



Statement by

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Executive Summary

Now, more than ever, our domestic, economic, and personal security needs are intricately linked to our national universal service policy. Today, in tandem with unprecedented technological advances, American consumers are dramatically altering their communications expectations both at work and at home.

Rural communications providers throughout the country continue to respond aggressively to this challenge, rapidly transforming their traditional switched voice systems into powerful and dynamic Internet protocol (IP) broadband networks. This is a natural response for these community-based providers that have a long history of taking their service responsibilities seriously. Yet, the successful fulfillment of their mission is not without tremendous cost.

Universal service plays an integral role in helping rural providers overcome these financial challenges. This industry program helps ensure that necessary cost recovery will flow to those that commit to serving the nation's economically challenging markets and consumers.

Clearly, our highest priority must center on strengthening and preserving our universal service policies in a manner that acknowledges the program's value and that simultaneously restores America's communications preeminence. Specific policy concepts that should be followed in order to accomplish a fiscally responsible and economically stimulating transition from the voice public switched telecommunications network to the Internet protocol broadband network to include the following:

- Include broadband in the definition of universal service and expand the universal service fund (USF) contribution base to include all broadband service providers and retain revenues as the basis for assessing the USF contributions;
- Affirm that universal service support should focus on providing consumers with affordable and comparable services and not used to stimulate competition;
- Allow universal service and intercarrier compensation reform to occur simultaneously by first allowing state commissions to reduce, on a company-by-company basis, intrastate

originating and terminating tariffed access rates to interstate tariffed access rate levels over a reasonable period of time. Second, by freezing interstate originating and terminating access rates in order to keep interstate access rates from increasing. And, third allow rate-of-return (RoR) carriers to recover lost access revenues not recovered in end-user rates through supplemental Interstate Common Line Support (ICLS) support and allow price-cap carriers recover lost access revenues through Interstate Access Support (IAS);

- Require recipients of any new supplemental ICLS and IAS access cost recovery to voluntarily agree to Title II regulation of their broadband services and to forgo the retention of excess earnings;
- During the transition from the PSTN to a complete IP broadband network require all Internet Protocol/Public Switched Telephone Network (IP/PSTN) traffic and specifically interconnected voice over IP (VoIP) traffic to pay applicable universal service, access, and intercarrier compensation charges;
- Require tandem switching rates and special access transport rates to be cost-based;
- strengthen the process for securing universal service eligibility (ETC status);
- eliminate the identical support rule and provide support based upon a carrier's own costs;
- reject ideas to distribute support via auctions, vouchers, or other untested means;
- allow the program to operate as envisioned by lifting program caps and freezes; and
- remove this private program from the federal budgeting process.

While there are those who continue to overlook the program's long-term and unprecedented success, such is not the case with regard to this panel's chair, Rep. Rick Boucher (D-VA) and his colleague Rep. Lee Terry (R-NE). Together they have pursued legislative strategies over the course of the prior two Congresses to ensure the program's effectiveness and long-term strength. NTCA and its members have supported their efforts in the past and expect to do so in the future.

Introduction

Thank you for the invitation to participate in today's discussion regarding the critical importance of the universal service program and how best to strengthen it for the future. For the past 6 years I have served as the General Manager of the Logan Telephone Cooperative in Auburn, Kentucky. I also currently serve as the Region 3 Director on the board of the National Telecommunications Cooperative Association (NTCA). My remarks today are on behalf of Logan Telephone, as well as NTCA and its 579 other rural community-based members that serve rural areas throughout the nation.

Specific Company Dynamics

Organized as a cooperative, Logan Telephone's top priority has always been to provide every one of our consumers, who are also our owners, with the very best telecommunications and customer service possible. We serve 5,961 customer lines across our 596 square mile rural service area that is entirely encompassed in one isolated region of our state. This is about 10 lines per square mile. We employ a total of 27 people and in 2008 our annual operating revenue was about 9.7 million dollars. In our industry's parlance, as a small rural provider of this size, Logan Telephone Cooperative is a Tier 3 carrier.

By comparison, let me give you a quick snapshot of how Logan Telephone compares with several of the other witnesses submitting testimony today. Embarq, as a midsized, or Tier 2 carrier, operates in 18 states, has a work force of approximately 18,000 and annual revenues of \$6 billion. Verizon, AT&T, and Qwest are classified as large, or Tier 1 carriers, and also operate in multiple states. Verizon has a workforce of nearly 224,000 and annual revenues of \$97 billion. AT&T has a workforce of 302,360 and annual revenues of more than \$124 billion. Qwest has a workforce of 33,000 and annual revenues of more than \$13 billion. Finally, U. S. Cellular is a business unit of Telephone and Data Systems, Inc., a mid-sized wireline provider

that owns 82 percent of the wireless entity. U.S. Cellular is the fifth-largest wireless service provider in the country, serving six million consumers in 26 states with a work force of 8,700 and has annual revenues of \$3.7 billion. Clearly with operations of this size, the priorities and objectives of these companies are generally far different from Logan's community-based approach to service.

The entrepreneurial spirit of Logan Telephone is representative of our approximately 1,100 small rural counterparts in the industry, who together serve 50% of the nation's land mass, yet less than 10% percent of the population. Like the vast majority of our rural colleagues, Logan has always been an early adopter of new technologies and services. Logan currently has 1.5 Megabit broadband service available to 100% of our service area and we are currently working on a strategic network plan to deliver even higher speed services that our members are demanding. Rural Americans throughout Logan's service area, and indeed throughout the markets of NTCA members, are enjoying universal telephone service, access to broadband Internet services, and enhanced emergency preparedness. Many NTCA members are also introducing advanced video services and, in many cases, the first true local video competition to their areas.

Rural Telephony Trends

I alluded to Logan's dramatic efforts to deploy advanced infrastructure throughout our markets. We are simply responding to the reality that today, in tandem with unprecedented technological advances; America's consumers are dramatically altering their communications expectations both at work and at home. Consequently, traditional local switched networks dedicated to voice services are rapidly evolving into Internet protocol (IP) aware, packet-enabled routing systems. This enhanced infrastructure will help ensure consumers have the capability to transmit high bandwidth data and video as well as voice communications.

Over the past decade, NTCA has conducted an annual Broadband/Internet Availability Survey to gauge the deployment rates of advanced services by its member companies. A few details from the association's most recent (2008) survey are extremely informative. According to the results one hundred percent of the respondents now offer broadband to some part of their customer base, compared to 58% of survey respondents who offered broadband in 2000.

The respondents indicated something we have known for years – that America's rural providers consistently practice technological neutrality in their infrastructure deployment. In other words, they use a variety of technologies to provide state-of-the-art services to their consumers. In reality, due to the geographic and economic constraints they typically face, this approach only makes good business sense. With regard to broadband capable infrastructure, the survey found that 99% of the respondents utilize digital subscriber line (DSL), 44% fiber to the home (FTTH) or fiber to the curb (FTTC) (up from 32% last year), 17% unlicensed wireless broadband, 16% licensed wireless broadband, 14% satellite and 10% cable modem. In 1999 only 29% of survey respondents offered DSL service and none offered wireless broadband.

Eighty-two percent of the 2008 survey respondents continue to offer dial-up connections to the Internet at 56 kilobits per second (kbps) for customers desiring it – and a significant percentage do so. However, overall, dial-up take rates declined as broadband take rates rose over the course of the past year. With regard to broadband speeds, ninety-one percent of respondents' customers can receive 200 to 768 kilobits per second (Kbps) service, 83% 768 kbps to 1.5 megabits per second (Mbps), 58% 1.5 Mbps to 3 Mbps, 46% 3 Mbps to 6 Mbps, and 25% greater than 6 Mbps. On average, 11% of respondents' customers subscribe to 56 kbps service, 19% subscribe to 200 kbps to 768 kbps service, 36% to 768 kbps to 1.5 Mbps, 10% to 1.5 Mbps to 3 Mbps, 11% to 3 Mbps to 6 Mbps offerings, and 5% to greater than 6 Mbps service.

While the typical respondent is 98 miles from their primary Internet connection, an astounding ninety-three percent face competition in the provision of advanced services from at least one other service provider. Current competitors include national Internet service providers (ISPs), satellite broadband providers, cable companies and wireless Internet service providers (WISPs).

Respondents are taking numerous marketing steps to increase broadband take rates, including free customer premise equipment installation, price promotions, bundling of services, free hardware, free introductory service and free software. Just under one-half of respondents find it difficult to compete with price promotions offered by competitors.

Moderating Competitive Neutrality Based Deregulation

With that in mind let's turn to the specific focus of this discussion -- why we believe universal service program modifications are necessary and what they should include. It is instructive to point out that latching onto a somewhat vague reference within the Telecommunications Act of 1996 regarding explicit versus implicit cost recovery mechanisms, the FCC has subsequently been engaged in a 13 year crusade in the name of competition, deregulation, and overall competitive neutrality. In this movement's wake lies a critically injured universal service system, a dysfunctional intercarrier compensation system, and a disjointed and confusing structure of consumer rates.

The universal service system has unnecessarily hemorrhaged millions of precious support dollars to competitive providers, such as U. S. Cellular, that policymakers are unwilling to force to live by the same high carrier of last resort standards the incumbent sector has always had to meet. The intercarrier compensation system has been manipulated, arbitrated and rendered virtually ineffective by the industry's giants, such as AT&T, Verizon, and Qwest, and other competitors and emerging technologies. And finally, the consumer rate structure for local service has rapidly

inflated, again due mostly to the fixation of the industry's giants and policymakers alike to make all costs explicit and attempt to instill so-called competitive neutrality into the marketplace. It is time that we all acknowledged these actions for what they are not, which is to say that they are definitely not in the public interest.

The net effect of these dismal and misguided initiatives has been the emergence of a business operating environment of extreme uncertainty, in which rural providers have little assurance of cost recovery. In conjunction with the economic crisis our nation already faces, it is extremely difficult if not impossible to make long-term deployment decisions let alone to expect to find the credit resources to help roll out such investment. It is extremely disconcerting to see these formerly strong foundations of cost recovery beginning to crack and crumble toward dilapidation. Policymakers, as well as those in the industry that are not natural allies of these programs, have simply got to come to the realization that these structures are necessary, that they require maintenance, and that they cannot be modified or bypassed or otherwise ignored without resulting in a collapse of the nationwide ubiquitous communications network we have worked decades to construct.

Rural Telephony Cost Recovery

While there are often a number of factors that can stymie the deployment of high bandwidth rich fiber, such as regulatory uncertainty, long loops, low customer demand, and obtaining appropriate equipment, cost remains the primary obstacle. Truly the cost factor cannot be understated in rural provider scenarios as they have neither the corporate nor the consumer base economies of scale and scope that larger carriers would enjoy. This is why adequate and stable cost recovery is so critical to rural providers.

Cost recovery for rural communications providers generally consists of three primary revenue streams, and for the most part each one, on average, accounts for approximately one third of the

provider's revenues. They are: 1) direct payments from customers, 2) intercarrier compensation or payments from other carriers, and 3) universal service support. These interwoven elements are dependent upon one another to the degree that if any one is modified, the others are necessarily impacted as well.

Today, this entire cost recovery structure is under siege. The reasons for this are varied, but for the most part they stem from two root causes. The first has been the zealous efforts of policymakers and public entities alike to effectuate absolute competition and deregulation throughout the telecommunications market place. The second has been the simultaneous unprecedented explosion of technological advances that helped to at least give the perception that competition, deregulation, and universal service can coexist.

Universal Service And Intercarrier Compensation Reform Simultaneously

It is obvious that with our cost recovery system under such immense pressure that we need to repair each of this structure's elements – sooner rather than later. Yet, make no mistake that whether done through legislation, regulation, or a combination of the two, universal service and intercarrier compensation reform must be done simultaneously. This is because any dramatic shifts in cost recovery could have a devastating impact on rural consumers and their communications providers. NTCA has filed an extensive universal service and intercarrier compensation reform proposal with the Federal Communications Commission (FCC). For the purposes of this inquiry we only draw your attention to the elements of our plan that directly affect the universal service program or that otherwise have some sort of direct connection to our discussion today.

Policymakers have consistently recognized the necessity of providing rate-of-return (RoR) providers with the opportunity to secure reasonable cost recovery that includes a practical return

on investment. They have likewise recognized the unique characteristics of rural RoR carriers and the challenges they face in providing quality service to their rural consumers. And finally, they have recognized that RoR regulation operating in tandem with universal service has worked well, not only for providing quality service at reasonable rates, but also for encouraging the deployment of broadband in rural areas.

In this regard, NTCA continues to urge federal policy makers to create a restructure mechanism (RM) that would reside under the purview of the universal service system and operate in conjunction with its interstate common line support (ICLS) and interstate access support (ICS) mechanisms. The purpose of the RM would be to allow providers to recover essential costs that might otherwise be lost as a result of policy changes to the intercarrier compensation element of their cost recovery structure. Under the NTCA plan, RoR providers would recover these supplemental amounts through the ICLS and price-cap carriers would recover such amounts via the ICS. Consistent with RoR regulation, the RM calculation must produce ICLS support levels that ensure providers are able to successfully earn authorized, modest rates of return on total regulated operations, notwithstanding reductions in access rates, losses in access lines, and/or decreases in demand minutes.

We also call for these supplemental amounts to be offset by any increases in the federal subscriber line charge (SLC) of up to \$1.50/month, and any increase in local end-user rates up to a federal benchmark rate of \$20/month. This will reduce the overall size of the ICLS and IAS high-cost support mechanisms because a portion of the costs of network access will be covered through SLCs and end-user local rates. The federal benchmark rate should include local residential rates, state and federal SLCs and SLC-like charges, mandatory enhanced area service (EAS) charges, and per line state universal service fund collections. SLC increases, if any,

should be limited to what is required for the company to reach the federal benchmark rate and the overall SLC cap.

The Universal Service Broadband Orientation

Today there is widespread agreement that our national universal policy should embrace broadband and advanced services. Policymakers and the public alike agree that it makes no sense to maintain or craft communications related programs that are tied solely to voice services when we are operating in an era that is so dependent on data, video, and mobile capabilities.

The chair of this subcommittee, in addition to the three sitting FCC commissioners, all agree that broadband should be included in the definition of universal service. NTCA has previously urged the FCC to establish a broadband universal service policy. We have suggested that such a policy adequately consider the financial burdens that confront small, rural providers that strive to provide their consumers with advanced services. We have asked that such a policy ensure rural consumers have access to advanced services that are comparable in price and scope to those available anywhere else in the nation. We have requested that the FCC fully explore all the potential benefits, difficulties, risks and rewards associated with first defining “broadband” and then to determine how best to ensure this is a definition that can and will evolve over time.

It is important to reiterate that in the meantime, rural carriers have aggressively been deploying broadband. The Rural Utilities Service has already provided broadband specific financing of over \$6.3 billion and through the years has also provided many more billions that have indirectly helped deploy broadband capable infrastructure. Likewise, private financiers CoBank and RTFC have pumped several billion dollars each into the deployment of advanced communications infrastructure. And most recently Congress and the President have provided an additional \$7.2 billion for this purpose via the RUS (\$2.5 billion) and NTIA (\$4.7 billion) broadband financing

provisions of the American Recovery and Reinvestment Act of 2009. While a portion of these latest appropriations will arrive in the form of grants, for the typical loans, universal service support is still an essential ingredient in the providers' formula to successfully repay those loans. That is why it is so critical that we move quickly to formally associate the universal service program with the deployment of broadband and advanced services.

Limit Over Earnings

In conjunction with the Restructuring Mechanism (RM) discussed earlier, NTCA and its members have also agreed to take a dramatic step in proving to the world that their use of universal service funds is entirely in the public interest. Under this plan, RoR carriers, as well as price cap carriers seeking supplemental universal service support under the RM would voluntarily agree to have their broadband services regulated under Title II of the Communications Act and also allow their total company regulated Title II costs, revenues, and earnings to be considered as part of the determination in arriving at their future broadband universal service support levels.

It's been noted previously that policymakers, as well as the public at large, are asking the industry to deploy a nationwide ubiquitous broadband network. Rural providers are attempting to do their part in the rural high-cost areas they serve. These providers should neither be expected nor required to commit resources without a reasonable expectation of a return on their investment. Likewise, the FCC, Congress, and the American public are entitled to know that federal universal service dollars are being used prudently and for the specific purpose they were provided. The proposal we offer here accomplishes both of these objectives, ensuring that providers only receive supplemental support to the extent necessary to recover all reasonable regulated costs. In other words, carriers agreeing to this approach would be signaling to the

world that they are not overearning at the expense of the universal service system and its limited pool of resources.

Ensuring Stable Network Transitions

In the midst of this discussion of moving from a voice to a broadband oriented infrastructure is something called voice over Internet protocol (VoIP) service, that is a direct substitute for traditional voice telephone service. VoIP calls that utilize the Public Switched Telephone Network (PSTN) are called interconnected VoIP calls. To the extent interconnected VoIP calls utilize the PSTN; they should be treated like any other telephone call. Thus, the logical conclusion of policymakers must be to take specific action to require that all IP/PSTN providers, and specifically interconnected VoIP providers, pay applicable universal service charges, terminating interstate access rates, terminating intrastate access rates, and reciprocal compensation rates, until such time as there is no longer an functional PSTN and these or similar cost recovery fees are connected with the replacement network.

The reason this is so critical is that without such an immediate and clear directive, it is conceivable that carriers like AT&T, Verizon, and Qwest and others with extensive interexchange (long-distance) operations will immediately take advantage of this loophole. They could easily and readily use this loophole to classify all of their respective voice traffic as interconnected VoIP and by extension begin refusing to pay access charges.

Presently, our industry already experiences great difficulty collecting legitimate revenues due to access and intercarrier compensation arbitrage. In addition to this we confront extreme challenges with regard to so-called “phantom traffic” which is not billable either by design or accident. The chair of this subcommittee is well aware of all of these forms of arbitrage and has been associated with negotiations and actions to stem them in the past. We simply remind his colleagues that for the reasons just outlined, it is imperative that we have definitive action on these items, and sooner rather than later.

In addition, any comprehensive USF and IC reform should address tandem-switching rates. Congress and the FCC should establish cost-based rates for these services. The volume of minutes traversing a tandem switch is much higher than that of a local central office switch, therefore it would be reasonable to expect that the cost for providing these services would be lower than the cost of local switching. Reducing price cap carrier tandem transiting rates to cost-based rates would provide further savings for IXC's, VoIP providers, and consumers. Cost-based tandem-switching rates for AT&T, Verizon, and Qwest will assure reasonable access to these bottleneck facilities of the nation's largest carriers.

Furthermore, Congress should require all large, vertically-integrated communications carriers, such as AT&T, Verizon, and Qwest to provide non-discriminatory, cost-based special access transport services needed to reach the Internet backbone. Increasing broadband demand means that carriers must increase their transport capacity to the Internet backbone. When these carriers must purchase special access services at above cost rates, customers eventually will see these higher costs included in their broadband rates. These costs, as well as the middle mile transport¹ and the Internet backbone itself are significant cost factors in providing rural broadband service and must be addressed in any comprehensive reform.²

To achieve and maintain the goal of universal affordable broadband service for all Americans, the Congress and the FCC should regulate the terms, conditions and pricing of Internet backbone services, including special access transport needed to reach the Internet backbone, to ensure that large, vertically-integrated Internet backbone providers do not abuse their market power by imposing unfair and discriminatory pricing on small, rural communications carriers

¹ National Exchange Carrier Association (NECA), *Middle Mile Broadband Cost Study*, October 2001. NECA's findings were dire—concluding that high-speed Internet service is uneconomic in many rural areas. NECA further found that increased IP traffic will exacerbate, rather than ameliorate, the problem, as existing revenue shortfalls are multiplied as the scale of operations increases. For example, the study shows revenue shortfalls at \$9.7 million per year at a 0.5% penetration rate, growing to \$33.6 million per year at a 5% penetration rate, \$49.8 million at a 10% penetration rate, and \$63.8 million per year at a 15% penetration rate. NECA's sobering conclusion: "high-speed Internet service may not be sustainable in many rural areas based on pure economics. See *NECA Middle Mile Cost Study Executive Summary*, www.neca.org/source/NECA_Publications_1154.asp.

² Special access transport includes, among other services, packet-switched broadband services, optical transmission services (e.g., frame relay, ATM, LAN, Ethernet, video-transmission, optical network, wave-based, etc.), TDM-based services (e.g., DS-1, DS-3, etc.), and other future transport services to reach the Internet backbone.

providing retail high-speed Internet access service in rural, insular and high-cost areas of the United States. The FCC has already adopted some of these conditions as part of the FCC's approval of the AT&T/BellSouth merger.³ NTCA urges Congress and the FCC to broaden these conditions in the future.

Strengthening ETC Designations

But let us refocus more specifically on universal service. Earlier I alluded to the fact of how policymakers, in the name of competitive neutrality and for expediency sake, have mostly forgone their statutory responsibility to ensure the universal service program operates in the overall public interest. Truly this all begins with the responsible granting of eligible telecommunications carrier (ETC) or universal service eligible status to any given provider. Under the parameters of the statute and related regulations, the public utility bodies of the individual states hold the responsibility to make ETC determinations. However, in situations where such authority does not exist, or it is in fact abdicated, the responsibility of granting ETC determinations falls to the FCC.

From the beginning, it is has been the observation of NTCA and its members that the states, as well as the FCC, have largely failed to carry out this task from a clear public interest perspective. Generally ETC decision making has been biased toward establishing a so-called competitively neutral landscape. This has routinely been to the advantage of competitors who target support rich market pockets and the states where these dollars are flowing. It has been to the detriment of incumbents who have carrier of last resort obligations and ultimately consumers who ultimately shoulder the cost of these new amounts that begin flowing through the universal service program.

³ *In the Matter of A&T and BellSouth Corporation Application for Transfer and Control*, Order on Reconsideration, Appendix, Page 5, WC Docket No. 06-74, (rel. March 26, 2007).

Eliminating the Identical Support Rule

This problem has been extremely exacerbated by the FCC's longstanding arcane and nonsensical "identical support rule" which again all in the name of competitive neutrality, allows a competitor in a given market to receive support based on the incumbent's imbedded costs – even though the competitor's costs are usually far less because they have not been required to serve customers throughout the market area as incumbents must do. Perhaps the most vexing aspect of this rule is how it motivates competitors like U. S. Cellular to zero in on markets where there is the most money rather than markets where there is the most need.

This happens because without a requirement to serve the entire market area, and with a rule that says competitors will receive support based on the incumbent's costs, competitors target markets where universal service support is high because rural incumbents have been working hard to deploy services. Meanwhile the same competitors totally overlook the rural markets of the large carriers where deployment has typically not been widespread and where for this and other reasons universal service dollars are not flowing and thus would not flow under the identical support rule. Obviously this conundrum is not in the public interest and we are pleased to know your prior legislative initiatives have proposed the elimination of the identical support rule. We look forward to working with you to achieve its eventual elimination.

Expanding the Assessment base

If broadband services are included in the definition of universal service, it is only logical that contributions be based on information services as well as telecommunications services. NTCA has previously urged policymakers to expand the pool of universal service contributors to include all cable, wireline, wireless, electric, and satellite broadband Internet access providers, all voice substitute services, and all special access service providers. Section 254(d) specifically provides the FCC with permissive authority to require any provider of interstate

“telecommunications” to contribute to universal service. Requiring all broadband service providers and all voice substitute providers to contribute will provide sufficient universal service collections and create long-term stability in the USF contribution methodology.

The regulatory classification of cable and wireline broadband Internet access services as an information service does not preclude the FCC from requiring all providers of broadband Internet access service and all providers of voice substitute services to contribute toward universal service based on the revenues derived from these services. The underlying transmission component of all broadband Internet access services is “telecommunications” as defined by the Communications Act.

Sustaining a robust universal service program based on contributions from only a narrow class of carriers and services is impossible and certainly not in the overall public interest. If contributions are limited to a subset of services, the pricing differential between services that support the network and those that receive a “free ride” will cause services to migrate away from the services that support the network. Eventually, the network cannot be sustained in high-cost rural areas because the funding source will have disappeared. This is a classic example of the sort of non-competitively neutral environment the FCC has so often expressed concerns over yet to date the agency has failed to act to preclude such a situation from emerging.

Policies must also keep pace with how communications providers substitute traditional circuit-switched telecommunications services with IP facilities and technologies. The base should be uniform across all providers of facilities-based, broadband information services, regardless of the technology used. Only a contribution methodology that is inclusive of all technologies can achieve the Communications Act’s requirements that universal service support mechanisms be equitable and nondiscriminatory.

Likewise, we believe the contributions assessment methodology must be forward looking. Since AT&T first proposed a numbers based methodology, largely to shift this responsibility away from itself and its interexchange counterparts, the FCC has repeatedly put the concept on the bargaining table even though it lacks the statutory authority to move away from the statutorily mandated revenues assessment methodology. Now, several years later, at a time when policymakers and the public alike are demanding that we migrate to a fully broadband and advanced services capable infrastructure, variations of the AT&T numbers concept continue to receive consideration, both in Congress and at the FCC, despite the concept's backward looking approach to assessing a limited segment of the overall communications industry that was originally tied to voice service addresses in the form of voice telephone service numbers. The revenues assessment methodology is known, tested, operational and superior. We should stick with it.

It is true that due to the fact that the Communications Act mandates the revenues assessment be made based on a carriers interstate and international interexchange services that the assessment factor has had to escalate to derive the necessary support flows. So, rather than moving to a numbers based system that would dwell on only one segment of the industry would it not be far more equitable to simply expand the revenues that can be assessed to be inclusive of intrastate interexchange services as well. Furthermore, if policymakers were to merely embrace the universal service modifications NTCA has proposed to the FCC and that we are reiterating here today, there would be no need to consider something as backward looking and drastic as an untested numbers proposal.

Rejecting Unworkable Distribution Concepts

Through the years, various policymakers that had otherwise been frustrated in their endeavors to unravel the universal service program have occasionally attempted to limit the program in others ways such as via reverse auctions, vouchers, or other untested, unnecessary, and generally unworkable means. It is instructive to note that despite their proclivity to resurrect themselves, these concepts have routinely failed to garner any widespread support. A case in point is the idea of distributing universal service support in the form of individual consumer vouchers.

Rural carriers and their allies have long recognized the fatal flaw with this concept. Vouchers would act as a consumer welfare program rather than an effective cost recovery tool that ensures advanced infrastructure and services are effectively deployed. During the Senate's consideration of the Telecommunications Act of 1996, an amendment to distribute universal service support in the form of consumer vouchers was offered by Senator McCain (R-AZ). It was summarily and soundly rejected.

Last year, your colleague on the full Energy and Commerce Committee, ranking Republican Joe Barton (R-TX) introduced universal service reform legislation that proposed a variation of this concept that also advocated the idea of reverse auctions to distribute universal service support. Like vouchers, on the surface reverse auctions have a slight sense of appeal to some who believe they may incite efficiencies. But once you dig below the surface many problems quickly emerge and multiply.

In a reverse auction, unlike a traditional auction, bidders are encouraged to bid low. Thus, in a reverse auction for universal service fund (USF) support bidders would bid for the minimum amount of support they would require to serve a particular area. All other things being equal, the idea is that the lowest bidder would win. This is not viable for USF distributions according to Dr. Dale Lehman, Director of the Executive MBA in Information and Communication Technology at Alaska Pacific University, who has written extensively on this subject. In three different papers Lehman provides substantial evidence as to why USF reverse auctions would not be workable in markets with preexisting infrastructure. He concluded that “much of the

theoretical appeal of reverse auctions is dissipated under the actual conditions under which USF support will be provided.”

What Dr. Lehman is referring to is the fact that the reverse auction concept leaves too much to chance for rural communities that depend on USF support for ensuring access to high-quality, affordable communications services. Reverse auctions lead to questions about stranded investment if an incumbent carrier lost an auction and would have limited ability to support their past investments in their existing infrastructure. Reverse auctions could have a chilling effect on future investments in rural communications networks because of the uncertainty of the auction process. Also, low-bidding by a carrier that would ensure success in a reverse auction could lead to insufficient universal service funding to support the current infrastructure or upgrades to the network, leaving rural consumers with inadequate communications services.

Implementing reverse auctions, vouchers or other such concepts would be a serious mistake. Were policymakers simply to follow NTCA’s blueprint for universal service modifications there would be no reason to give further consideration to such ideas.

Today’s USF distribution approach is effective and Congress and the FCC should acknowledge the success of rate-of-return regulation and the embedded-cost methodology in achieving a 95% U.S. household voice service penetration rate. NTCA believes the same level of success can be accomplished for the ubiquitous deployment of broadband by using the proven USF mechanisms without relying on the untested, risky theory of reverse auctions.

Caps, Freezes, and Preserving the Underlying Network

For well over two decades, we have observed the FCC savoring a role it has never been granted by the Congress – that of the final arbiter over all matters relating to the actual size of the universal service fund. The obsessive control the agency refuses to let go of in this regard first emerged in strong form in the late 1980s and early 1990s when large carriers began to sell vast segments of their rural exchanges to rural carriers that apply the sort of committed operational model that is so necessary to effectively serve rural high cost markets.

With the sell-offs building, the FCC soon concluded that this process could ultimately have the effect of increasing the flow of dollars through the universal service system. Thus the agency quickly acted to limit this potential new support flow by implementing “temporary regulations” that required purchasing companies to request and go through a formal waiver process to receive support for acquired territories. It quickly became obvious that the agency had no intention of routinely granting such requests and over time, as other pressures began to tug at the universal service program, the agency only grew more resolute in its resolve to “control program growth” despite the fact that doing so was neither in the public interest nor its prerogative to begin with.

Now, years later, and many statutory directive later, not the least of which was the Telecommunications Act of 1996 with its expanded mission for the program, our industry still finds itself the unfortunate victim of this so-called temporary cap.

Today the FCC’s cap does have a rural growth factor associated with it which was negotiated between the agency and the industry several years ago. The factor is derived via a two-part formula that takes into account the annual change in the national consumer price index (CPI) as well as access lines. Again, it was envisioned as a mechanism to allow program growth, not decline. Unfortunately, we could never have imagined how the CPI would not track inflationary costs across the board and thus not always give a representative or helpful modification to the cap. Likewise, at the time of the rural growth factor’s creation we did not foresee the level of access line disruption our industry would begin to experience just a few short years later.

Today we find ourselves in the very difficult situation where policymakers and the public are mandating dramatic and costly infrastructure upgrades to meet their bandwidth demands. Meanwhile, simultaneously, the rural growth factor is moving in the reverse direction, responding to unusual CPI factors and access line loss that is occurring throughout the industry. The problem is further exacerbated each time a new ETC designation is granted or one of our colleagues launches an aggressive new deployment initiative such as a fiber to the home upgrade.

Yet the need for our underlying infrastructure never evaporates. In most rural communities today, if there is no underlying local exchange infrastructure, the citizens of those communities will be left with substandard or no service at all. Most people don't stop to think about it, but our underlying wireline infrastructure is generally a key element that ensures consumers receive wireless calls. A popular misconception is that wireless phones communicate directly with one another. They do not – rather they ride for a significant portion of their trip on the wireline infrastructure. The same is true for Internet access, VoIP services, and even for video applications, and this is especially true when we are talking about the consumers that reside outside the community's municipal borders.

Mr. Chairman, your prior universal service bills had provisions that formalized the FCC's temporary cap on the high cost fund which you explained to us was in part an effort to secure support from that industry's larger carriers. To our knowledge such support has never materialized in any significant form or fashion. Indeed, worse than that, over the course of the past year or more these carriers have simultaneously dangled their carrot of support for a capped fund before you, while actively pursuing regulatory strategies that would drop access and intercarrier payments to a level of .0007 cents per minute with the residual for rural carriers to be picked up via the very fund they urged you to cap.

These sorts of disingenuous negotiations should neither be entertained nor tolerated. Furthermore, in light of the dramatic interest displayed on the part of this Congress as well as President Obama and his administration with regard to broadband and advanced infrastructure deployment, now seems exactly the wrong time to even consider capping the universal service fund. With these facts in mind, we urge you to reject the cap concept and instead take formal steps to statutorily remove the FCC's temporary cap on the program.

Removing Universal Service from the Budget

With all of these factors in mind, it seems to us that now is a logical time to again give serious consideration to doing something that should have been done long ago by formally removing the universal service system from the federal budget. Your earlier universal service packages would

have effectuated such an outcome and we encourage you to make that a part of any legislation you introduce this year. Prior to 1995, the universal service system was never considered a part of the federal budget because it had always involved transactions of private monies between private sector parties. The only reason it became part of the budget was because Congress allowed the Congressional Budget Office and the Office of Management and Budget to make assumptions and interpretations that the flow of support was somehow federally oriented. They made this misinterpretation based on the opinion that following the enactment of the Telecommunications Act of 1996 the statutory directives on contributions and distributions gave an implied suggestion that these were federal associated amounts.

Yet the fact of the matter is that even today, these monies are still private monies, not funds that are being appropriated from the federal Treasury. The only difference now is that the Universal Service Administrative Company that oversees the program's financial transactions is subject to FCC oversight and approval. This is another reason some have tried to make the direct federal correlation. Nevertheless, during the course of discussion and debate that has continued over whether or not to subject the program to the parameters of the federal Anti-Deficiency Act, OMB has issued a lengthy analysis and conclusion that clearly acknowledges these are not federal monies. Wouldn't it be proper to explicitly remove the program from the federal budget process? We believe so.

Conclusion

IP-enabled services and all communications services rely upon a healthy and robust network infrastructure to reach end users. The one issue that must be resolved to ensure the existence of a robust nationwide ubiquitous communications network that can support IP-enabled and other advanced services in the future is cost recovery. Without adequate cost recovery there will be no network for any communications service, including VoIP, to reach consumers be it wireline, wireless or some other medium.

Unfortunately there are still those that believe a central element of our industry's cost recovery formula becomes irrelevant as infrastructure deployment milestones are achieved. We must pledge to work together to eradicate this way of thinking. Such viewpoints completely ignore the reality that networks must also be maintained and upgraded. Despite technological advances, it is, and will continue to be, significantly more expensive to serve rural America even after a ubiquitous broadband network is built.

Again, all service providers and consumers benefit from a robust national network infrastructure. The current structure of cost recovery enabled us to achieve our impressive 95% national telephone penetration rate. In order to achieve those same penetration rates with broadband and whatever emerges thereafter, we may well need to modify the program periodically, but the key is to have the network in existence and operational in the first place.

I ask you to look to the future rather than sculpting rules that will only meet short term goals. In 1983 my father purchased a state of the art home computer called the Commodore 64 that had an incredible 64 thousand bytes of memory. Today's standard computers ship with over 2 billion bytes of memory. The memory requirement has doubled about every two years. Broadband is following a similar path. The 10 megabit speed of today will be the dial up service of tomorrow. We can only guess what the speed requirement will be 10 or 20 years from today. We can only imagine the applications that we will ask our networks to support. Every American citizen will require the best communications in order to productively do the jobs required to compete in the global economy. We must invest in this critical infrastructure or be left behind by the world. The words of our new president ring true when applied to Universal Service. "The challenges we face are real, they are serious and they are many." The members of NTCA are ready to meet

these challenges to ensure that no one is left behind. Only through your help in maintaining a strong USF program will we be able to succeed.

Mr. Chairman, we are excited to have someone with your knowledge of our industry and your commitment to rural America in a position to affect leadership and develop policies that will ensure America's broadband and communications preeminence will shine once again. Thank you for the opportunity to testify today, and I look forward to answering any questions you or your colleagues might have.