Testimony of Kathryn C. Brown

Before the House Rural Caucus

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Mr. Chairman, members of the Caucus, thank you for inviting me here to discuss rural communications and USF issues with you. My name is Kathryn Brown, and I'm Senior Vice President of Public Policy Development and Corporate Responsibility at Verizon. My background is attached at the end of my testimony.

By way of background for Verizon, we serve a total of 53 million lines in 29 states (plus the District of Columbia and Puerto Rico). Verizon Wireless serves over 43 million customers across the country. We provide high-speed broadband connections via DSL, wireless broadband (called EV-DO), and, soon, fiber to the premise.

Rural interests and communications policy go back to 1934, when Congress first codified a goal of encouraging available, affordable communications to all Americans, i.e., universal service. At the time, we were a mostly agricultural, rural society, and there was one telephone network. Federal and state regulatory bodies created a system that relied on subsidy flows from other phone services—long distance service, business service, e.g., —to keep the price of local phone service far below cost.

From the 1930's to the 1950's, rural loan programs helped rural telephone companies build out and substantially upgrade their networks. In the next few decades, prior to divestiture in 1984, covering the costs of serving rural areas was handled under the old settlement process between AT&T and the independent telephone companies. This involved regulators setting rates in such a way that service to high cost areas was supported by revenue from other parts of the telephone business – Bell companies and

AT&T. A Universal Service Fund (USF) more akin to what we have today was established in 1988, post-divestiture. The 1996 Telecom Act set a policy that subsidies, including USF, should be explicit. The FCC has been implementing that policy in the last few years. One component of the USF is the High Cost Fund, which was designed to assist telephone companies serving rural and high cost areas. Today, the money for the Fund comes from a surcharge added to bills for long distance and other interstate retail services provided by Verizon and others.

The world has significantly changed since passage of the 1996 Telecom Act. Now we have multiple networks – traditional wired telephone networks, wireless, cable telephony, and the Internet. Rural areas that once had difficulty getting basic telephone service now have wireless networks and high-speed broadband access. FCC data show that 97% of the population is served by 3 or more wireless carriers. More than half of rural households use wireless service. Eighty-four percent of teens in rural America now have cell phones and use them for a substantial portion of their normal calls. FCC information also shows that 93% of all zip codes have some type of high-speed access. The National Telecommunications Cooperative Association has polled its members, and the responders indicate that 74% of their customers can get broadband service.

The expansion of competition and addition of new technologies and services is reaching into rural areas. Consumers have more and more choices and are using these different means of communicating – including free e-mail, Instant Messaging and wireless phones – as substitutes for traditional landline phones. And these choices affect usage patterns and the revenues that the USF funding system generates. USF still follows the patterns of 1934 and the old network. Long distance, and now wireless and DSL, customers pay a surcharge to cover USF. The rate for 1st quarter of this year is 10.7%, up from 8.9% in

the 4th quarter of last year —a 20% increase. At the same time, customers who use cable telephony, and the majority of VOIP customers, don't pay this surcharge because the services aren't classified the same way as long distance and wireless.

The money from the surcharge goes to local telephone companies to cover their high costs of providing telephone service in certain areas. But is it working, and does it fit the new world we're in?

The size of the high cost fund portion of USF has more than doubled in the last 9 years. The number of carriers eligible to receive funds has increased. Wireless and other competitive companies have been qualifying to receive USF money, often in the same geographic area where a traditional local telephone company is getting money.

The Wall Street Journal reported last month that some small telephone companies get 2/3 of their revenue from USF and access charges from long distance carriers. That means only 1/3 of their revenue comes from actual customers.

Meanwhile, there have been significant changes in the interstate telecommunications business. We're seeing the steady decline of traditional long distance revenue, on which the USF surcharge is assessed, and its replacement by cable telephony, instant messaging, e-mail, and VOIP. Nearly half of long distance calls have been displaced by other forms of communications. Most Americans – including virtually all rural citizens – can access the Internet. Access to the Internet by rural Americans is virtually the same as for those in urban and suburban settings. Email and Instant Messaging – usually free – are attractive substitutes for the long distance calling that was once a mainstay for rural Americans. These new forms of communication aren't paying into USF the way

other communications providers – like Verizon and the long distance carriers do. The base of revenue from which we can get USF money is shrinking, making that surcharge amount likely to keep going up, in turn making long distance rates likely to go up for those consumers who continue to use traditional long distance.

Given this situation, the current USF system is just not sustainable in the new world. Clearly, the existing funding system – reliant as it is on artificial regulatory distinctions and increasingly challenged by competition and changing patterns of consumer use – must be reformed.

One concept that is worth looking at is the use of telephone numbers or billing accounts for phone service as the means of collecting revenues, perhaps on a flat charge per number or account. This avoids artificial distinctions between providers (like long distance and local service providers). A flat rate charge would include all voice service providers - wireless, cable companies, VOIP providers, and telephone companies.

With regard to distribution of universal service funds, a combination of changes needs to be considered. For example, in some areas, phone rates are subsidized so heavily that rates are 60 percent below the national average for local phone service. Poor families in urban areas may be paying far more for monthly phone service than affluent customers in ski resorts. We need to look at this situation and, frankly, in some states, gradual adjustments need to be made in phone rates to lower subsidies and improve efficiency.

Another consideration for reforming universal service is to limit the number of eligible carriers. We could limit funding to one carrier per area; or one line per customer. Some

parts of the country continue to be served by one carrier, and in a truly high cost area, a subsidy may well be justified. But once competition enters an area, the market should be permitted to work to keep prices in check and to encourage service expansion. The original purpose of universal service subsidy was, and should be, to get facilities out to more remote areas. Once more facilities are in place by virtue of competitors' investments, subsidies are no longer needed.

Additionally, the fund could be capped, providing a transition from a world of subsidy to a world of market-based competition; again, as competition enters an area, subsidies should decrease.

We can develop a sustainable USF funding system to provide continued support where needed for basic phone service. It can be done gradually if we set firm targets and give all companies time to adjust to the reality that in the new world, competition and technological change will drive out subsidies and undermine inefficient programs and carriers.

On the broadband side of the equation, there are many companies who are working on creative solutions to bring broadband to more and more of America. Verizon believes that changes in policy that have been made over the last few years to remove government mandated prices for access to our networks have created new incentives to invest, more competition and more choice for consumers. The reliance on competition and reduced regulation to drive investment is working, just as it did in wireless and in the cable industry.

But there is much that can be done too in cooperation between industry and government. Public-private partnerships, cooperation with consumer groups,

collaboration between sectors like communications with IT/computer companies, and targeted subsidies and incentives are some of the possibilities to further broadband deployment. These options hold promise for making broadband even more widely available. As examples, let me tell you about two of Verizon's projects in this area.

In Grundy, Virginia, Verizon Avenue partnered with Alvarion (a wireless technology firm) and Virginia Mountain Micro (a computer services provider) to offer a wireless broadband solution in a town with a population of 1,200. The town used federal funds to buy the equipment, Verizon provided the network and the local computer services company provided the customer support. Together, we created a fixed wireless solution for the village.

In 2003, Verizon Avenue, ATNIEDC (Affiliated Tribes of Northwest Indians Economic Development Corporation) and the Bill & Melinda Gates Foundation entered into a three-year partnership to build and support a high-speed Internet access computer network to 20 families who live in on the Sauk-Suiattle Indian reservation in the remote Cascade Mountains. Verizon Avenue will build the wi-fi network, which can be accessed almost anywhere on the reservation, ATNIEDC will provide computer training, and the Gates foundation will fund computer equipment through its grant program.

As you know, the new world is about broadband, and bringing its benefits to all Americans. Broadband is a platform that provides more choices to consumers in the form of Internet applications such as VOIP, email, and videoconferencing. The more broadband we have and the more widely deployed it is, the more options citizens all across the land have to communicate. So what can Congress do?

The first thing we need is a national broadband policy. Let's clear out the regulatory underbrush so we aren't all tangled up in some regulations applying to one company's service, but not another company's, or one state's regulations applying to one technology but not another. We're talking about the new networks competing for broadband customers, and we need a policy that keeps these networks free to compete in the marketplace. In this competitive arena, consumers have more choices. There are more networks out there today – wireless, cable and telephone among others – and more competition. We don't need old-style regulations, unevenly applied, to protect consumers. Let's establish a national broadband policy letting the market work and continue to expand broadband availability throughout the country.

Second, we need to rationalize universal service law along the lines suggested earlier in this document. This does not mean eliminating service, causing rate spikes to end users, or bringing about the demise of smaller companies. It means setting timetables, allowing for transitions to occur and allowing markets to substitute wherever feasible for subsidies. It means a focus on what's needed, where, and how we make the transition from the old to the new world.

Third, Congress should consider whether it's appropriate to encourage companies to use alternative sources of funding, instead of the USF, for expansion of new technologies and services.

The United States has a good record on making telephone service universally available and affordable. But the USF system for funding service to all Americans was designed well before today's world of competition among many types of communications providers, well before new technology made multiple forms of communications possible,

and well before broadband became critical to economic development. The old USF system cannot continue to be funded from declining long distance revenue, or from the revenue of only some voice service providers. And, the old system cannot continue without limitation. Congress should establish a national broadband policy, should rationalize current universal service provisions, and should consider alternative funding mechanisms to bring the communications system into today's world. Thank you for your time.

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Kathryn C. Brown is senior vice president - Public Policy Development and Corporate Responsibility. She has been with the company since June 2002. She is responsible for policy development and issues management, public policy messaging, strategic alliances and public affairs programs, including Verizon Reads.

Ms. Brown is also responsible for federal, state and international public policy development and international government relations for Verizon. In that role she develops public policy positions and is responsible for project management on emerging domestic and international issues. She also manages relations with think tanks as well as consumer, industry and trade groups important to the public policy process.

Before joining Verizon, Ms. Brown was a partner at Wilmer, Cutler & Pickering and a member of the firm's Communications and Electronic Commerce practice, where she focused on the legal and regulatory challenges for communications companies in the converging telecommunications market.

For two years, Ms. Brown was the Chief of Staff of the Federal Communications Commission (FCC) where she managed Chairman William E. Kennard's agenda on all telecommunications, broadcast, and spectrum matters. She previously served as the Chief of the FCC's Common Carrier Bureau, where she led key initiatives implementing the Telecommunications Act of 1996.

Before working at the FCC, Ms. Brown was the Associate Administrator, Office of Policy Analysis and Development, at the U.S. Department of Commerce's National Telecommunications & Information Administration. In that position, she was closely involved in formulating and articulating the Administration's position on the Telecommunications Act of 1996 and in promoting the deployment of advanced technologies both here and abroad. Ms. Brown also worked for eight years at the New York State Public Service Commission in various capacities, including as the Director of the Consumer Services Division and as Litigation Attorney and Managing Attorney for Telecommunications with the Office of General Counsel. Prior to joining the NYPSC, she was the Deputy Clerk of the New York State Court of Appeals.

Ms. Brown received her J.D., summa cum laude, from Syracuse University College of Law in 1980 and her B.A., magna cum laude, from Marist College in 1974. She is admitted to practice in New York and the District of Columbia.

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