Prepared Testimony of Verizon Senior Vice President Peter B. Davidson
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"Universal Service Reform Act of 2009"
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Chairman Boucher, Ranking Member Stearns, and Members of the Committee: Thank you for the opportunity to discuss reform of the Universal Service Fund (USF) and the new Universal Service Reform Act of 2009 circulated recently by Chairman Boucher and Representative Terry. The Committee has always been a leading voice on universal service policy, and this legislation is a good starting point to put policies in place to sustain USF and direct the funds it collects to the real communications needs of consumers.

Over the past year, there has been a great deal of discussion about the importance of innovative wireline and wireless communications networks and services to consumers. We also have talked a lot about encouraging deployment and adoption of next generation networks and discussed how these networks will help keep America competitive in our global economy and address some of our most pressing challenges, such as health care reform, education, and energy conservation.

These are all critical goals, and, with the help of the Committee, we have made great progress with policies that will result in the ubiquitous deployment of wireline and wireless broadband networks: Congress passed mapping legislation last year and the economic stimulus bill this year. And we now have a full complement of FCC commissioners, all of whom are committed to a broadband agenda and are working hard on creating a national broadband plan.

In achieving the overarching and worthy goal of bringing broadband to everyone, we now have different tools to address different facets of this challenge. We should ensure that those funds and programs targeted for broadband mapping, deployment, and adoption have a chance to work. We will then need to figure out what worked well, where we still have challenges, and what solutions are best suited to getting all Americans access to broadband services.

There will no doubt continue to be an important role for the Universal Service Fund to play going forward. But right now the fund is in trouble and in no shape to contribute to the broadband solution. The high cost fund is literally at a tipping point – having grown from $3.5B to $4.5 billion in only five years. At the same time, the revenue base which funds USF is shrinking rapidly – declining almost $2 billion dollars between fourth quarter 2008 and fourth quarter 2009. As a result, the USF "contribution factor" is near an all-time high and is projected to rise again the first quarter of next year to *more than 14%* just to pay for the fund at today's level. These fees are really hitting consumers hard, especially in these economic times, and this trend is simply unsustainable.

The problem with universal service is not that we are spending too little money; it's that we are not spending it on the right services in the right places. We cannot put off the tough choices on the major issues any longer. We have to fix the broken universal service framework before layering on additional priorities, broadband or otherwise. The draft Universal Service Reform Act takes us a big step forward by addressing five of the most pressing matters:

- An overall budget for the high cost fund;
- A new contribution methodology;
- Competitive bidding for wireless support;
- A date certain for related reform of intercarrier compensation; and
- An end to traffic pumping.

Allow me to address each of these issues.

The draft Universal Service Reform Act would bring broadband directly into the universal service fold. Broadband creates quality jobs and increases the competitiveness of the communities it reaches; makes it easier for citizens to engage with their communities and government officials; and helps to address critical social challenges like healthcare, education, and energy efficiency. So it makes sense to provide some kind of targeted support for broadband in unserved areas. If we make broadband part of the Universal Service Fund, however, we have to figure out a way to create a smart and sensible relationship between the two.

The essential first step is to set a budget for high cost universal service funding. This seems simple, and it is. It's no different than, for example, buying a car. Nobody would sign an agreement to buy a new car with all of the latest features automobile technology can offer without knowing the price of the car. Likewise, we cannot ask consumers, who contribute to the fund through charges on their bills, to write a blank check to pay for a redesigned high cost program. Some suggest that any limit on high cost funding could be harmful to consumers in rural America. Just the opposite is true. A high cost program with no ceiling would harm rural America. Consumers in rural areas pay for the Universal Service Fund just like everybody else. It's their money, and if the fund grows, they will pay more. Policymakers should appropriately balance the obligation to fund service in high cost areas with the need to ensure that the fund is sustainable for everyone.

The debate is not theoretical. We know from the sea change in communications technology and services over the last few years that only imagination constrains the potential for new, better, and faster services. And we also know from the tremendous growth in the high cost fund over the same period that the USF is not suited to meet the demands of its existing programs, much less new broadband programs. Without some restraint the USF contribution factor will surely rise to 15%, even 20% or more. We simply must have the discipline at the outset of any overhaul of the high cost fund to define some reasonable funding boundaries.

Second, the way we “fund the fund” through an assessment on interstate revenues from telecommunications services is a mess. This system may have worked in the old days of one network and only two services – local and long distance voice calls – but it’s not practical with the converged, any-distance services consumers expect today. The draft Universal Service Reform Act acknowledges the need to update the universal service contribution system and directs the FCC to figure out the best way to pay for the fund.

It is particularly important to get the USF contribution system right in the broadband era. The current system is another example of how technology can outstrip regulation. A contribution system based on revenues derived from particular types of services will always produce competitive inequalities. For example, so-called "over-the-top" VOIP providers such as Vonage did not pay into the USF until 2006. Today, Google Voice is not paying into the fund. And tomorrow there will be another next-generation service that competes with assessable services for the same customers but does not pay into the fund. This situation skews the market by delivering a double blow to services that pay into the fund. Not only do these services have to pay USF themselves, they also have to “make up” for the contributions that the fund loses from migration to certain next-generation products that do not fit into the current contribution system. The system is not equitable for anyone, and it must be changed.

The current contribution system also is not practical. The system is based on the erroneous notion that it is possible in today’s world to distinguish between interstate and intrastate services and between telecommunications and information services. Only interstate telecommunications services pay USF. But these distinctions are withering away, and we cannot pretend that they do just for universal service contribution purposes. Today, consumers buy many different communications services from a variety of providers that rely on different technologies. Consumers have options from wireline, wireless, Internet protocol, satellite, and other providers. Many of these choices include "all distance" bundled offerings that lump together video, voice, data, and other services all for one price. Some, but not all, of the revenues from these offerings may be USF assessable. This forces providers to make different, arbitrary allocations and skews the market toward services and providers that do not contribute to the Universal Service Fund. These complexities are getting worse every day as the same technological advances that policymakers seek to encourage through other federal programs make it impossible to maintain the fiction that a revenue-based USF contribution system is sustainable.

The draft Universal Service Reform Act would commit the FCC to take a hard look at an alternative contribution system. That is a good start. The best contribution methodology is one mentioned in the bill – a flat charge on each working phone number to pay for all or part of the USF contribution base. It is particularly important to fix the contribution system now. As I mentioned, the USF contribution factor next quarter will likely be more than 14%, which is the largest in the history of the fund. Not that long ago the factor was about half that size. The contribution factor has historically jumped around, but its upward trajectory and new peaks have pushed the fund to the brink. Just as troubling, the assessable base of interstate revenues is getting smaller and smaller. Interstate telecommunications revenue, the basis for all universal service funding, is now at the lowest level ever since the FCC began using quarterly revenues in the contribution factor calculation in 2001. That is not surprising given the shift away from traditional, USF-assessable services. But this is a trend that cannot continue if the Universal Service Fund is to survive and meet the new, important communications needs of people and healthcare facilities in rural areas, schools and libraries, and low income consumers.

The problems of a revenue-based system are not fixable by broadening the contribution base or by making other changes to the revenue system itself. Any revenue system will involve unworkable distinctions between what is and is not a contributing telecommunications service. The move away from simple telecommunications services toward more complex services is what's driving dollars out of the funding base. A numbers-based contribution system on the other hand fixes these problems by assessing contributions on an objective and readily measurable basis that is not affected by these shifts in demand. In fact, the "number of numbers" continues to increase steadily. Working phone numbers in the public domain increased by more than 60 percent between 2000 and 2008 to about 650 million numbers.

A numbers-based system with a small, set charge on each working phone number and narrow exceptions is better for everyone. It is better for consumers because many would see a decrease in the USF charges they pay each month, and a flat charge per number is easier to understand than a percentage charge that jumps around every month based on consumption. Frankly, nobody understands the universal service charges on their bills today. Low income consumers receiving assistance under the Lifeline program would also pay no USF, unlike the current system. A numbers system is better for policymakers because it would be easier and cheaper to administer and audit. And a numbers system is better for providers because it fairly spreads the contribution burden around and makes paying into the Universal Service Fund much simpler.

Third, a competitive bidding system is the best way to distribute high cost support to wireless carriers. The draft Universal Service Reform Act recognizes the benefits of this market-based approach and sensibly puts in place a forward-looking competitive bidding system to support and expand the reach of wireless networks.

The time is indeed now to once and for all fix the way wireless carriers draw support from the USF, which today doesn't make any sense. Currently, while wireless funding is capped overall at the state level, the per-handset subsidy amount paid to wireless carriers is calculated based on the per-line amount that is paid to the wireline incumbent serving a high cost area. In some cases, this encourages wireless carriers to serve areas where the incumbent receives substantial high cost funding, not necessarily to build out their networks into unserved areas. In addition, payments to wireless carriers are the same even if there are multiple providers that offer mobile service in the area – including carriers that compete without any USF support at all.

This is not how the system should work, and it is certainly neither an efficient nor effective way to meet the market's current and future mobile broadband needs. Universal service funding should be used to make sure all Americans have access to the services they want and need to be successful in the communications age, not to pay wireless carriers to sell more handsets in areas where there is a viable business case to offer service even without any universal service subsidies.

The right competitive bidding system will fix these problems. Competitive bidding breaks the artificial link between wireline and wireless funding and will bring the Universal Service Fund in line with established procurement procedures at other federal agencies. Many important goods and services such as critical product development work for military equipment and repair work for bridges and roads are purchased by competitive bid contracts. There is every reason to believe competitive bidding can also produce quality services in high cost areas and save consumers some money over the current system at the same time.

Some suggest that competitive bidding will result in low-quality service in rural areas. If we set up the system in the right way, that just isn't true. Quality of service considerations are not unique to the communications industry, and competitive bidding is the standard way that government, at all levels, makes important procurement decisions. The FCC will need to address quality of service requirements in rules for a competitive bidding system, but that is manageable through legally enforceable contracts signed with those wireless carriers that win the bid to provide service in a high cost area.

The contracts that result from the competitive bidding process should also include wireless network build-out and maintenance obligations. Unlike the current system that subsidizes wireless carriers based on a wireline model, this will ensure that consumers get what they are paying for – that is, expanded reach of wireless networks. Getting wireless infrastructure into those areas where there are needs is essential as policymakers also struggle to fill remaining gaps in broadband access with the right technologies based on individualized facts and circumstances in these areas.

Fourth, we have to fix the broken intercarrier compensation system at the same time we update the Universal Service Fund. The key elements of the multi-year intercarrier compensation reform effort are not in dispute. We all just need a little help mustering up the resolve to get this done. The draft Universal Service Reform Act eliminates inaction as an option by setting a deadline for reform.

Universal service and intercarrier compensation (the charges that companies pay each other when traffic is sent to or received from the traditional phone network) are linked because regulators have in the past seen revenues from intercarrier compensation charges as a tool for keeping local phone rates affordable, something the universal service does expressly through subsidies paid directly to carriers. But supporting universal service with intercarrier compensation charges is not possible any longer in a market based on technologies that do not rely on yesterday's phone network. The current intercarrier "system" relies on the idea that there are meaningful distinctions between interstate and intrastate services and between telecommunications and information services. As with universal service, migration to next-generation services makes these distinctions meaningless and drives dollars out of the intercarrier compensation system. In fact, high charges by some carriers for access to their networks impedes roll-out of new and advanced services in rural areas that could benefit most from these services.

The draft Universal Service Reform Act requires the FCC to act on intercarrier compensation reform within one year. That's certainly doable. Parties mostly agree that a single, low, uniform charge for terminating traffic on a network is the right solution. Carriers should also have the opportunity to rebalance their end-user rates, and to the extent they cannot recover lost access revenues they would have received going forward from their own customers, carriers could recover part of the difference during a transition period from a new universal service program. The new USF intercarrier compensation program should be expressly transitional and decline over time.

Fifth, we have to stop the so-called "traffic pumping" schemes that have plagued the industry the last several years, and the draft Universal Service Reform Act would help do that. Traffic pumpers game the intercarrier compensation system by exploiting antiquated FCC and state rules through collusive arrangements to drive traffic way up in some rural areas that historically have very low traffic volumes and correspondingly high access rates. Local exchange carriers in these rural areas then partner with chat-line and other providers, who market their services as "free," and share these excessive access revenues. The intercarrier compensation rules that allow LECs to charge other carriers high access rates in rural areas are designed to help ensure that consumers in these sparsely populated areas receive affordable and reliable service. The rules are not supposed to allow for these traffic pumping scams that have cost customers of more reputable carriers millions of dollars. Comprehensive reform of intercarrier compensation by the FCC might take care of the traffic pumping problem, but that is a long-term effort and these schemes must be stopped once and for all right now. The draft Universal Service Reform Act would make it illegal for traffic pumpers to charge other carriers for access on traffic subject to these revenue-sharing agreements.

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There are no perfect or easy solutions to the many universal service and related issues facing the Committee and the new FCC, and we cannot predict all of the many more innovations and changes that will surely take place in the communications marketplace. But we share the commitment to the goal of bringing these transformative technologies to all Americans and encouraging widespread broadband adoption. We also know that the Universal Service Fund and the universal service programs many of our fellow citizens count on are too important to let the fund slide further and further into crisis.

With the help of the Universal Service Reform Act we can get the Universal Service Fund moving down the path of sustainability and toward meeting the communications needs of our country. Thank you.