CLIENT
MEMORANDUM

FCC REFORMS FEDERAL UNIVERSAL SERVICE PROGRAM AND SEEKS COMMENT ON FURTHER PROPOSED CHANGES

The FCC recently adopted an order ("*Order*") in which it established interim measures to address concerns about the short-term viability of the federal Universal Service Fund ("USF" or "Fund").[1] The Commission also issued a Further Notice of Proposed Rulemaking ("*Further Notice*") seeking comment on additional modifications to the contribution methodology that would convert the current revenue-based assessment methodology to one based on connections or telephone numbers.

The universal service contribution system is being reevaluated in large part because of changes in the telecommunications marketplace since the current assessment program was instituted in 1997. USF contributions are currently determined by calculating a percentage of all interstate and international end-user telecommunications revenue. Many at the FCC are concerned that the pool of interstate and international telecommunications revenue is shrinking because of, among other things, substitution of traditional interexchange service for wireless and Internet-based services. In addition, the bundling of telecommunications and non-telecommunications products makes it difficult to distinguish between telecommunications and non-telecommunications services for purposes of determining contribution obligations. At the same time, the total annual federal USF disbursements have grown from $ 1.9B in 1997 to approximately $ 5.5B in 2002. The Commission, thus, faces the dilemma of adopting an assessment methodology that would transfer the burden of universal service funding to a more stable base of contributors while staying within the Commission's congressional mandate to fund universal service through interstate telecommunications.

This memorandum briefly summarizes the Commission's interim changes to address these issues and the Commission's request for comments on additional modifications to the current assessment methodology.

Interim Changes

In the *Order*, the Commission instituted three primary changes to the current revenue-based system that are intended to "sustain the universal service fund and increase the predictability of

[1] *In re: Federal-State Joint Board on Universal Service; 1998 Biennial Regulatory Review--Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability and Universal Service Support Mechanisms,* CC Dkt No. 96-45 & CC Dkt No. 98-171, Report and Order and Second Further Notice of Proposed Rulemaking, FCC 02-329 (rel. Dec. 13, 2002).

support in the near term,"[2] while it examines more fundamental reforms. The primary interim changes are as follows:

1. The safe harbor that allows wireless carriers to assume a portion of their telecommunications revenues are interstate will be increased from 15 to 28.5 percent;

2. USF contributions will be based on projected, collected end-user interstate revenues, instead of the current historical, gross-billed revenues method; and

3. Carriers will be prohibited from including a mark-up above their USF contribution rate if they choose to recover contributions as a line item on customers' bills.

First, the Commission concluded that the current 15 percent wireless safe harbor no longer reflects the extent to which wireless consumers utilize wireless service for interstate calls and that increasing the safe harbor to 28.5 percent would ensure that contributions remain equitable and nondiscriminatory.[3] This change will become effective beginning with fourth quarter 2002 revenues.[4] While the Commission previously allowed wireless carriers to report either actual revenues or the safe harbor amount for each corporate entity separately, wireless carriers are now required to make a single election to report actual revenues or to use the relevant safe harbor for all affiliated entities. Consequently, if one wireless entity chooses to report actual interstate revenues, all affiliated companies subject to the same safe harbor category must do the same.[5]

Second, the Commission modified the contribution methodology by assessing contributions based on contributor-provided projections of collected end-user telecommunications revenues for the following quarter instead of basing contributions on historical end-user revenues accrued.[6] For purposes of the revised contribution methodology, "collected end-user" revenues have been defined by the Commission to mean gross-billed end-user interstate and international telecommunications revenues less estimated uncollectibles.[7] The purpose of this change was

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[2] *Id.* at ¶ 1.

[3] The safe harbor percentages for paging providers and analog SMR providers, which do not primarily provide wireless telephony, are 12 percent and one percent, respectively. In the *Order,* the Commission decided not to adjust these safe harbor percentages.

[4] Fourth quarter 2002 revenues will be reported on the February 1, 2003 FCC Form 499-Q.

[5] *Order* at ¶ 26. The Commission's definition of affiliate for purposes of this requirement is "a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person." *Id.*

[6] *Id.* at ¶ 29.

[7] *Id.* at ¶ 32. The FCC defined "uncollectibles" as the percentage of interstate and international telecommunications revenues that the contributor anticipates will not be collected from end-user customers. *Id.* The Commission declined to adopt a pure collect and remit system (under which only revenues actually

largely to address the widely held belief that many interexchange carriers (*e.g.,* AT&T and WorldCom) are experiencing declining end-user revenues. Since such carriers' contribution assessments are based on a declining revenue stream, they have been purportedly forced to collect a higher percentage from end users than the applicable percentage rate for the USF contribution factors. This practice has caused customer confusion and has left AT&T, WorldCom and those similarly situated with an artificial competitive disadvantage.

Third, although previous rules allowed carriers to include a mark-up above the contribution factor, the FCC has prohibited this practice beginning April 1, 2003. This rule change is an attempt to increase billing transparency and decrease consumer confusion regarding the charges.[8] Carriers will still have the ability to utilize a separate line item charge to recover the actual contribution and may bill the item either as a flat amount or as a percentage, as long as the line item does not exceed the total amount associated with the contribution factor.[9]

Further Notice

In the *Further Notice*, the Commission seeks input regarding long-term changes to the methodologies used to calculate universal service contributions. First, the Commission seeks comment regarding the interim changes to the revenue-based methodology and whether they are sufficient to ensure the long-term viability of the USF. The Commission asks whether bundling of local and long distance services raises problems for carriers in identifying interstate telecommunications revenues and whether it is appropriate for the Commission to abolish the safe harbor for wireless carriers because of increased capability to determine actual interstate and end-user telecommunications revenue.[10]

The Commission also seeks comment on connection-based and telephone number-based methodologies as potential alternatives to the current revenue-based system to provide a sufficient and predictable source of funding universal service. In particular, the Commission seeks comment on the following three connection-based contribution systems:

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collected would be subject to contribution) because it determined that such a system would reduce incentives for carriers to recover universal service contributions from their customers. *Id.* at 39.

8 *Id.* at ¶ 45.

9 *Id.* at ¶ 53. The Commission also concluded that all eligible telecommunications carriers (ETCs) are prohibited from recovering contribution costs from their Lifeline customers. This prohibition extends the prohibition of what was previously only applicable to ILECs to any CLEC or CMRS provider designated as an ETC. *Id.* at ¶ 62.

10 *Id.* at ¶¶ 67-68.

1. A contribution methodology that would impose a minimum contribution obligation on all interstate telecommunications carriers and a flat charge for each end-user connection depending on the nature and capacity of the connection.

2. An assessment based purely on capacity. Under this proposal, the contribution obligation for each end-user connection would be shared between access and transport providers.

3. An assessment of switched connection providers based on their working telephone numbers.

For purposes of this proceeding the Commission has defined connections as "facilities that provide end users with access to an interstate public or private network, regardless of whether the connection is circuit-switched, packet-switched, wireline or wireless, or leased line."[11] However, the Commission clarifies that connection-based assessments are not being considered in this proceeding for information service providers or broadband internet access.[12]

Comments and reply comments are due 30 and 60 days, respectively, from the date of publication in the Federal Register (which has not yet occurred).

If you wish to obtain additional information regarding the federal Universal Service program and how it might affect your operations, please contact Thomas Jones (202-303-1111, tjones@willkie.com) or David Don (202-303-1133, ddon@willkie.com).

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11 *Id.* at ¶¶ 76, 87 (indicating that this definition of connection could be modified depending on which version of the proposal is adopted).

12 *Id.* at ¶ 77. The Commission states that the issue of whether to assess broadband internet access would be deferred pending action in the proceeding regarding classification of wireline broadband Internet access. *See Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers,* CC Dkt No. 02-33, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002).