TESTIMONY OF KYLE McSLARROW
PRESIDENT AND CEO
NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

on the

Discussion Draft of the Universal Service Reform Act of 2009

before the

Committee on Energy and Commerce
Subcommittee on Communications, Technology, and the Internet

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Good morning, Chairman Boucher, Ranking Member Stearns, and Members of the Subcommittee. My name is Kyle McSlarrow and I am the President and Chief Executive Officer of the National Cable & Telecommunications Association. Thank you for inviting me today to testify on the discussion draft of the Universal Service Reform Act of 2009. We welcome the discussion draft as a valuable and important first step toward bringing the universal service fund (USF) into the 21st Century.

NCTA represents cable operators serving more than 90 percent of the nation's cable television households and more than 200 cable program networks. The cable industry is the nation's largest provider of residential high-speed Internet service, having invested more than $145 billion since 1996 to build two-way, interactive networks with fiber optic technology. Cable companies also provide state-of-the-art digital telephone service to more than 20 million American consumers. Cable operators are committed to expanding access to quality voice and Internet services, and the dramatic growth in cable broadband subscribers is evidence of their success in doing so.

As a major contributor to the federal universal service fund, the cable industry has a significant interest in USF issues. We share and applaud your goal to cap the size of the high cost fund and transition away from a monopoly-era support program and toward a more modern, neutral, and forward-looking mechanism. With the same goal in mind, we recently asked the FCC to open a rulemaking to reduce high cost support in areas where there is durable unsubsidized competition. We believe the growth of local competition gives Congress the opportunity to curb the growth of the high cost fund and turn its attention to how best to support the deployment and adoption of broadband services. Based on our research, we have concluded that there is up to $2 billion dollars in high cost subsidies currently being provided in these competitive areas.

Other elements of the discussion draft would improve the implementation and administration of the USF programs. For instance, the draft adds the principles that universal service mechanisms should be competitively neutral and that such mechanisms should be "explicit" as well as "specific, predictable and sufficient." These are valuable additions to the framework on which the FCC and the Federal-State Joint Board base policies for the preservation and advancement of universal service. It is also past time to recognize, as the discussion draft does, that providers other than traditional common carriers should be eligible to receive USF support. We are pleased that the bill would confirm the FCC's statutory authority to adopt a numbers-based contribution mechanism. Finally, we support the provisions in the discussion draft that would outlaw "traffic pumping" and the use of "phantom numbers" that seek to exploit or avoid the current access charge rules – and direct the FCC to reform those rules through comprehensive intercarrier compensation reform.

We also agree that it is appropriate to consider tailored broadening of the universal service program to include carefully targeted subsidies for broadband service. As the discussion draft recognizes, however, the transition from a voice-centric USF system to one that supports broadband will entail significant changes. We recommend the Committee consider changes that not only include measures to control costs through a meaningful cap on the size of the high cost fund, as the discussion draft acknowledges, but also include a reduction in high cost program support where it is no longer needed, and the tailoring of support for broadband services to areas and consumers that currently lack access to such services. A renewed USF program must also include reform of contribution mechanisms and provide a new method of calculating high cost program support. I will discuss each of these issues in turn.

<u>The Local Exchange Marketplace Has Changed Substantially Since Congress Created the USF Program in 1996</u>

When Congress directed the FCC to create the Universal Service Fund program in 1996, incumbent local exchange carriers (ILECs) had a monopoly in the local exchange market, interexchange carriers were the only companies providing long distance service, wireless was a nascent service generally considered to be a luxury, and broadband Internet access was virtually nonexistent. Thirteen years later, the marketplace has changed completely. Cable operators today provide voice service to over 20 million voice customers, often offering it in rural areas throughout the country. Already, cable's entry into the voice market has produced billions of dollars in consumer benefits and promises even greater benefits in the future.

Notwithstanding these fundamental marketplace changes, however, the high cost program operates as if nothing has changed since 1996. Even as millions of Americans take service from facilities-based wireline competitors, and millions more decide they no longer need wireline voice services at all, the high cost fund continues to provide billions of dollars of support for wireline voice services provided by local telephone companies. And because of structural flaws in the high cost program, new entry by facilities-based competitors often has the perverse effect of *increasing* the subsidy a geographic area receives. As a result, the total size of the federal USF program, and the resulting burden on consumers, continues to escalate at a staggering rate. The current USF program is on an unsustainable path, with the contribution factor expected to rise above 14% next year – its highest level *ever* (as compared to under 6% ten years ago).

USF Reform Requires a Cap on the Size of the High cost Fund

A critical first step in USF reform is placing a cap on the size of the high cost fund. Unless high cost support is brought within reasonable bounds, it would be imprudent to expand the high cost fund to cover broadband services. The discussion draft caps contributions for high cost support at its current level, but we are concerned that the growth factor and various exceptions to the cap may not effectively limit the size of the fund. For instance, the discussion draft changes the calculation of high cost support for non-rural carriers and repeals certain existing limits on high cost support – and then permits an upward adjustment to total contributions to account for any increased demand for universal service funding caused by these changes. The unlimited upward adjustment to reflect changes in intercarrier compensation could also substantially increase the overall size of the high cost fund. Finally, the discussion draft permits an upward adjustment in the size of the fund to account for increases in the total number of ILEC access lines, but no reduction in contributions if the total number of ILEC access lines declines.

By increasing the overall level of contributions, all of these upward adjustments will increase the burden on consumers without any real change in the services they receive. Increasing the scope of state USF programs, as proposed in the draft, could add to this burden. On the other hand, any cap on contributions must be implemented in a manner that ensures sufficient USF support for tribal lands, which have been persistently underserved.

High Cost Support Can be Reduced or Eliminated in Areas Where Basic Service Can Be Provided Without Such Support

One of the fundamental problems with the current high cost scheme is that it does not include any mechanism for reassessing which providers and areas should receive support. With competition now firmly entrenched in much of the United States, we believe a mechanism that directs high cost support away from areas with unsubsidized competition can and should be added to the USF framework to ensure that support is targeted to areas that require it. In our view, this mechanism would advance the objectives of the discussion draft.

An effective cap in the size of the high cost fund is absolutely necessary to protect consumers and promote greater efficiency. Particularly if Congress decides to bring broadband within the scope of USF, consumers should not be expected to pay any more than they do today. We believe that the growth of competition in the provision of voice service offers an opportunity to bring the high cost fund under control. Specifically, USF support can be reduced or even eliminated in areas where there is unsubsidized wireline competition. Cable voice service is available to approximately 80 percent of U.S. households. In rural LEC study areas, more than 6.6 million households, or 43 percent, have access to cable voice services. The presence of an unsubsidized competitor in a market is, in our view, clear evidence that universal service support is no longer necessary. The Universal Service Reform, Accountability, and Efficiency Act Of 2008, introduced by Reps. Barton and Stearns, likewise recognized that USF support is not needed where consumers have access to affordable voice communications offered by one or more unsubsidized providers. In markets where both wireline providers are currently receiving support, by contrast, continued support may be necessary to ensure that consumers continue to enjoy a competitive choice.

Briefly, NCTA's proposal envisions a two-step process by which the Commission would reassess the level of USF support for providers in areas experiencing unsubsidized wireline competition. In *Step 1*, a petitioner could challenge the necessity for high cost support by demonstrating that one of two triggers is satisfied:

> Trigger 1 – More than 75% of households in the relevant telco study area can purchase service from an unsubsidized facilities-based wireline competitor (or more than 50% of

> households can purchase such service and there is evidence that competitors are not avoiding higher cost areas).
>
> Trigger 2 – The state has deregulated the rates for local exchange service in the relevant study area, thus permitting provider costs to be recovered through competitive pricing of voice and other services.

Both triggers constitute strong evidence that government support is no longer needed to ensure that consumers can receive service at reasonable rates.

In *Step 2,* the ILEC would have the opportunity to demonstrate the minimum level of support needed to ensure that consumers can receive service in areas *not* served by the unsubsidized wireline competitor. The goal is to determine the costs that are attributable to customers in the noncompetitive portion of a study area and that cannot be recovered through the revenues from regulated *and unregulated* services provided to those customers.

NCTA's proposal is a modest, but critical, first step toward meaningful and needed USF reform. It targets areas where continued government support is least likely to be needed because there is durable competition. In this regard, the proposed competition trigger is satisfied only where there is extensive facilities-based wireline competition; neither wireless nor over-the-top VoIP satisfies that trigger. Indeed, the majority of rural LEC study areas do not currently qualify under this trigger. Even in areas where one of the triggers is satisfied, there are no automatic reductions in support – *LECs will have a full opportunity to identify costs that cannot be recovered from customers, including provider of last resort costs*.

We encourage you to consider NCTA's proposal as part of your USF reform effort. We have provided more detail on this approach – including an economic analysis – in a petition for rulemaking we filed with the FCC the week before last. We believe our proposal should enable the Commission to reassess the continuing need for almost $2 billion in funding. It offers a mechanism for reducing unnecessary high cost support, which will help bring the contribution factor, and the resulting burden on consumers, under control. Of equal importance, once the existing USF program is on a better trajectory, Congress or the Commission can begin to consider whether, and how, to use USF funding to provide targeted support to programs that promote broadband deployment. It would be premature to use the USF as a vehicle for subsidizing broadband deployment, however, until the high cost program is placed on more solid footing.

We appreciate that the discussion draft also seeks to target high cost support, by calculating support based on wire center costs rather than statewide averages and providing support only to the extent that the ILEC's forward looking costs per line exceed 2.75 times the national average. This proposal assumes, however, that USF support is needed whenever costs are high – without first considering whether unsubsidized investment is taking place that makes such support unnecessary. Combining the wire center approach with NCTA's proposal could help meet the objective of targeting support where it is truly needed.

Even in non-competitive areas, targeting support to wire centers may be difficult to implement because the FCC no longer requires many of these carriers to keep or report the necessary cost data. A regime in which support is calculated based on the cost of providing telephone service to a particular wire center, but where the FCC has no ability to verify those costs, poses a risk of waste, fraud, and abuse. We believe that part and parcel of the wire center approach would be the adoption of appropriate accounting requirements, including a requirement that ILECs allocate common costs to non-supported services provided over their networks (e.g., multichannel video service), before providing USF support based on wire center costs. In this regard, it's also likely that the FCC's USF cost model is out of date and therefore may not be useful in modeling the cost of modern broadband networks to determine the level of subsidy required in a particular wire center.

Universal Service Support for High-Speed Broadband

The proposed legislation would allow USF support to be used for broadband facilities. Given the importance of broadband to our economy and society and its increasingly central role as a communications medium, we agree that it is appropriate to consider changes in the high cost program to help achieve the national goal of universal access to broadband. But the history of staggering growth in the high cost program suggests that the USF should have a narrowly defined role with respect to broadband, especially in light of additional government support coming from appropriations to programs managed by RUS and NTIA under the Recovery Act. The need for USF support for broadband will be better understood in the coming months, as NTIA and RUS award broadband infrastructure grants under the Recovery Act – and as the state mapping agencies complete their work on a comprehensive inventory of broadband availability.

At a minimum, we encourage you to limit any USF support for broadband deployment to those areas that currently do not have broadband facilities in place. Cable broadband service – which was created from billions of dollars of private investment and without any significant government subsidy – is already available today to 92 percent of U.S. households and subscribed to by more than 40 million of those households. It would be a poor use of scarce government resources to subsidize a broadband competitor in communities – including many small rural communities – where cable operators have invested risk capital to deploy broadband services. Government subsidies for one competitor in markets already served by broadband also might discourage the existing provider from making continued investments in its network facilities.

Given widespread broadband deployment, we believe that Congress should focus on promoting broadband *adoption*. Even in areas with one or more broadband providers, there are often barriers to broadband adoption – such as affordability, lack of a computer or other equipment to connect to the Internet, and low levels of basic "digital literacy." As Congress intended, a portion of the broadband grant and loan programs created by the American Recovery and Reinvestment Act should be targeted at programs to increase broadband affordability and adoption. The existing Lifeline and Link Up Programs are specifically designed to subsidize connectivity for users who need such assistance. Expanding these programs to include access to broadband could help bring the benefits of broadband to low-income consumers. The discussion draft recognizes that broadband support should be available on a technology-neutral basis. In light of the important social objectives served by expanding USF programs to include broadband, however, we believe that funding for broadband adoption programs should come directly from the government rather than by imposing new contribution obligations on service providers or their subscribers.

Reform of the USF Contribution Mechanism

The FCC currently assesses the USF contribution requirement on a provider's retail interstate telecommunications revenue, as required under the 1996 Telecommunications Act. While this approach may have been appropriate in 1996, however, the current monthly surcharge is approaching an unsustainable 13% on monthly telephone bills and, as I noted earlier, is expected to rise to 14% next year. NCTA has long supported basing USF contributions on assignment of telephone numbers and we appreciate that the draft discussion bill would permit the FCC to adopt a numbers-based contribution mechanism. A numbers-based contribution scheme, if properly structured and implemented, holds out the prospect of providing a more stable, predictable and nondiscriminatory funding mechanism that would affect all providers and end-users of voice services equitably, irrespective of the particular technology used to provide that service. Because the vast majority of American consumers use at least one service with an attached telephone number, a numbers-based contribution requirement reaches an extremely broad base of providers and consumers.

Recognizing the difficulties in identifying and assessing only interstate telecommunications services, the proposed legislation would authorize the FCC to "employ any methodology to assess such contributions" including methodologies based on all communications service revenues or on working telephone numbers. We welcome this statutory reform. However, the bill also would permit the FCC to impose contribution requirements on all "communications service providers," which would authorize contributions based on broadband revenues.

NCTA believes that expanding the USF contribution requirement to include broadband revenues is unnecessary and counterproductive. There is no evidence that an untapped pool of non-contributors would be brought into the system through a broadband assessment. Rather, an assessment on broadband service likely would be paid almost exclusively by people that already contribute on their voice services. Moreover, assessing USF contributions on broadband providers would raise the cost of broadband service for consumers of those services – impeding rather than facilitating the goal of improving broadband penetration. Taking such a step seems particularly ill-advised in the current economic climate, where customers may be particularly sensitive to increased costs.

<u>Competitively Neutral Eligibility for Funding</u>

If the high cost program is to achieve the goal of competitive neutrality, any entity that can provide services of sufficient quality should be eligible to receive such support. The discussion draft makes two important changes to support competitive participation in high cost programs: first, by opening the program to all communications service providers able to provide required services, rather than limiting participation to only telecommunications carriers, as in the current program; and second, by defining the service area of an eligible provider to be the area where the provider is licensed or authorized to provide services, rather than requiring all providers to serve the area defined by an underlying incumbent local exchange carrier or seek a waiver. We welcome these important proposed changes to the USF program.

On the other hand, other provisions in the bill detract from the goal of competitive neutrality. For instance, the requirement in the discussion draft to provide broadband service as a condition of eligibility applies only to entities that currently do not receive USF funds. By contrast, existing recipients, *i.e.*, RLECs and ILECs, are excused from this requirement for 5 years – which could enable them to forgo broadband deployment in unserved areas and use USF support to compete against cable companies that have relied on risk capital rather than government support to build out their networks. More broadly, as noted above, the bill would also allow LECs to continue to obtain high cost support to compete against unsubsidized wireline providers. We would ask you to reconsider these disparities.

Conclusion

NCTA shares the Subcommittee's belief that USF reform is imperative if the program is to be able to continue to meet its goals and adapt to the significant changes in technology since the program's inception. We remain committed to working cooperatively and constructively with Members of this Subcommittee and other stakeholders to address these issues. We appreciate the opportunity to share our views with you and thank you again for the opportunity to appear today.