area of contribution methodology. The Commission collects funds for the various universal service support programs pursuant to section 254(d) of the 1996 Act. Service providers must pay a percentage of their revenues from interstate end-user telecommunications services to the Universal Service Fund. This percentage, called the contribution factor, changes on a quarterly basis depending on the demand for funding and the base of reported revenues. The contribution factor for the fourth quarter of 2003 is 9.2 percent.

Several trends have combined to put upward pressure on the contribution factor, which in turn has increased the funding burden on some consumers. While interstate telecommunications revenues grew between 1984 and 1999, they have since been flat or in decline as a result of price competition and migration to bundled services and new technologies. 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, information services such as Internet access, and customer premises equipment. Such bundling has been a boon for consumers, but has made it difficult to isolate revenues for interstate telecommunications services. Additional competitive pressures lie ahead on the technological horizon, as communications become more Internet-centric, as is the case with e-mail, instant messaging and voice over IP applications.

Because Federal universal service contributions under existing rules are assessed only on interstate revenues from end-user telecommunications services, this shrinking of the applicable revenue base has contributed to a steady, incremental rise in the contribution factor over time. And this trend is likely to continue as these new products and technologies become more and more popular.

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:

- The Commission increased the safe harbor that wireless carriers may use to determine the interstate percentage of their revenues from 15 percent to 28.5 percent.
- The Commission also adopted an interim regime that eliminated the time lag between the reporting of revenues and the recovery of contributions, which lessens the relative burden facing long distance carriers with declining interstate telecommunications revenues.
- And the Commission prohibited mark-ups of contribution costs on customers' bills to ensure that carriers cannot profit from inflated line charges (at least one major long distance carrier was assessing a "Universal Service Connectivity Charge" for residential customers of 11 percent when the relevant contribution factor was 7.28 percent).

While these are important steps, serious issues remain that the Commission must address to ensure the sustainability of universal service funding. Bundling together interstate and intrastate services and telecommunications and information services gives carriers the opportunity and incentive to understate the portion of their revenues that is subject to assessment and increases the difficulty of identifying interstate revenues. As a result, contribution factors over time are likely to continue their ascent given a contribution methodology based solely on interstate telecommunications service revenues.

The Federal-State Joint Board (the "Joint Board") has recommended that Congress amend section 254 of the 1996 Act to provide the FCC with authority to assess intrastate revenues, in addition to interstate revenues. I heartily support this rec-

ommendation. At the Commission, we have begun considering the effect such a change would have on universal service. A total revenue assessment would make it easier for carriers to identify what revenues are counted for contribution purposes. Moreover, such an assessment would be lower and more stable than one based on interstate telecommunications revenues alone, although it bears mentioning that it is still the consumer that ultimately pays for universal service, and none of the proposals reduces the overall size of the fund.

The FCC has also been contemplating whether to make substantial changes to the current methodology under existing statutory authority and is actively considering different contribution approaches. The Commission has sought comment on alternative methodologies based (in whole or in part) on end-user connections, including an approach that would collect based on assigned telephone numbers.

These approaches arguably could create a more sustainable model for continuing universal service in the future as the digital migration marches on. 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. Additionally, 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.

Critics of these proposals—including carriers that would face increased assessments based on a connections-based methodology—argue that the effect of these proposals would be to reduce significantly the contributions of long-distance carriers (which have very few assigned telephone numbers or end-user connections) in violation of the statutory requirement that all carriers contribute on an equitable and nondiscriminatory basis.

I am convinced that reform of the Commission's contribution methodology is required in the short-term if we are to ensure the sufficiency and predictability of support. To that end, I hope to forge a consensus so that this proceeding can be completed in the first half of next year. As the market for telecommunications and information services continues to evolve, I believe that a purely revenues-based contribution methodology may no longer be the best way to promote Congress's universal service mandate. Our overriding goal is to ensure that universal service funding remains stable. I have challenged the industry and the Commission's staff to continue to explore flexible and forward-thinking options that meet this test. Rest assured that the Commission will leave no option unexplored.

As more communication services move to the Internet, questions will persist as to whether information service providers should be required to contribute to the fund. Fortunately, Congress has afforded the Commission with discretionary authority to assess those that are not telecommunication service providers, but do use telecommunications. The Commission has sought comment, in the *Wireline Broadband Notice of Proposed Rulemaking*, on whether all facilities-based providers of broadband services should be subject to the same contribution obligations as providers of telecommunications services.

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 providers. The Commission accordingly sought comment on whether it should exercise its permissive authority and require all facilities-based broadband Internet access providers to contribute to the universal service mechanisms.

Throughout our analysis, of course, we must balance the needs of funding these programs against the real burden that our contribution requirements could impose on consumers if we do not manage those requirements carefully.

Distribution of Support

The incremental increases in the contribution factor have resulted not only from the shrinking of the interstate revenue base, but also from the marked increases in the demand for money from the fund. Much of the increased demand has resulted from the FCC's reform of the interstate access charge system, which has removed the implicit support in interstate access charges and created two explicit universal service mechanisms. As a result of these changes, many incumbent LECs ("ILECs") now recover costs from the Universal Service Fund that previously were recovered through access charges from long distance carriers.

This reform was required by the 1996 Act's requirement that the Commission eliminate implicit funding of universal service and create explicit funding mechanisms instead. In addition, the designation of wireless carriers and other competitors as eligible telecommunications carriers ("ETCs") is increasing program demand.

Growth on the demand side has been less of an issue with respect to the schools and libraries, rural health clinics, and low-income mechanisms, particularly since the first two mechanisms are capped under our rules, but the Commission must ensure that they remain efficient and effective as well.

High-Cost Support

1. ETC/Portability Issues

Before enactment of the 1996 Act, only incumbent LECs received universal service support. In recent years, however, wireless carriers and competitive LECs have been designated ETCs. While competitive ETCs receive a very small percentage of high-cost funds overall, their share has been increasing noticeably in the last year and there has been a coinciding surge in the number of ETC applications as competition blossoms. Indeed, there are 27 pending applications at the FCC. Competitive ETCs receive support under the “identical support” rule (also called “portable support”), which provides per-line support based on the incumbent carrier’s costs. Incumbents do not lose support when a competitive ETC captures a line, because they just receive more support per line for their remaining lines. Meanwhile, the competitive ETC gets support for every line it has as well. Rural LECs have argued that this regime creates uneconomic arbitrage opportunities and threatens the viability of universal service, while competitive ETCs generally contend that providing identical support—whether based on the ILEC’s embedded costs or based on forward-looking economic costs—is essential to competitive neutrality.

In November 2002, the Commission asked the Federal-State Joint Board on Universal Service to consider the intersection of competition and universal service in rural areas. The Joint Board, under Commissioner Abernathy’s able leadership on the Federal side and Commissioner Nan Thompson’s leadership on the state side, subsequently sought comment on several key issues, including the manner in which competitive ETCs receive support and the impact of providing support to competitive ETCs on the growth of the Universal Service Fund. The Joint Board also sought comment on the process for designating ETCs and whether the FCC should establish guidelines for consideration by the state commissions that make these determinations under section 214(e)(2) of the 1996 Act. In July, the Joint Board held a public forum on these issues, and a wide range of industry representatives, consumer advocates, and state commissioners provided valuable insights.

Parties have advanced a wide variety of proposals regarding portability in their comments and at the public forum. Several groups of ILECs argue that competitive ETCs should receive support based on their own embedded costs. Some competitive ETCs argue that incumbents and competitors should receive support based on forward-looking economic costs. One proposal to control growth would be to continue basing support for all ETCs based on the incumbent’s costs, but cap per-line support amounts upon entry of a competitor and consider supporting only a single connection per customer. ILECs generally oppose this proposal, arguing that reforming the ETC-designation process—in particular, making the public interest analysis more exacting—would suffice to keep the Universal Service Fund from growing too large.

When it has finished considering the record, the Joint Board will make its recommended decision to the FCC, which we anticipate receiving in early January 2004. I look forward to reviewing it then.

2. Support for Non-Rural Carriers

While rural carriers receive the lion’s share of high-cost funding, “non-rural” carriers (the Bell operating companies and other large LECs) also receive high-cost support. Whereas rural carriers receive support based on their embedded costs, non-rural funding is determined based on forward-looking economic costs. Non-rural carriers receive support in a particular state if the statewide average cost per line, as determined by a forward-looking cost model, exceeds the national average cost by a certain margin. Currently, non-rural carriers receive support in eight states (Alabama, Kentucky, Maine, Mississippi, Montana, Vermont, West Virginia, and Wyoming). While non-rural carriers in other states serve many high-cost wire centers, their statewide average costs are not sufficiently high to receive support. Nonetheless, rural carriers receive substantial support in each of the states for which non-rural support is unavailable under the other portion of the high-cost mechanism. Non-rural carriers in these states also receive Federal support under the interstate access support mechanism, which distributes approximately \$650 million annually to replace implicit support from interstate access charges.

I realize that this Committee is considering legislation that would alter the distribution of non-rural support. The Commission recently completed its own review of this support mechanism in response to a remand by the Tenth Circuit Court of

Appeals of an earlier FCC decision. The court ruled that the Commission had not adequately explained how the non-rural support mechanism is sufficient to enable states to set rural rates that are reasonably comparable to those in urban areas. In addition, the court directed the Commission to consider how to induce states to ensure rural and urban rate comparability within their borders, since the Federal mechanism aims primarily to mitigate cost differentials among the states and states have jurisdiction over local rates.

Here again, the Commission has taken action. I am pleased to report that at the Commission's October Open Meeting the FCC took another step toward addressing the outstanding legal challenges to the non-rural mechanism. In the Tenth Circuit Remand Order, the FCC adopted a national threshold to determine when non-rural, high-cost support should be available by balancing the legitimate state need against the risk of excessive support. Importantly, in that proceeding the Commission asked a range of questions designed to make available additional, targeted Federal support as a means of inducing states to adopt explicit support mechanisms that will be sustainable in a competitive market.

Low-Income Support

As I have described, 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. Earlier this year, the Joint Board released a Recommended Decision on proposals to bolster the effectiveness of Lifeline and LinkUp. This Recommended Decision suggests new ways for low-income consumers to qualify for support and also addresses questions regarding states' efforts to engage in outreach and to verify program eligibility. The goal of the pending rulemaking is to remove impediments to beneficiaries' receiving support while simultaneously preserving the integrity and enhancing the efficiency of the program.

As always, the Commission will also continue its universal service related outreach efforts. Announced in August of this year, "Project Heartland" is aimed at building connectivity in rural areas and specifically targets three regions for additional FCC efforts: Alaskan Native Villages, the Appalachian region and the Mississippi Delta region. The Commission will continue our work with groups such as the Appalachian Regional Commission, the Delta Regional Authority, the Alaskan Rural Development Council and the National Congress of American Indians.

Schools and Libraries and Rural Health Care Facilities

Finally, the 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). Now that the Commission has had significant experience overseeing these programs, we are considering a variety of rule changes in pending proceedings. These rulemakings, like the Lifeline/LinkUp rulemaking, aim to eliminate red tape while ensuring continued program integrity.

As I mentioned previously, at the Commission's Open Meeting on November 13, 2003, the Commission will consider an Order to modify the rural health care mechanism. This support mechanism has been underutilized, so the notice of proposed rulemaking sought comment on ways to alter eligibility requirements to eliminate obstacles to rural health clinics' receiving support, while remaining faithful to the statutory purposes. Facilitating telemedicine by connecting rural health clinics to regional hospitals and universities is perhaps one of the greatest applications enabled by advances in telecommunications technology, and it takes on added importance in light of the increased homeland security threats—including bioterrorism—that our Nation confronts today.

Enforcement

Finally, there is an important and perhaps underappreciated component of our universal service work that I would like to call to your attention. In recent months the FCC has taken significant steps to bolster its Universal Service Fund enforcement. The FCC has taken swift and decisive enforcement action against wrongdoers and has streamlined its process for identifying future violations. For example, in September, the Commission proposed a forfeiture against Globcom, Inc., a long-distance reseller, for violating the Commission's rules by failing to pay universal service contributions and to report accurate revenue information. The *Globcom Notice of Apparent Liability* is the largest forfeiture the Commission has ever proposed for such violations.

Indeed, officials at USAC report that, in the wake of our enforcement action, USAC has experienced a notable increase in entities complying with our rules by paying their fair share into the fund. Through enforcement, the Commission is ensuring that the contribution burden is spread as widely as our rules currently require. This effort has contributed directly to slowing the rapid increase in the contribution factor and may well lead to a measurable decrease in this quarter's number.

The FCC's Enforcement Bureau is also actively enforcing the Commission's new debarment rules, which establish procedures to prevent persons who have defrauded the government or engaged in similar acts through activities associated with or related to the schools and libraries support mechanism from receiving the benefits associated with that program. Finally, the FCC has developed a formalized process for coordinating and referring apparent violations of our USF rules to other government agencies, such as the Department of Justice, where appropriate.

IV. Conclusion

I would like to thank you, Mr. Chairman, for calling this hearing, and I look forward to working with you and other members of the Committee on these challenging and critical issues.

Senator BURNS. Thank you, Mr. Chairman.

And despite the Commission's early constant tinkering, we might say, the current assessment mechanism has not resulted in sufficient funds to preserve and advance these goals that you spoke of. In fact, the base of the funds that are collected are constantly shrinking, as noted by just about every Member on this Committee, and clearly the system is in bad need of expanding the base of contributors for those revenues and a system based on factors that interstate revenues and end users.

You might want to think about that. Senator Lautenberg has joined the Committee this morning. Do you have a statement, before we start the questioning here?

STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. That's very generous of you, Mr. Chairman, to permit me to do that. In order to expedite things, I'll ask that the full statement be included in the record.

Senator BURNS. Without objection.

Senator LAUTENBERG. Thank you very much.

[The prepared statement of Senator Lautenberg follows:]

PREPARED STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Mr. Chairman,

Thank you for holding this hearing on the Universal Service Fund.

"Universal service" is the Federal Government's commitment to the American people that they would have access to "a rapid, efficient, nation-wide, and worldwide" communication service with "adequate facilities at reasonable [rate.]"

We need to keep this commitment.

We all know that the Universal Service System faces increasing demands for support and that the Fund is actually growing in dollars.

Today, the Fund stands at more than six *billion* dollars, compared to just 1.7 billion in 1997.

While this indeed is a lot of money, Universal Service's funding base—fees and charges assessed on interstate and international end user telecommunication revenues—continues to decline.

In 2001 and 2002, the universal service funding base declined by an average of 8 percent per year.

The decline in universal service's funding base will continue unless we stop carriers from finding ways to avoid contributing to the Universal Service Fund.

I would like to briefly point to two specific funds within the Universal Service Fund that I believe are critically important to all Americans, particularly people in my part of the United States.

First, the low income support fund is very important to children, single mothers and low income families in high-cost of living areas, like my home state of New Jersey.

Second, "E-Rate" fund is important to thousands of school and libraries throughout America. I know there have been some problems with the problem, but the goals and contribution of the E-Rate funds to school and libraries are worth preserving.

So while we discuss the future of the Universal Service Fund, we should keep the long-term viability and proportionate funding of these two important programs intact.

Thank you, Mr. Chairman. I look forward to hearing from our witness.

Senator BURNS. Senator Smith, of Oregon, thank you for joining us this morning. Do you have a statement?

**STATEMENT OF HON. GORDON H. SMITH,
U.S. SENATOR FROM OREGON**

Senator SMITH. I do, Mr. Chairman. And, if I may, I'd actually like to present it, because I think it's very important to this hearing.

And so I thank you for holding this hearing on the Universal Service Program. I believe it's a critical issue to rural America. In my opinion, universal service strikes at what is good about our form of government. It's a partnership between government and private sector to ensure that families in all parts of America have access to basic telecommunications service to improve their quality of life and provide economic opportunity. And it's fundamentally about fairness. Rural Americans are entitled to telephone service at fair rates and quality, as compared to telephone service provided in cities.

But the Universal Service Program has challenges. The revenue base, as you've noted, is declining, while demands for funds are growing. And I think fundamentally what my testimony says is that we are not meeting the test of fairness and equity.

I'll try to abbreviate, Mr. Chairman, because I want to point out that the Chairman of this Committee, his state of Arizona, his telephone users pay \$4 million into this fund, and yet they don't receive one dime from this. Not one dime. Residents of South Carolina, the Ranking Member, South Carolinians pay three million into this non-rural program. They get nothing in return. Texas pays nearly \$13 million into the non-rural program, and they get nothing back. Residents in New Hampshire pay more than one million and receive nothing. Virginia, they pay six million and receiving nothing. Louisiana pays \$2.5 million into the non-rural fund and get nothing back. In my state of Oregon, we pay \$2.5 million into the non-rural fund. We receive nothing in return. Yet Oregon has many remote rural areas, just like Montana does.

Mr. Chairman, I would ask, in the interest of time, that my whole statement be included in the record.

Senator BURNS. Without objection.

[The prepared statement of Senator Smith was unavailable at time of printing.]

Senator SMITH. But I think it is critical that S. 1380, the bill I've introduced with Senator Bayh, of Indiana, at a minimum be adopt-

ed by this Committee, and ask that our chairman help us figure out how to make this fair.

There are three states that receive money from this, significant money. Eighty-five percent of the United States get nothing, and that cannot be fair.

And so I don't want to take all of the time this morning, but my plea to Chairman Powell is to help us to fix a program that is clearly broken. It is also to address the concerns some may have that we have a broader approach to solving this problem. That may take a long time, and, frankly, we need to fix this soon.

All you have to do to see where the money is going, it's going to Mississippi, Alabama, and West Virginia. Eighty-five percent of the money is going to those three states. And a few states—Montana gets a little, Wyoming gets a touch, Kentucky, New Hampshire, Maine, or rather Vermont, not New Hampshire. The rest of the states, all of which have rural areas, all of which have ratepayers paying into the program. They get absolutely nothing for this. And I just think that that is a mistake, and the evidence is behind me, and we ought to fix it.

Thank you, Mr. Chairman.

Senator LAUTENBERG. Mr. Chairman.

Senator BURNS. OK. Senator Lautenberg?

Senator LAUTENBERG. We have spent \$1.7 billion in 1997. And while this is, indeed, a lot of money, Universal Service's funding-base fees, charges assessed on interstate and international end-user telecommunication revenues, continue to decline. In 2001 and 2002, the Universal Service funding base declined by an average of 8 percent per year. The decline in the service base, the funding base, will continue unless we stop carriers from finding ways to avoid contributing to the Universal Service Fund.

And I'd like to briefly point to two specific funds within the Universal Service Fund that I believe are critically important to all Americans, and particularly people in my part of the country. First, the low-income support fund, very important, children, single mothers, low-income families in high cost-of-living areas, like my home state of New Jersey. Second, the e-rate fund. It's a critically important fund at thousands of schools and libraries throughout America. And I know there have been some problems with it, but the goals and the contribution of the e-rate funds to schools and libraries are worth preserving. So while we discuss the future of the Universal Service Fund, we should keep the long-term viability and proportionate funding of these two important programs.

And I'm quick to mention, since we, in New Jersey, are noteworthy, about the difference that we generally get back on the dollars we send down to Washington. We're about 49th in return on those dollars, and, in particular, with all the Universal Service funds, we sent in 219 million, and we got back 43 for our poor and remote people. We have them, in New Jersey. We have—unfortunately, every state has them, but we have more than our share.

So, Mr. Chairman, I thank you very much and commend you for holding this hearing, and I enjoyed hearing from the commissioners.

Senator BURNS. I'm going to recognize Senator Stevens. He's got other duties to perform over in Appropriations. And so I'd recognize the Senator at this time.

Senator STEVENS. Well, I do appreciate the comments that the Chairman has made, but I think it would be good for us to focus a little on history here before we go into the question of what should be the future of the fund.

When I came to the Senate, for instance, in Alaska, the Army provided all of the service for telephones in Alaska. It was completely a government system. We traveled through to a private system. And Hawaii at that time had a very poor system. Senator Inouye and I asked for a concept of equalization of costs. "Rate integration" is what we called it. And that started a concept of developing a fund, on a private basis, by the carriers themselves. It was not government money at all. The interstate rate pool was not administered by the FCC at all.

It wasn't until 1996, the demands of that fund, having grown and grown and grown, that we decided that we ought to find a new title, and we called it the Universal Service Fund. It still was not Federal money, it was not taxed money; it was contributions from those people who used the basic interstate service into a fund to assure that every portion of the country could receive a call from the interstate fund. But the 1996 Act added to that the concept of the e-rate, the concept of providing service to schools, libraries, and health facilities, no matter where they were. And the concept that you're calling low-income fund was really that e-rate started in this Committee, as a matter of fact, by Senators Snowe and Rockefeller, put in an amendment to require this.

The demands from that fund are now what is causing the enormous increase in demand for Universal Service contributions. So I think we ought to look back and wonder a little bit whether the users of communications services should continue to provide the assistance to schools, libraries, and health facilities, and have us be willing not to call it a tax. There still is an enormous demand to assure that the telecommunications system, really the total communications systems now, it's no longer used, it shouldn't be called telecommunications, telephones aren't involved in a lot of it. The communications system of the country demands unification to the point where no matter where you are, from Key West to Point Barrow, or from a northern port in Maine to the border of California down by San Diego, no matter where you are you should be able to freely access any other place in this country. And, as far as that's concerned now, you should be assured we're working to make certain that our people could reach anywhere on the globe as inexpensively as possible so we can continue to be the dominant partner in the global economy.

Now, we're at the place now where Universal Service has to be reformed, but I think we need really a conference of this Committee to say where are we going. Should we turn to the financial Ways and Means Committee and say maybe you should devise a way that we meet these demands for the schools, libraries, and health facilities without putting the burden on communications systems. I'm not saying we should or shouldn't, but maybe we should, because that's a considerable increasing burden that has

nothing to do with communications. And in my state, it demands a significant portion of that contribution, and I applaud it. We now have connections to all of our schools, and we now have connections to all our health facilities, and we've developed what we call telemedicine because of it.

But the policy question we have here today is what to do with Universal Service in the future, and I think it demands more than a review of what you have under your jurisdiction, Mr. Chairman. It demands more of a review of what social concerns are we going to require the users of communications to pay for. And once we get that decided, then we can decide what system the communications system itself should contribute to make sure that it is ubiquitous, that it will meet any part, any demand from any American anywhere for communications.

I'll close by saying I hope you heard about the two young snow machiners that were going across Mount McKinley, the area south of Mount McKinley. Now, some people don't believe snow machiners should be in that area, but they were going there, having a grand time racing across, and they didn't see a crevasse. And, lo and behold, one of them went down the crevasse, and his partner, when he got his machine stopped, he looked down the crevasse, and there, down there about 120 feet, is his partner, standing on the skis that were wedged in the ledge in this crevasse. And they shouted and argued for awhile. And finally, the gentleman down in the crevasse pulled out his cell phone and dialed 911. A satellite happened to be going over, picked it up and notified the local nearest 911, which was in Anchorage, and within 35 minutes a National Guard aircraft picked him out of the crevasse.

Now, that may not mean much to you, but it does to me. But beyond that, that's ubiquitous coverage. The capability of getting a call from anywhere in the United States, even down the bottom of a crevasse, to assure health and safety and the ability to get aid. Now, I think that's what we ought to do. We ought to concentrate more on that.

But I urge you to start thinking about what are these increasing demands on this system before and should we find some way to limit those, or should we find some way to pass them off before we decide who should start contributing to overall Universal Service Fund.

Thank you very much.

Senator BURNS. You weren't the young man at the bottom of that crevasse, were you?

Senator STEVENS. If I was, you would have left me there.

[Laughter.]

Senator BURNS. Yes, he was the man at the bottom of the crevasse.

Mr. Chairman, you've heard the comments up here. And I would ask you, and I guess we're talking this morning about broadening the base of revenues and how they're derived. And let this Committee know, if you believe the lack of necessary statutory authority to adopt appropriate contribution mechanisms, what changes in the law would you recommend?

Mr. POWELL. Well, I think the first and most obvious thing, which I think you have introduced legislation to deal with is the

fact that we currently are legally forbidden from assessing on intrastate revenues. And I think that as we struggle through what solutions we might make and to the method in which contributions are assessed, that is a significant impediment, not only because it's a source of funding, which I think is the obvious reason, but because more and more converged services make very little distinction between a long distance or an interstate communications and an intrastate communications.

So, for example, in wireless technology, you see buckets of minutes. They're just buckets of minutes, as far as consumers are concerned. There's little difference between local and long. That's causing an enormous difficulty in separating out what constitute the interstate revenues and what constitute the intrastate revenues. And it's also an incentive for carriers to under-represent what portion of their revenues are actually interstate. And you start, in essence, estimating and sometimes guesstimating what that is. If all sources of revenue were available to the program and the Commission, that significant allocation challenge would be removed, and I think you would probably get a fairer representation of contributions and the methodology.

Senator BURNS. When you talk about telecommunications, and we talk about the different ways that we communicate, and in your statement you talked about those new services that have come on-line that maybe should be a participant in that revenue base, would Voice over Internet Protocol fit in that category?

Mr. POWELL. I think that there's nothing that prevents you from asking the question about whether any new services that comes along, like that one—

[Laughter.]

Mr. POWELL.—could or couldn't be in the base. I think that that judgment has to be something in which you're balancing the various objectives that you achieve. I do believe there are times when Congress and the Commission have provided incubation periods for new and emerging technologies, because it wants to promote the competitive objectives of the statute or the innovation objectives, in which it doesn't impose that assessment for some period of time, as a part of fostering that.

But I do think that nothing should, per se, be off the eligibility list.

Senator BURNS. Senator Dorgan?

Senator DORGAN. Mr. Chairman, thank you very much.

Again, Chairman Powell, thank you for being here and participating in this. Specifically, if you can, what services do you think should and should not contribute in the future, just as a policy matter?

Mr. POWELL. I do believe that what's going to happen over a decade or more is that basically all services are going to become IP protocol-based, which means, in essence, communications are going to be the Internet. And I think that as that metamorphosizes, we are going to have to metamorphosize the Universal Service Program to operate in that environment. So I think that there is a legitimate question about if and when those services begin to meet the principles that are themselves outlined by the Congress in this statute, when is it being subscribed to by a substantial portion of

the community, et cetera, et cetera. But I do believe that probably the largest category in the migration that ultimately we'll have to ask the question about assessing.

Senator DORGAN. You describe in your testimony that perhaps we should look at systems that are not necessarily revenue-based, but isn't a revenue-based system a system that would make the most sense, generally?

Mr. POWELL. Well, I'm not sure of that. I mean, what we're finding is that, you know, when a system is revenues-based, you're very dependent on the throes of the marketplace. And for a long time, interstate revenues were very stable, but they've become very tumultuous because of the changes in the market. So we have, for example, just long-distance-carrier decline, interstate revenues there have declined dramatically over time. We have a service innovation that is combining services in ways that's very difficult to determine the actual revenues.

I think the key to the program is stability, and one of the reasons I think it's worth examining some of the connection-based proposals is, I believe that they're a little more stable as a factor than whether a company has a good revenue quarter, or is projected to have a good revenue quarter, in a market that's likely to remain relatively tumultuous over this digital transition period.

Senator DORGAN. Let me ask, just for a moment, about the decision by the FCC that wireline broadband service is an information service and not a telecommunications service. As you know, when that decision was considered by the FCC, there were concerns about that. When we wrote the Telecommunications Act, it seems to me that we would not have—of course, that was 1996, and what has happened is the world has changed. It changes and then changes again, there's this metamorphosis in communications. But I don't know that—I don't believe any of us would have imagined a day when the newest invention for communication over a phone line that is broadband would not be called a telecommunications service. Can you go through for me your thinking or reasoning there?

Mr. POWELL. Well, I do want to be clear, the Commission has yet to rule that wireline services are information service. It's just a proceeding that's underway. We do so with respect to cable modem services, but we have yet to complete our proceeding on DSL or wireline services, just to—

Senator DORGAN. Right.

Mr. POWELL.—just to make the record accurate.

I think what we are facing, just to put it in a nutshell, the challenge for the Commission is, all communication services are rapidly metamorphosizing to things that look more and more like Internet, more and more like information services, and less and less like telephone services, of the traditional variety, which is creating all kinds of gray areas in which new services have to be classified.

Congress does have definitions of telecom services, but it also has explicit policies associated with Internet and information services policies. I think those decisions were made at a time when those categories were more clearly defined, and those categories are becoming more and more ambiguous. I think the Commission is facing factual challenges, as it sees new services emerge, as to what

their nature is under this statute, and I think that's going to continue.

Senator DORGAN. Yes, I understand a final decision hasn't been made, but my understanding of the announcements was that that was a direction you were heading, or you had tentative conclusions. Maybe I'm missing—

Mr. POWELL. That's accurate, yes.

Senator DORGAN.—part of that. And if that's the case, under the 1996 Act, only, "telecommunications services," are eligible for Universal Service support. Is that right? And if that's the case, if your tentative conclusion becomes a permanent conclusion, then broadband can never be supported by Universal Service. And if we migrate telephone service to broadband, for example, if we're moving in this direction, are we moving in a direction where your determination at the FCC will preclude a significant amount of service from ever being eligible for Universal Service, and how do you reconcile that?

Mr. POWELL. Let me take a moment with that question, because I think the answer is, not necessarily, not really. Because, first of all, on the contribution side, I think Congress, in its wisdom, gave the Commission permissive authority to assess contributions for those who use telecommunications, even if they're not telecommunications services. So I, personally, am strongly of the view that we do have legal authority to assess Universal Service contributions against information service providers that use telecom.

On the receiving side, here's what the Joint Board has moved toward and the Commission has moved toward. The Universal Service funds don't actually go for services; they go for network costs and infrastructures. And the advantage that we have is, the vast majority, if not all, of the infrastructures on which broadband services are provided are integrated networks that are also part of telecommunications infrastructures. And so it is the case today that our policies are that there are no barriers. We don't attempt to require people parse what portions of their network are being used for information services and what portion of their networks are being used for telecom services, in receiving Universal Service funds.

So to try to put that in a nutshell, a typical DSL network is being used for telephone services and information services, and the Universal Service receipts that they are obtaining can be used for investing in and improving the network, under our rules, regardless of what services on the service layer are ultimately going over that. And so I think what we try to do is be careful to say the funds are for network costs and infrastructure investment and are less tied to specifically what services run over them, to the greatest extent the law permits, and so a lot of money, Universal Service money, is, in fact, being used for infrastructure modification and upgrade that provides broadband services in rural America.

Senator DORGAN. Mr. Chairman, I see my time is expired, but let me just mention that in Section 254, the call in that section for Universal Service explicitly in the 1996 Act had it covering advanced telecommunications and information services. So whatever we do as we move in this direction, it's critically important that we provide universal service support for that technology that rep-

resents the basis for telephone service for people who live in high-cost areas.

Mr. Chairman, thank you.

Senator BURNS. Senator Sununu?

Senator SUNUNU. Chairman Powell, in your statement you talked a little bit about portability. I know this was something that Senator Stevens mentioned in his opening remarks. I did not hear his "opening" opening remarks. And I would like for you just talk a little bit more about this issue of portability and ways that we should be mindful not to undermine portability as we look at changes to the Universal Service Fund.

Mr. POWELL. I think that's right. The one thing I would say is, what makes this challenge is, I think, Congress and the Commission have lots of goals, and many of them put strains on other goals. And so one of the things we see happening is, the fruits of success of the 1996 Act are part of what presents the challenge. So what we've had is an increasing amount of competition, an increasing amount of carriers, facility-based carriers and other type of carriers, entering markets and competing for consumers. We also have had successful technology migration and substitution. So we are seeing dramatic increase in uses of new technologies to provide communications systems, where once we only had the landline telephone system.

We shouldn't be upset about that. That, to me, is a wonderful accomplishment. But what it means is there are a whole lot more supplicants showing up to the Universal Service trough looking to access that money as a way of lowering their costs, as well. And so one of the issues associated with portability is, as carriers begin to come into markets and you're dealing with more than just the traditional incumbent that's providing service, but others who are competing at it, now you have issues of technical neutrality to concern yourself. Are you biasing one technology over the other by the movement of the funds? Are you biasing competitive entry or preventing competitive entry, depending on the policies you adopt? So this a problem that has been presenting itself because of the successes of our other policies.

And so what do we have to get right here? I think what we have to get right here it to make sure that the availability of funds and the allocation of them do not inadvertently bias one competitive alternative over another, because I don't think the Government should be in the business of picking the winners and losers in a market. And I think competition is for rural folks, too. I don't want a policy that would discourage entry or investment into rural America to offer competitive choices to rural consumers.

The problem is, we're coming out of a relatively monopoly environment in which these problems wouldn't have been presented. So what portability is about is, if you win a customer, what do you get? Do you get all the Universal Service funds that the incumbent got? Do you get them based on the same cost that the incumbent had, or your own costs, or some other model of costs? And so those are the hard questions. And I'm happy to say these are very well teed up. This is something the Joint Board has been working on for a very long time, had a series of hearings in the summer, and are about to give us a recommendation on both eligible tele-

communication carrier policy and portability policy. So this is pretty ripe for a set of decisions on the Commission's part.

Senator SUNUNU. What are the critical concerns or critical issues, in your mind, or in the collective mind of the board, in comparing the advantage and disadvantages of assessments based on telephone numbers versus number of connections or the number of lines?

Mr. POWELL. Well, in many ways both are connection-based approaches. They're administered differently. One uses telephone numbers, one uses pure connections, but they're both basically connection-based approaches.

The general benefit of the connection-based approaches is that it tends to be a more stable basis on which to assess. It tends to be a somewhat more technology-neutral basis on which to assess. But the critics would say what it potentially does is dramatically shift away certain classes of carriers from being contributors. The telephone approach is the most egregious in that regard, in this sense, that right now the biggest burden probably rests on long-distance interchange telephone carriers. Under a telephone-connection based, most long-distance carriers don't have telephone numbers associated with their customer relationships, and they could arguably be free completely, under the wrong kind of connection-based system, from contributing at all.

And so the statute also tells us that the burden has to be equitably distributed among providers. So if you had a system that might make sense but left some out or shifted the burden dramatically to other classes, we could be challenged as not meeting the statute's requirement of equitable distribution. So that has been one of the great criticisms of the contribution method, and specifically the one associated with numbers.

Now, if you'll indulge me, there's a way to deal with that. One of the things the Commission is looking at is the possibility of hybrid approaches; that is, a basic connection approach that also uses revenues to supplement that approach in some creative way so that some of those abuses are mitigated. But we're still working through that.

Senator SUNUNU. Finally, are there any specific technologies that have caught your attention that you would want to highlight that you think have the greatest potential to reduce the cost of Universal Service as we look out over the next 5 or 10 years?

Mr. POWELL. Yes. You know, this is why I tried, in my statement, to make clear that we should see this as an opportunity and an exciting moment for Universal Service, because one of the great advantages of a lot of the new high-technology stuff is, it's dramatically lower in cost to deploy and utilize than some of the cost structures that we've had to administer in the traditional wireline telephone system.

I always like to use, just as a dramatic example, you know, a satellite, at 28,000 feet sees Butte, Montana, just the way it sees Manhattan, and it may make no distinction in its technological solution as to the way it delivers services.

Wireless, even wireless terrestrial services, enjoy certain costs and geographic advantages that a company that has a string of

wire over a mountain, down the hill, and 600 miles to the next house doesn't have.

And so the key, to me, if we get our policies right, is that these things are colors on a palette of paint, and we can use them and apply them where they're optimal, given the demographics or the geographics of particular parts of the world.

But one reason I think the leading agenda at the Commission right now is wireless technology is because we think it holds some of the greatest advantages for ubiquity, affordability, and lower-cost services for all consumers in all regions. And, as the Senator said, it was a wireless technology that would get the guy out of a crevasse. Nobody strung a twisted copper wire down there in case someone happens to fall in that location. There's no phone booth down there.

Senator BURNS. Thank you, Senator.

I'll tell you what I'm going to do. I'm going to just recess the Committee. We've got about four or 5 minutes on this vote, and everybody can go vote, and then everybody can come back. Is that fair enough? And we'll stand in recess until we get back.

[Recess.]

Senator BURNS. Senator Smith is next. Well, Senator Lautenberg was, but Senator Smith is here. I'm going to ask him just to take the gavel just for a second. I've got about a 15-minute thing I've got to take care of, and so, Senator Smith, the Committee recognizes you, and you've got the gavel to do anything that you want to do at this time.

[Laughter.]

Senator SMITH [presiding]. Now, what do I do with all this power?

Senator BURNS. It could be fleeting, you know.

[Laughter.]

Senator SMITH. Thank you, Mr. Chairman.

And, Chairman Powell, thank you for coming today. It's always a pleasure to see you. And you heard my abbreviated opening statement. Obviously, when it comes to the disbursement, I think these are your charts. We didn't prepare them, we got them from the FCC. And I think they speak for themselves in that, at least as to the distribution formula, there are a lot of people in rural areas, a lot of people everywhere, from all areas, making payments into this fund that get nothing back for it. And I understand that where they're served by long-distance carriers, they're somehow excluded, but then they also ought to be excluded from the charge, it seems to me. And I'm wondering if you can help us come up with a fairer distribution formula than this represents.

Mr. POWELL. Of course we can always do our best to help. I think there's something very, very important, though, that we have to also put on the table, because I think these charts are accurate, to the extent of what they are.

The Universal Service Program is multiple programs, multiple pots of money that are expended for similar purposes. These numbers represent only the non-rural high-cost fund, only the money that is paid to the largest carriers in a state, which represents about \$230 million. But we also have the rural high-cost fund, which represents more like \$3 billion, which is distributed to every

one of the 50 states in the United States. So, for example, a state like Virginia, that you mentioned, that does not get non-rural high-cost support for its large carrier, does get \$70 million in rural-cost support, so that every state is receiving a fairly decent amount of high-cost Universal Service support, the difference being which carriers are receiving it. So a state like Virginia, their large incumbent may be getting no high-cost support, but their rural carriers throughout the state are getting a significant amount.

I only say that because I think as we wrestle through what the fair distribution is, we have to look at what everybody's getting from all the pots of money. Moreover, the large incumbents also get money from other funds, like the state Universal Service Fund and the interstate access fund of \$650 million, which they draw from, as well.

So that only makes the picture more complex, and so we wouldn't want our data to suggest that states are getting nothing. They're getting nothing from that bucket of money, but the huge bucket of money in high-cost, the \$3 billion bucket, almost all of those states are getting pretty significant amounts of money.

But we wrestle with how to make the distribution fair.

Senator SMITH. I love Mississippi and Alabama and West Virginia, but do they benefit from those other pots of money, too?

Mr. POWELL. They absolutely do. I wouldn't argue that there aren't states that get substantially more high-cost support than other states, but I think one of the things we're, I think, either by design or handicapped by is the essential premise of Universal Service is shifting money from some states to other states, to call it like it is. And that's just an absolute natural and automatic part of the program.

Senator SMITH. Well, it just seems to me that giving so many states nothing out of that pot of money just, on its face, seems unfair. And they may have large carriers, but it seems to me if they're paying into that pot, they ought to get something back out of it in some distribution formula that includes them.

Mr. POWELL. Well, again, I think the one thing I may slightly disagree with is, I think that, you know, people pay into the Universal Service Fund, and they are getting something back. I don't know how dramatic it is that it comes out of bucket A instead of bucket B, if it's real money, for the citizens of that state. And then there are states who aren't getting anything. You know, a state like Virginia that doesn't get the support that you mentioned, is getting \$70 million from the other fund; but a state like Senator Lautenberg's New Jersey, is—or high-cost, high-paying states like Florida—are paying into both of these programs and getting very little from either.

But some of that, I don't know how to completely cure, in that the fundamental premise of the program is to move money from some states, actually have them pay and have that money distributed elsewhere where it's more needed. But I suppose we can always work on a fairer distribution, so I wouldn't want to foreclose—

Senator SMITH. Have you seen the bill that Senator Bayh and I have introduced, or do you have any comment on it?

Mr. POWELL. I think my only—I haven't studied it, but I do know the basics, and I think my only comment would be in terms of the Congress making an assessment if one of its motivating concerns is equitable distribution. But to do that fully and fairly would be to also honestly take into account the full range of the programs and what states are getting, as opposed to look at only one fund in isolation. That would only be a recommendation and a caution.

The other thing is, the proposal to do it based on high-cost rate centers, which I think I understand to be the proposal, as long we understand that if we did that today that would be a massive increase in universal funding requirements. You would have to help me, but I think the statute probably—the proposal recognizes the need to cap that at some point, because if it weren't capped, you would be talking about, I think, a very, very serious increase in the Universal Service funding requirements on a high-cost rate-center basis.

And then if we're going to have a cap, then you have a whole issue about what happens when demand exceeds the cap and how do you distribute when you don't have enough money to meet the formula. I apologize for not knowing the details well enough to—

Senator SMITH. Well, currently rural states are penalized by what's called "state averaging" because they have a larger city in them, in that the carrier in the larger city serves those rural areas, but they're penalized by having a larger city. And what our bill does is focus on rural wire centers and allows the SEC to determine the costs fairly on that basis. Does that make sense to you?

Mr. POWELL. It makes sense that I understand what the concern is and what's trying to be addressed. You know, we have been fairly comfortable with the state-averaged system, but I think there are legitimate arguments about doing it differently. But the only thing I would also caution is, there are a lot of major carriers who—the reason that they have this problem is that they've sold off their rural exchanges. And if a company is going to sell off its rural exchanges to rural companies so that increasingly it is serving fewer people in those rural communities, and then wants the same universal service recovery from that, that's at least something, to be sure, that we want to embrace. But that's why we think, you know, sometimes when you have a large company, the averages help capture the full range of what they're serving. But I don't argue with you that the fact of averaging always has an over or under inclusive consequence.

Senator SMITH. Well, understanding averaging, I'm not asking for dollar-for-dollar payment, a dollar back for every dollar put in, but it does seem to me that when you have roughly 44 states that get absolutely nothing out of this pot of money into which they contribute, that, on its face, it just speaks of unfairness.

And so we're going to push this and see if we can't give you the authority to modify that formula or perhaps—I know your Commission has addressed it already and have kept the status quo, as it's been. Obviously, I'm hoping to incentivize you to do something different. But I appreciate very much your considering it.

I think my only additional comment is, in the FCC's decision last month it sought comment on how states should be given the opportunity to request additional funds. When do you expect the FCC to

conclude this proceeding? And even if the FCC is capable of finishing the proceeding next year, which is probably optimistic, do you realize that it would have taken the FCC 8 years to implement the Universal Service Provision Act of 1996? I guess, again, it comes down to, is that really fair for rural customers served by larger carriers?

Mr. POWELL. Well, I would have a difficulty saying exactly when the proceeding would be completed, since we just initiated the rule-making. I don't know the amount of comments we will receive, the breadth of them, the depth of them, or the complexity of them, but I will promise you it will not be 8 years. And I certainly won't be here for it—

[Laughter.]

Mr. POWELL.—if it's 8 years long.

But I think this is a very—you know, I can only commit to you that I think we understand the importance you and others attach to it, and we'll commit the Commission to try to get it done as quickly as possible and have it be a priority.

Senator SMITH. Very good. Is Senator Lautenberg coming back, do you know?

Well, those are my questions. OK, while we're waiting for Senator Lautenberg—

Mr. POWELL. OK.

Senator SMITH.—I'll take up your time, Michael. Appreciate it.

In your written testimony, you state that, quote, "We must evolve our Universal Service programs," and that, quote, "We need a more rational method of distributing Universal Service support." The FCC was recently given an opportunity to equitably spread non-rural funds throughout the Nation. But, instead, they again adopted for the status quo. It goes to the fairness again, and our hope is that you meet again and decide differently.

In most of its recent decisions, the FCC goes to great lengths to state that the Commission's role in Universal Service should be limited to supporting states that, "that do not have the resources within their borders to support all of their high-cost lines." Recognizing this theory, the FCC has chosen to put the burden on 40 states with the responsibility to implement the 1996 Act, while it chooses to implement the Act for the remaining eight to ten states.

And I think your point to me is that, as to that pot of money, that's an accurate description, but as to others, it may not be.

Can you speak to what sort of fairness would be represented if you included all the pots of money that are involved here?

Mr. POWELL. Well, I just think if you include all pots of money, the gap between them is shrunk substantially, and you might still come to the same conclusion. I haven't done the math of exactly how people would line up. But I think if Virginia goes from it-gets-nothing to it-gets-70-million, and Colorado goes from it-gets-nothing to 60 million, if Montana goes from nothing to 60 million, then, the fairness gap between, their getting nothing and they would get more, I think, is shrunk. And so you may still conclude that there needs to be adjustments if fairness is the objective.

But I think that you would find states are closer than our data would suggest by looking at a single bucket. That is, a state that looks like zero isn't really zero. If you're focusing on what the state

receives, it's usually substantially higher. And then, whether that compared to a state that's getting, looking at your chart, something like Mississippi that's also getting more from this, looking at the delta there—

Senator SMITH. Well, on this—your chart shows Mississippi from this one pot as getting \$120 million. And, you know, if Virginia gets 70 from a different pot, but they're getting \$120 million from this pot that is of concern to me, how much does Mississippi get from that other pot? In other words, why is Mississippi so high? I mean, I love Trent Lott, but why is it so high?

[Laughter.]

Mr. POWELL. Now you're really going to get me in trouble.

[Laughter.]

Mr. POWELL. I think that you always just—you know, the challenge of Universal Service is that you always have to look at what its first principles are, and I think it's above my pay grade as to whether people support a system that's meant to export money from some states to other states who have higher cost infrastructures. But that is what the system is. That's what it's been for a very long time. That's the way the statute works. And so the idea that all states would somehow equally receive or get the same amount that it pays in, I would only challenge that that's, sort of—it's a great notion, except for it's the opposite of the Universal Service Program. If everybody got what they paid in, then it wouldn't be the Universal Service Program, it would be some program where we just raise, collect, and distribute money. I don't know what its purpose would be.

Senator SMITH. No, I don't disagree with that, but every state has a rural aspect to it. Some, like mine, have a lot of rural aspects, and Montana, as well. And it just seems to me if Mississippi is getting \$120 million from this pot, and Oregonians are contributing to that pot and getting nothing for it, that, on its face, that just doesn't seem right.

So I've made my point, and I'd sure appreciate your help on it, Michael.

Mr. POWELL. Thank you.

Senator SMITH. Thank you very much for being here.

Mr. POWELL. Good talking to you.

Senator SMITH. You bet.

Senator BURNS [presiding]. Thank you, Senator Smith.

And with your line of thinking, I think you stated, Mr. Chairman, that the Joint Board's going to make their recommendations back to you fairly quickly. When will they make those recommendations?

Mr. POWELL. Well, the ones we were speaking of is—the Joint Board is currently considering the ETC designation questions and the portability questions, and we anticipate that they will submit a recommendation to us probably sometime in early January.

Senator BURNS. Well, it's my thought right now that we should wait on those recommendations before we take a look at disbursements. And also I think they're going through an exercise where they're doing that now.

Mr. POWELL. Yes.

Senator BURNS. And those recommendations—I think right now what we have to deal with is to broaden the revenue base to limit—to bring down the load on just those folks who use long distance to ensure its viability.

Whenever we start looking at the schools and libraries, we know we've had an explosion, we know that over 90 percent of the schools are wired now. I'm asking why should there be any more of a drawdown. When does that fund start to—that curve start down as far as expenditures are concerned, because we've done basically what we would say that we were going to do?

Mr. POWELL. Yes, it's a good question, actually. It's hard to say exactly when in time, but it would seem to me, at least in concept that the biggest part of the schools and libraries fund, in terms of money, is connections. And, you know, connections are something tangible that, they're either in now or they're not.

Services, support of services is something that is, sort of ongoing, right? Every year you have an Internet service bill or a telecommunications service bill. So that component of the program seems to me to be more ongoing and dynamic. But I think the tough question for us, and perhaps even for Congress, is at what point, do you declare, that connections portion of it is beginning to diminish? Because there will be those who argue that now that you have connections, you need a strong maintenance program for those connections, you need expensive help desks for those connections.

One of the challenges in a program like this, even though I happen to believe the program's goals are absolutely worthy, and have no problem with them and have no problem with the program, at some point you're going to have the courage to say it's not a program that can continually creep. Because with technology, I can always make you an argument where there's something else that would make it better. And so at what point do we start to say that begins to get into the realm of that should be the state's responsibility or the school system's responsibility? It's hard to know exactly where that line's going to be drawn. We're not quite there yet. I want to be clear about that. But I do think it's worth starting to talk about. What are the indicia of beginning to scale back on certain things. And then there are still swaths of schools that just haven't really fully been gotten to that we still have important work to do.

Senator BURNS. And I would also—putting in that same category, the business of telemedicine.

Mr. POWELL. Oh, yes.

Senator BURNS. We've tried—

Mr. POWELL. Well, the—

Senator BURNS. We've tried—I will tell you, Mr. Chairman, we have tried to do business with the healthcare financing system, as far as Medicare is concerned, for reimbursements for electronic consulting and this type of thing. When I look at my state of Montana, and I don't think we're any different than any other state, we look at our demographics in our rural areas, the age is going up. In other words, our amount of seniors are in rural areas where there's considerable distance between them and their healthcare providers. That trend will continue in my state for quite some time, so we're

kind of concerned. We know healthcare will be delivered in a different way than has been done in the past. And the medical community in rural areas, such as Montana—I don't think we're rural, I think we're frontier, that's one step beyond rural—they have responded to that very well. Now, Universal Service did play a role in that. But also I think it's time that the healthcare, the system itself in healthcare, should start assuming some of those costs of delivering healthcare into rural areas and to energize that community that we're going to do things differently.

And I would also—you recently commented on one thing the FCC needed to do to reform Universal Service, was to end regulatory arbitrage opportunities. Can you explain to this Committee what that statement means?

Mr. POWELL. Well, I'm not sure where it comes from, but I'll do my best. And I'll just answer broadly, because I think this is a challenge for regulators all the time.

Let's just be blunt. When the government throws out a pot of money, people go after it. And it will incent behavior. It will incent private actors who are in the business of making money for figuring out how to get as much of it for themselves as possible and to keep others from getting as much of it as possible. So I think the government has a very, kind of, special regulatory responsibility when it is administering programs that include government-mandated pots of money, because I think you can distort behavior or drive things in directions that you may or may not mean to. You can bias competition, you can frustrate the arrival of different kinds of technology because those aren't profitable, not because the market says so, but because money is paid for one, but not the other.

So, when I say that, I'm sometimes talking about intercarrier compensation, the way carriers compensate each other in a technology-changing world—sometimes I think that issue's raised in Universal Service—both of which are where regulators are saying a lot about who gets paid and how, and who gets their costs recovered and how, because the minute you get into that business, you're in the business of very smart companies figuring out how to position their business model to maximize their advantages.

Sometimes that does not mean they will do the thing that's best for consumers of the market, because they're not really acting in a market; they're acting in a regulatory system, and they're arbitraging the opportunities. And I think we've seen that in things like the misuses of reciprocal compensation, intercarrier compensation, Universal Service, even schools and libraries. Some of the fraud actions that the government's bringing, you know, you put it out there, and they will come. And there are people with some unsavory stuff who showed up. So you have to be particularly disciplined about protecting that.

Senator BURNS. And I'm also hearing that in some cases, as far as the Universal Fund is concerned, there is—and as far as contribution, societal contribution, what is good for the majority of the people, that there is a point of diminishing returns.

Mr. POWELL. Oh, I think so, or that at least we have to have an honest willingness to ask that question repeatedly, which I think is what, you and some of your colleagues were getting at. As we

go through this great migration to Internet light technology, I think it's an important moment to be, sort of, reinitializing, what are we really trying to do with Universal Service, who is it really for, what are we trying to actually achieve. It's actually a fairly old—this is a hundred-year-old program, in essence, and its original conception, I think the purposes are, unassailable, but what you're trying to achieve and the best way to achieve it seems to me to be constantly—should be subject to reexamination.

So, for example, like we were talking about, if satellites were suddenly an optimal platform for voice communications, you'd have a very different set of questions associated with satellite-deployed voice communications than you did with copper-deployed ones. And I think if we just act like the Universal Service objectives are the same thing as the fund, we're going to make mistakes.

The fund is a means to an end. It's not the only one, but it is a means to an end. So protecting the fund for its own sake shouldn't be the question. Protecting the goals and the role of the fund in protecting those goals seem to me the way I challenge our staff to think about it, because I'm scared we'll miss other innovative ways to make sure the citizens of these rural areas are served.

Senator BURNS. Well, we've got sizable challenges ahead of us—

Mr. POWELL. Yes, sir.

Senator BURNS.—and quite a lot of dialogue. And I don't think our accumulation of testimony and material to read before we finally get to bottom line—because we know this difference now, we see long distance as just a different kind of a world now, it's all you can eat in 49 minutes or whatever, and you buy so much time. And I know that probably causes great heartburn for auditors and this type thing on how do we collect, and I know we have to look at that, as far as the revenue base.

But when carriers have to allocate costs between jurisdictions, I think probably this is the greatest challenge that we have, without resorting to burdensome audits, how in the world does the Commission ensure that those carriers are paying their fair share in the USF and the markets? I'd have to ask if the markets don't move forward toward, they're moving toward bundling, and they argue for a new assessment kind of mechanism, I think they're crying for it. Is that a proper assessment?

Mr. POWELL. I think that's right. It's just a matter of what. And what's the answer to that question?

In many ways, I think the future has enough clarity now that we know things are going to look very, very different, in terms of the system of communications that we have, who the players in that system of communications are going to be, and how they're going to be more similar than different. I mean, all the buzz words about convergence are basically right. You're going to have communications companies and communications services, and they are not going to be, as a technical matter, particularly different from other kinds. I mean, it may be a visual picture, but it's still just bits.

And so what I try to think about is, we all have short-term things we need to do, mid-term things we need to do, but we need to be crystal clear about where we think we're going to be, and understand that what we should really be saying to ourselves is,

“What’s Universal Service in 10 years, when everything’s IP or all the companies in the communications sector have reordered themselves into large communications services and provide suites in buckets?” And so every incremental decision we make may be for the moment. Maybe it’s to save the contribution factor for this quarter. But it should always be done in a way that’s moving productively in the direction of where you think the trends are taking you anyway, and not choose ones that might work for the corridor but are going at cross-purposes of where you have to probably ultimately get to.

Senator BURNS. Well, if the 1996—and with all of its imperfections, the 1996 Act that deregulated a lot of areas—and I would say that part of the great economy that we experienced in the 1990s was due, quite a lot of that—we didn’t know how much venture capital was out there ready to come into the telecommunications industry until we did dereg a good part of it. Did we do it right? I’m not going to go into that. But what it did, it allowed those investments to come in, and it has clarified. You are right, we see the future now a lot better. Had we not passed the 1996 Act, if we were still operating under the 1995 Act, it would be as cloudy out there now as it was in 1996, and with not too many changes, to be right honest with you, that would have happened in the telecommunications industry. So I think you’re exactly right.

I want to thank you for coming this morning and sharing your thoughts on this. There will be other dialogue and other opportunities. And, Mr. Chairman, I was told awhile ago, with a little phone number, that there will be some more questions forthcoming, and if you could respond to them and the Committee, we could certainly appreciate that.

And I thank you for coming this morning, and this hearing is closed.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS,
U.S. SENATOR FROM SOUTH CAROLINA

Thank you, Mr. Chairman. Once again, today's hearing focuses attention on one of the cornerstones of U.S. telecommunications policy—namely, our commitment to ensuring that *all* Americans have access to quality communications services at reasonably comparable prices. While the promise of universal service began in the 1930s as a justification for the continuation of AT&T's monopoly, this principle has endured past the break-up of AT&T in 1984 and was explicitly articulated by Congress in the Telecommunications Act of 1996. As a result, our commitment to ensuring "universal service" continues to serve our Nation well in today's ever-changing communications marketplace by promoting the economic and social well-being of numerous communities across America.

Unfortunately, over the last few years, the long-term viability of our current mechanism for supporting universal service has come into question. Recent increases in the size of the Universal Service Fund and the shrinking base of interstate revenues have resulted in calls for major modifications to the current contribution mechanism. In addition, growing wireless substitution and the rapid evolution of "voice-over-the Internet" technologies threaten to place even further pressures on our current system of supporting ubiquitous, nationwide access to communications services. And while proposals to change the current contribution methodology have been under review by the FCC since May 2001, the FCC has yet to adopt significant changes that would ensure the long-term stability of the Universal Service Fund.

In an attempt to address the logjam at the FCC, Senators Burns, Stevens, Dorgan and others have held a series of roundtable discussions with industry stakeholders to try and highlight differences and identify common ground. I want to commend my colleagues for their efforts in this regard. I look forward to working with them in the days ahead to draft legislation that will improve our current system.

In undertaking this task, it is my hope that our friends in industry will join with us in recognizing that time is of the essence. Unless we are able to construct a system where all who benefit from the communications network help to support its universal availability, the continued evolution of new Internet-based communications technologies will only increase the strain on an already creaking system.

As a result, today's hearing comes at a critical juncture, not only for our efforts to create an equitable and sustainable means of collecting support, but also for our understanding of what level of service should be supported in a society that will increasingly be dependent on advanced communications capabilities. As the FCC addresses these new challenges, it is essential that it keep in mind Congress' underlying goal of ensuring that consumers in all regions of the Nation have access to reasonably comparable services at reasonably comparable prices.

With this as our guide, I look forward to the testimony of Chairman Powell and to his responses to our questions.

PREPARED STATEMENT OF HON. DANIEL K. INOUE,
U.S. SENATOR FROM HAWAII

Our discussion this morning revisits critical issues regarding the sufficiency, stability and viability of the Universal Service Fund. Indeed, today's examination follows earlier hearings conducted by this committee during the 107th Congress and this past April specifically focused on our current mechanism for funding universal service. This matter has also been under consideration at the FCC for some time. As a result, we are pleased to welcome Chairman Michael Powell and look forward to his testimony, which we hope will further illuminate these important issues.

At its foundation, our commitment to universal service is founded on the belief that basic communications services should be available to all Americans at reasonable rates. Under the Telecommunications Act of 1996, Congress reaffirmed its com-

mitment to this principle, explicitly stating that the definition of universal service would be sufficiently flexible to capture “an evolving level of telecommunications services” so that all Americans might enjoy the promise of advances in communications technology. Additionally, Congress expanded the universal service commitment to include schools, libraries and rural health care providers as well as other eligible telecommunications carriers with the understanding that as telecommunications services reach more and more individuals, *all* Americans benefit.

While our fidelity to these principles remains resolute, there is a growing recognition that our current method of funding universal service, which today relies on assessments to a telecommunications carrier’s interstate and international voice revenues, is under increasing pressure. The evolution of new communications technologies such as Voice-over-Internet-Protocol (VoIP) communications as well as the increasing popularity of bundled wireless and competitive service offerings threaten to further diminish an already shrinking funding base. At the same time, the cost of providing universal service support continues to increase. Total universal service disbursements have increased from \$1.8 billion in 1997 to \$5.3 billion in 2002, and the fund is estimated to reach \$7.1 billion by 2008. The rapid increase in the size of the fund coupled with the decline in interstate revenues has prompted the FCC to institute stopgap measures to temporarily stabilize the collection mechanism.

There appears to be growing consensus that the question before us is no longer whether the universal service funding mechanism should be changed, but how it should be changed. The Commission is currently considering several proposals. While some proposals seek to modify the existing revenue-based mechanism, others propose instituting a “per connection” or “per telephone number” approach. Each of these plans would affect the proportionate share of contributions that each sector within the telecommunications industry collects as well as the relative share contributed by residential and business subscribers.

In the end, there is a growing awareness that the pressures on universal service being brought to bear by a rapidly changing communications marketplace will require action, perhaps congressional action, sooner rather than later. As a result, I look forward to our discussion today with Chairman Powell, and to working with my colleagues in the days ahead toward placing our universal service system on firmer footing.



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