

Testimony of Fred McCallum
Vice President Regulatory
BellSouth Corporation
Before the House Congressional Rural Caucus
Task Force of Telecommunications
February 2, 2005

Mr. Chairman and members of the Committee:

Thank you for this opportunity to appear before you today and provide BellSouth's perspective on the Future of Telecommunications and the Universal Service Fund in Rural America.

I am Fred McCallum, Vice President of Regulatory for BellSouth Telecommunications in Atlanta, Georgia where I am responsible for the development and support of the company's state and federal regulatory policies. I have worked in the telecommunications industry for 18 years in various positions with BellSouth.

BellSouth is a communications company offering comprehensive voice, data, internet and video services in urban and rural areas throughout nine Southeastern states. In addition, BellSouth's affiliate, Cingular Wireless, provides wireless services throughout the United States.

BellSouth receives high cost funding as a non-rural carrier in three states, Mississippi, Alabama and Kentucky. We serve many rural areas of the Southeastern United States where we receive no high cost support. In four of our nine states, we provide service to more rural customers than all small independent companies combined. In addition, BellSouth's customers contribute

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over \$200 million dollars in support to the fund annually through the universal service charge that appears on their bills. Because BellSouth serves many rural areas, both USF supported and non-USF supported, we endorse fundamental regulatory reforms that will enable us to invest in all rural communities.

The theme of the forum today, The Future of Telecommunications and the Universal Service Fund in Rural America, focuses on the two critical public policy questions. First, how can we improve the future of our telecommunications industry to benefit rural America? And second, how can we protect our country's commitment to the principles of Universal Service, which are currently at risk.

The Future of the Telecommunications Industry

So how can we shape the future of our industry to benefit rural America? By modernizing our communications laws to reflect the reality of how people communicate today. The way people communicate has changed drastically since the 1996 Telecommunications Act was passed. Telecom policy today is detached from the reality of the communications marketplace. Despite the good intentions of many, the pace of change within the regulatory process simply cannot keep pace with the rapid technological and competitive change that has characterized the communications marketplace over the last ten years. Today's regulation has become a burden on the economy. It is "sand in the gears" of innovation; and its time to get the sand out.

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To start, it is critical to recognize the forces impacting the communications market. Two fundamental disruptive trends are shaping communications. Customers are shifting from wireline technology to wireless technology, and from narrowband voice technology to broadband technology. Current regulatory policy, however, reflects neither of these trends and continues its historical focus on the regulation of wireline networks. This has resulted in a regulatory system that severely hampers wireline carriers' ability to bring broadband, video, and other new, innovated services and technologies to rural customers to compete with other broadband, wireless and video providers.

The shift from wireline to wireless is plainly evident. There are 4 to 6 wireless competitors in most markets. The number of wireless access lines surpassed landline access lines in 2002. Wireless revenues surpassed wireline revenues in 2003. Total usage on wireless networks either has or shortly will surpass usage of the wireline network. And this year we will reach 10% of U. S. households that have completely "pulled the plug" and substituted wireless for wireline phone service. The data clearly shows, as a recent study confirmed, that wireless service is indeed replacing wireline service.¹

¹Stephen B. Pociask, *Wireless Substitution and Competition* (December 15, 2004) (attached).

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The shift from narrowband to broadband is just as evident. With the proliferation of the Internet, customers are demanding faster and faster connections. Broadband has one of the fastest adoption rates of any product or technology in history, moving from nearly 0% of households in 1998 to over 20% at the end of 2004. Research data tells us that applications like email and instant messaging, numbering in the billions daily, have replaced over 40% of what were formerly local wireline calls.

Regulators have largely been unable, and at times unwilling, to recognize and react to these trends, and have continued to pursue government managed competition, often through needless obsolete regulation of wireline networks and services. It is time to overhaul the regulatory landscape by putting consumers in charge of the competitive communications marketplace, not the government.

Retail regulation should be confined to a consumer “no frills zone.” Under this approach, very basic service rates would remain regulated, but bundles of services would not. The intercarrier compensation process must also be reformed in ways that compensate providers for the use of their networks, while seeking to minimize or eliminate arbitrage. Wholesale regulation should be limited to requiring non-rural phone companies to unbundle local copper loops at negotiated rates. Business relationships between communications carriers should be moved to commercial agreements, and away from Government

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mandated terms and conditions. Public safety measures, such as 911 emergency services, support for law enforcement, and access for the disabled, must continue to be protected. We can't, though, continue today's practice that requires only one group of competitors to fulfill these obligations. Rather, we must ensure that all of these base-line social obligations are equitably apportioned and supported by all competitors, regardless of the technology they choose to serve the public.

Stabilize Universal Service

Preserving the principles of universal service is necessary to provide affordable, modern services to rural customers. Unfortunately, the Universal Service Fund (Fund), as it is presently constituted, is unstable and, in the longer term, unsustainable. The Fund size has grown from \$5.3 billion in 2000 to \$6.5 billion in 2004, with estimates for 2005 reaching \$7.0 billion. The revenue base that supports the Fund, currently limited to revenues from interstate telecommunications services, excludes new technologies and services like VoIP and cable modems. As a result, the base of support for universal service has declined from \$18.9 billion in 2000 to \$18.3 billion in 2004. During the same time, the contribution factor, or percentage of retail interstate telecommunications revenues that customers pay to support the Fund, has risen from 5.9% in 2000 to 10.7% today. This declining base of contributors cannot continue to shoulder the ever-increasing responsibility for this important public

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policy. This problem is further exacerbated by the combined burden of local, state and Federal taxes on telecom services that typically exceeds taxes on other products and services by a factor of three or four, placing telecommunications in line with alcohol and cigarettes in the “sin tax” category. These trends demonstrate the need for broad universal service reform that will address the Fund’s growth and establish a broader, more equitable contribution base.

The current system contains some disturbing competitive disparities as well. As noted above, the shift from narrowband to broadband is gaining momentum. Broadband VoIP service, which is largely unregulated and provides no universal service support, will continue to grow, replacing traditional wireline long distance service, which does support universal service. In addition, DSL based Internet access services, which support universal service, are at a significant competitive disadvantage to the dominant provider of Internet access services, cable modem, which does not support universal service.

VoIP and cable modem services derive value from being able to use rural networks supported by universal service and by the fact that many schools and libraries are connected to the Internet with the aid of universal service funding. Yet these services bear none of the responsibility for supporting universal service.

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By broadening the base of contributors to include all services to include VoIP and cable modem services, and extending the contribution base to intrastate as well as interstate service, these disparities can be eliminated and the Fund can be stabilized.

Summary

The nation's telecommunications laws must be updated to reflect the significant changes that have taken place in technology, and the concomitant shift in the consumer marketplace that has occurred over the last decade. We must speed up the deployment of advanced communications services and applications to rural America, and encourage the investment in the advanced networks and infrastructure that will make this a reality. Preserving our commitment to the principles of universal service will require steps to stabilize the Fund for the short and long term.

Thank you for your interest in these important issues and we look forward to working with you in developing legislation.