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U.S. House of Representatives Committee on Energy and Commerce,
Subcommittee on Communications, Technology, and the Internet
“Universal Service Fund Reform”
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Chairman Boucher, Ranking Member Stearns, and Members of the Committee: Thank you for the invitation to discuss reform of the Universal Service Fund (USF).

I think it is fair to say that consumers, the communications industry, and policymakers agree that modern communications networks and affordable communications services are: 1) a prerequisite for economic growth and competitiveness in all regions of the country and in communities large and small; and, 2) an essential platform to address major social challenges, ranging from environmental improvement to the delivery of quality education and health care.

In the past year we have made remarkable progress in establishing policies that will result in the ubiquitous deployment of wireline and wireless broadband networks. We are here to discuss another important piece of the puzzle: reforming USF. Today I'd like to discuss the progress made in formulating a broadband agenda for America, the need to stimulate broadband demand, and some specific reforms to sustain USF and direct the funds it collects to the real areas of need.

During the 110th Congress, policymakers, the communications industry and consumers were focused on the need for a broadband agenda, with a focus on getting broadband to unserved and underserved parts of the country. We discussed the need to 1) fund broadband mapping to identify unserved areas, and 2) create a capital fund to build the broadband infrastructure in those areas. We also discussed ways to reform universal service.

Today much has changed. First, Congress last year passed mapping legislation. This year, Congress, working with the Obama Administration, created the capital fund to deploy infrastructure in those areas of the country that do not have access. The stimulus package provides more than \$7 billion for investment and deployment of broadband and \$350 million for broadband mapping. So, it now appears that we have a plan to identify the holes in broadband coverage and the funding to begin filling those holes with infrastructure grants.

It is important as we think about Universal Service to put the issue in perspective. Over the past decade new technologies and robust competition have delivered a far broader variety of telecommunications services to a far greater number of Americans than at any time in our history. Consumers are seeing costs decrease for their wireline and wireless communications services. Today well over 90 percent of U.S. households can access broadband technologies. More consumers are connecting, seeing speeds increase and getting more out of the host of new services that enhance their online experiences. Thus, we have an opportunity to focus USF more precisely on those fewer areas of the United States that remain un- and underserved.

Verizon is doing its part. We continue to deploy and innovate around FiOS – America’s first all-fiber, next-generation broadband network – which is available to 13 million homes and businesses. On the wireless side Verizon spent \$9.4 billion last year in the 700 MHz auction to help us deploy our fourth-generation Long Term Evolution (LTE) network, which ultimately will help bring high-speed wireless broadband to consumers across the nation, including those in some underserved regions. We are commencing our LTE testing later this year and will work as quickly as possible to roll out the service commercially. We also completed our acquisition of Alltel, which is largely a rural wireless carrier, from the private equity investors who bought it less than a year earlier. Alltel’s customers are already benefitting from the acquisition in two ways – they are

now part of an 83-million-strong nationwide calling family, and by the end of this year we will upgrade Alltel's EV-DO network to higher speed Rev. A technology.

Verizon's efforts underscore our long-term commitment to offer our customers the best possible broadband networks and to spur innovation across the Internet. These efforts – and those of other companies – are also the result of forward-looking, consumer-focused policies, as well as a commitment of billions of dollars to deploy the networks that now serve as the critical infrastructure for America's economy.

While funding for broadband-infrastructure investment is important, it addresses only the supply side of the supply-demand equation. There should also be a focus on the demand for broadband services. Fewer than 60 percent of households have chosen to subscribe. Why? Access to a computer is certainly a factor. Price can also be an issue, but it is cited by only 14 percent of those who don't subscribe. In some cases the information and services offered to consumers are simply not important to them. In other instances consumers need a better understanding of the relevance of the available applications and services in their daily lives. Fortunately, government at all levels, schools, employers, health-care providers, businesses and non-profit organizations are all increasingly using broadband to interact with citizens, employees, customers, and students. Whatever we do to make the applications and services available online more attractive to each consumer will drive the demand and deployment of better broadband facilities.

One key to increasing demand, we believe, is introducing students to broadband technology and services. If we give our students broadband access and make the end-user devices available to them, and if we can develop the online educational resources, such as Thinkfinity.org (the Verizon Foundation's highly rated signature program, and a web portal for a host of educational tools for teachers, parents and students), then the demand from these new consumers

will drive deployment. The recent stimulus package takes a step in the right direction by providing funds to leverage broadband technology and thereby create demand by supporting computer labs for schools, health-care IT and virtual medical records, and smart power grids.

The Administration is quickly moving to disburse broadband mapping funds and broadband-deployment grants made available in the stimulus package, and I know we are eager to see how those funds are deployed and what needs are met. The funds provide a significant opportunity to make substantial progress in the universal deployment of broadband services by providing the capital needed to invest in broadband networks in those areas where deployment is not economically viable.

There are two tools that the National Telecommunications and Information Administration and Rural Utilities Service could use to help identify areas where broadband deployment is not occurring: state broadband maps and state technology plans, which many states have created. These necessarily should inform the federal grant-making process. Even where these formal processes have not been completed, states generally are aware of parts of their geographies that are without broadband access. Using this data from the states, the initial round of NTIA and RUS grants should be made for projects meeting at least three criteria (beyond specific projects funded in the legislation to create jobs): 1) projects that a state has identified or otherwise agreed will extend broadband service to an unserved area; 2) projects with applicants who have a successful track record of deploying and providing broadband service; and, 3) projects that use a technology that is appropriate for the area to be served. Subsequent rounds of grants could be informed by the data the FCC is collecting and analyzing through the so-called Form 477, the broadband mapping that states develop via stimulus funds, as well as other work that state and local governments undertake to develop their technology plans. This approach would facilitate the transparency needed to ensure that the funds are spent efficiently,

as well as the coordination between RUS and NTIA, so that together they get the job done.

In this new environment let's now look at a longstanding component of national telecommunications policy, the Universal Service Fund. The purpose of the fund is to ensure that all Americans have access to communications services. Verizon has supported this goal, and over time USF has succeeded. Today, most consumers have access to multiple carriers – wireline and wireless – for their communications needs.

Yet USF – especially the high-cost fund – is a program that is behind the times and badly in need of reform. It remains focused on yesteryear's technology, and attempts to fit new technologies – wireless and broadband – into a telecom framework. It does little to deploy new services – wireless and broadband – to areas that are unserved; as a result it is not meeting its fundamental objective: providing universal service. Moreover, it spends consumers' dollars very inefficiently.

We need to reform and update the Universal Service Fund to better serve rural America. In the 110th Congress, Chairman Boucher and Representative Terry proposed universal-service-reform legislation, as did Ranking Members Barton and Stearns. Both proposals provide helpful guidance in navigating the path to reform, and Verizon looks forward to working with the subcommittee on new legislation during this Congress. With that in mind, I'd like to offer several suggestions:

1. **Cap the size of the high-cost fund.** As we see it, the problem is not that we are spending too little money on universal service. The problem is that we are not spending it on the right things. It should be spent to deploy mobile wireless and broadband services to unserved areas.

2. Use a reverse auction to award funding to mobile wireless carriers. The current system for funding wireless carriers requires our customers and your constituents to cough up their hard-earned dollars to pay unjustifiably large subsidies to multiple carriers in many locales across the country. Consumers aren't just ensuring mobile-wireless service for their fellow citizens; they are paying multiple carriers to provide service in the same areas.

And why are all these carriers flocking to provide service in these "high-cost" areas? Because the basis for the subsidy is the cost for the incumbent wireline provider in that locale; if the wireline carrier's costs trigger a \$25 per month subsidy for each line, each mobile-wireless carrier can receive a \$25-per-month subsidy per device provided in that locale.

This system must be changed.

Verizon supports using reverse auctions or competitive bidding to distribute universal-service support to mobile-wireless carriers. We think competitive bidding is the best way to determine how much a wireless carrier really needs from the Universal Service Fund to offer service throughout a high-cost area. It will also ensure that we subsidize only one wireless carrier in an area.

Competitive bidding is not a new concept; it is the standard means by which government and businesses buy goods and services. The government uses competitive-bid contracts for many important projects where high-quality service is essential, such as development of military equipment and repair work to bridges and roads. The FCC can do the same thing in this context and ensure that any contract it signs with an auction-winning wireless provider mandates a certain level of service.

Competitive bidding will require that wireless providers expand their coverage in ways that today's system does not. To win the auction, a wireless carrier must agree to serve an entire area, not just the smaller, more densely populated locale for which the provider often receives support today. The contracted area could be a wire center or it could be an area that corresponds to the spectrum license that a wireless carrier holds. (To facilitate build-out in unserved areas, the legislation should also facilitate tower-siting.)

Some suggest that perhaps a better approach than using competitive bidding to determine universal-service support would be to base it on a wireless carrier's costs. We disagree. It is difficult – and always contentious – to identify a company's "costs", and to make judgments about which costs should "count" and which ones should not. The FCC and the courts have struggled with these issues for a long time. Unlike incumbent carriers, wireless providers have never been subject to traditional cost and rate regulation, and it will be a challenge to determine costs. For example, in a world where multiple carriers receive a subsidy, will a carrier with only three customers in a given area be able to divide its cost of service by three and receive a subsidy based on its per customer cost? Will the cost of spectrum be included, and how will that cost be determined? Bottom line: basing USF for wireless carriers on cost will open a can of worms.

More important, universal service should encourage efficient providers. We need reform that breaks the link between funding levels and costs in order to ensure that universal service doesn't reward companies for high costs. Competitive bidding forces providers to evaluate their own business models and network capabilities, and to make their own judgment about what amount of support is necessary. If that amount is not competitive, the carrier will not win the support.

3. Provide support for the "middle mile." We urge you to consider a separate, temporary subsidy program that would promote broadband deployment

by supporting the “middle mile” transport costs some broadband providers face in high-cost areas.

Broadband Internet-service providers in rural areas need transport services to carry their customers’ Internet traffic to and from long-haul networks that connect them to the Internet. Some have referred to those transport services as the “middle mile” to distinguish them from the “last mile” connections to end-users. A broadband Internet provider serving a rural part of a state will, in most cases, have to transport its Internet traffic over a greater distance than a broadband provider serving a city in the same state. In many states, rural providers have met the demand for middle-mile transport services by constructing their own fiber-optic transport networks, often through a consortium. In some rural high-cost areas, however, the cost of the additional transport mileage is high enough to impinge on a rural broadband provider’s ability to offer services in those areas.

To address these additional mileage costs, Congress could direct the FCC to create a program through the Universal Service Fund that would offset some of the transport-mileage costs in these rural areas. This program should fall within the overall cap on the high-cost fund and should itself be capped at a set amount. Any support also should be available for a fixed duration sufficient to provide recipients an opportunity to build a customer base, add new services, form a consortium or otherwise cover the costs of the transport. The program should also be technology neutral so that we fund the most efficient technology in that area.

4. Eliminate state-wide averaging. Today, the high-cost fund supports rural wireline carriers based on their embedded costs. Non-rural companies serving rural areas, however, receive support based on a cost model that averages a company’s costs across a state. In certain states, this creates

serious inequities among carriers. We need a better way of providing support to these carriers.

Chairman Boucher's bill would replace this cost model with a system that is based on a company's costs in a wire center. An appropriately designed wire-center approach is a good place to start and may make sense so long as resulting increases in the fund are offset by reductions elsewhere.

5. Base USF contributions on phone numbers. There is widespread agreement in the industry that the current contribution methodology, which assesses interstate and international telecommunications-service revenues, is badly broken. As a result, in 2008 the universal service contribution factor (which determines the universal service fee consumers pay) climbed to over 11 percent, undermining the very goals USF is supposed to achieve.

The current revenues-based contribution system is outdated. It was designed for a world where phone companies offered customers separate local and long distance services. Today, consumers buy from a variety of providers "all distance" bundled offerings which often include video, voice, and data for one price. To report revenues, providers must make difficult distinctions between what portion of their revenues is "interstate" or "intrastate" or "telecommunications" or "information services." These complexities get worse as companies roll out more advanced services like IP and broadband. As a result, companies that compete with each other for the same customers pay into the fund in different ways, skewing the competitive landscape.

The best solution is to adopt a more stable, equitable and simple contribution system that consumers can more easily understand: a collection system based on telephone numbers, in which a company would contribute to the Universal Service Fund based on its assessable telephone numbers. This would stabilize the contribution base because the "number of numbers" is

growing. It is also better for consumers because it puts more of the contribution obligation on business services and because the amount of the surcharge that appears on consumers' bills will not vary from month to month. Finally, a numbers-based system will be much more transparent and easier for the FCC and Universal Service Administrative Company to audit.

Under this system there is no need to directly assess broadband services, since these services would contribute to the extent they use phone numbers. Today, companies do not contribute to the fund based on revenues from broadband services, and it is important to continue this policy going forward. Levying an additional surcharge on broadband services could dampen demand and would be inconsistent with the Administration's efforts to increase broadband demand and penetration. In addition, appropriate adjustments should be made for certain wireless family-share and pre-pay plans to ensure equity.

6. Give the FCC a deadline to complete intercarrier-compensation reform. At the same time that we update universal service, we need to change the intercarrier-compensation system. Intercarrier-compensation payments are the charges that companies pay each other when traffic is sent to or received from the traditional phone network.

Nearly everyone in the industry recognizes that the current intercarrier-compensation system is antiquated and broken. It is based on the idea that there are meaningful distinctions between interstate and intrastate services and local and long distance services. As with USF contributions, the distinctions underlying the intercarrier-compensation system no longer exist and should no longer drive policy.

The high charges that some carriers impose for terminating traffic increase the costs of deploying services in rural and high-cost areas and discourage competitors that want to provide such new and advanced services as Voice over

IP. These high rates are not sustainable as the market evolves and as the industry increasingly relies on technologies that do not depend on the traditional phone network.

The FCC should mandate a brief transition to a single, low, uniform rate when companies terminate traffic. Carriers that have to lower their access rates as a result of such reform should have the opportunity to recover these lost revenues from their end-users. To the extent that the permitted end-user-rate rebalancing does not give a LEC the opportunity to recover its access shift, the LEC should recover the remaining amount from a new mechanism within the Universal Service Fund. Over time, that amount should decline to reflect the decline in access-charge revenues now occurring in the marketplace. I note that the bill sponsored by Chairman Boucher and Representative Terry specifically allows such changes to the USF.

The FCC is ready to act on intercarrier-compensation reform. Last year the industry spent months briefing these issues and engaging in a productive and meaningful dialogue on reform. Congress should provide the FCC with a deadline to reform the intercarrier-compensation system.

Verizon believes that the reforms we have proposed will help create a Universal Service Fund that is sustainable in this new communications marketplace, meets the needs of consumers in high-cost areas, and provides carriers with the proper incentives to invest and innovate so that all of our citizens can participate in the broadband world we are building. We look forward to working with the Committee and the FCC to meet these challenges.

Thank you.