CompLECS & Universal Service Assurance

How Competition Will Strengthen Universal Telephone Service

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TCG

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The following is the text of the presentation given by Robert Annunziata, President of Teleport Communications Group and founder of the Competitive Access Provider ("CAP") industry, delivered at the Third Annual Intelligent Network Summit on June 1, 1994 sponsored by both Telephony magazine and Bellcore.

I consider it a privilege to be here and I am honored to address this audience of distinguished telecommunications professionals. During the next few days, this gathering will assess and discuss the exciting opportunities as well as the pitfalls that still face the intelligent network.

Many questions must still be resolved: What are the standards that will be adopted? How "open" will the open network really be? And who will be the customers?

Over the years a certain amount of scepticism has built up in the telecommunications industry regarding announcements of new technology applications, services or network deployment. Delays and postponements have been notorious. That's why this conference should be enormously helpful in creating the proper perspective about where the intelligent network is today and where it is headed.

Certainly, forecasting the future is hazardous to reputations. Even with TCG, our experience demonstrates that despite the best of plans, the future is always elusive, always challenging.

TCG, for example, celebrates its Tenth Anniversary this month. We have changed and have grown in ways we never thought possible. For example, when we first started in this business in 1984, some thought TCG stood for "Those Crazy Guys."

Then as we succeeded in New York and Boston and other major markets, we were pretty proud and many observers thought TCG stood for "Those Courageous Guys."

Now, ten years later and with some significant cable companies as our principal investors, some people think that TCG has now become "Those Cable Guys." (But we are not a cable company!)

In our hearts, TCG still stands for "Teleport Communications Group." From what was a group of a half dozen individuals in 1984, we're now 900 men and women whose energy, enthusiasm and skills have all contributed to achieving a Tenth Anniversary. How did they do it?
By developing new local telecommunications services and taking a more focused customer service philosophy into the local marketplace. Certainly TCG does not offer every service that the local telephone company does. Nor do we offer services in all the same places served by the traditional local telephone company.

Rather, TCG's success has been built on a simple strategy: serve only those markets that are either un-served or under-served by the local telephone company so that we don't have to try to compete head-to-head with billion dollar companies. Stated differently, most local phone companies provide very good services at reasonable prices to most of the consumers in their services areas.

What this really means is that only poorly performing telephone companies really have anything to fear from competition!

Excellent telephone companies are seeing that local competition can be a significant benefit. As Rochester Telephone knows, it can lead to less regulation and more opportunities. And here in Chicago, Ameritech has concluded that a competitive local market can be the key to new opportunities and growth.

Carol Wilson, Telephony's editor, noted some of those changes in a recent editorial titled "Of NatCAPs andCompLECs." Carol was referring to a talk I gave in April on dealing with the future of the "CAP" or "Competitive Access Provider" industry.

Briefly, what I said in April was that most CAPs are evolving rapidly along two parallel tracks. The traditional CAP -- a fiber network providing private lines and special access in a downtown central business district -- is an endangered species. I also said that these CAPs must either become part of a "National CAP"--a "NatCAP"-- or become a Competitive Local Exchange Carrier -- a "CompLEC."

NatCAPs will continue to do what CAPs have always done: serve telecommunications-dependent businesses who need the operational and strategic security that comes with having a diverse source of supply for critical local services.

But it is no longer enough for a CAP to be a diverse source only for so-called "dumb" services such as private lines and special access. Today's corporate telecommunications manager wants diversity in all local services. This means that CAPs must provide "intelligent," enhanced local switched services such as ISDN, Centrex, and switched access as well as new data services.
A traditional CAP serving one or perhaps a few central business districts is unlikely to have the financial resources, technical resources or economies of scale that are needed to compete effectively to provide businesses with a full range of intelligent local telecommunications services.

NatCAPs, however, will possess the necessary resources, skills and economies of scale.

The foundation of the “NatCAP” business is solid: telecommunications-dependent businesses will always need the operational and strategic security that comes from having two local carriers providing services over diverse facilities. Since the traditional LEC cannot be diverse from itself, when a customer’s primary need is diversity the LEC simply can’t satisfy this customer. TCG, of course, can.

And the need for diversity will grow as LECs continue to expand into some of their largest customers’ businesses. For example, long distance carriers, alarm companies, and information services providers will not tolerate being dependent on a LEC which is a powerful strategic competitor. TCG certainly appreciates all the business that LECs are driving off their networks and on to ours.

I mentioned that there were two paths for CAPs. The second evolutionary path is to become a “CompLEC,” that is, a Competitive Local Exchange Carrier.

What will a CompLEC do? The same as a “NatCAP:” serve markets and customers that are un-served or under-served by the incumbent LEC. Making the big assumption that law and regulations would allow it, a CompLEC will develop wherever there is substantial mass market dissatisfaction with the incumbent LECs. With substantial fiber networks in 19 major markets nationwide and more planned... With five advanced digital switches already in service and another six scheduled by year-end, it is fair to say that, today, TCG is the country’s leading NatCAP.

While our new advertising tag line holds TCG as ... “The Other Local Phone Company,” it is aimed at the business user that needs and appreciates the operational and strategic security we offer. Nevertheless, the slogan will have appeal in any obviously un-served or under-served market.

But all of these characteristics, be it TCG’s network growth, switch deployment or evolving businesses market opportunities, beg a fundamental issue in today’s local telephone service environment.
As Carol Wilson’s editorial noted, nowhere in my April speech did I discuss in detail TCG’s views on the important “Universal Service issue.” She is right.... I didn’t. I will now.

The short response is that TCG issued a concept paper proposing a “Universal Service Assurance”-USA-plan in December 1993.

The longer response is that Carol’s editorial was right on target: it is important that the industry and policy-makers know where companies like TCG stand with respect to Universal Service.

Making sure that every individual can afford local telephone service is one of the greatest obligations that telephone companies undertake. And TCG and the rest of the CAP industry is committed to sharing this obligation.

The intelligent network offers us the prospect of enormous changes in the way we communicate. That lies in our future.

What I am proposing is to improve the way Universal Telephone Service operates today. The result will be a better mechanism in which all carriers contribute to Universal Service Assurance and that will more equitably and efficiently distribute any needed “subsidy”...Today and for tomorrow.

Just as the telecommunications industry has changed, and just as the CAP industry has changed, now Universal Service can and should be changed.

What I’d like to share with you this afternoon are some thoughts on how Universal Service can be improved, how the obligation can be shared and how these improvements can be delivered more efficiently in a competitive local marketplace.

As most of you know, the existing Universal Service System has three components:

1. subsidies for needy, low income consumers,
2. subsidies for companies serving high cost areas, and,
3. subsidies for residential ratepayers in general.

It is a patchwork of regulatory actions by the FCC and the states that implement the goal articulated in the Communications Act of 1934, to provide access to the network for every consumer at
"reasonable charges." This patchwork is simply inappropriate to current realities. And it is certainly inappropriate as a model for the future.

Among its most glaring inefficiencies is that the current system does not encourage or reward efficiency. For example, efficient telephone companies pay into high cost funds that support inefficient telephone companies. It maintains the status quo and does little to improve service for consumers.

In contrast, competition enhances efficiency and consumers get a real choice, better products and better prices.

Because the existing Universal Service approach inhibits efficiency and consumer choice, while competition would improve both, it is clear that competition and the existing Universal Service mechanism are working at cross purposes.

Telephone companies that now have the Universal Service "obligation" complain that in a more competitive era, it will be too much of a burden. Well, TCG wants to assume its fair share of the national Universal Service obligation. Let me tell you how we can do that.

**Point One:** TCG will subsidize consumers, not telephone companies.

Why should we be forced to subsidize telephone companies, particularly those earning hundreds of millions, if not billions, of dollars of profits every year?

Yet today, TCG and other so-called "competitors" are forced to subsidize the LECs through explicit payments assessed against us for the telcos' benefit, such as specific contribution charges, "Universal Service Elements," "RIC charges," and so forth.

But I have no idea whether any of these above-cost surcharges extracted from TCG by LECs are actually used to support a needy consumer or a consumer in a high-cost area. It may very well be that we are supporting a telco's fleet of limousines or paying for corporate strategy meetings at posh resorts.
Point Two: Let all local carriers – CAPs, LECs, NatCAPs, CompLECs – pay into a “Universal Service Assurance Fund” on the same basis.

This will mean that the funds can be properly accounted for and all local carriers will have similar burdens. It is clear to me that this Universal Service Assurance Fund must be independent of any telecommunications carrier. It must be administered by a neutral third party.

Will this administration require a big bureaucracy? No, because a system of debits and credits can be managed relatively easily, and TCG’s Universal Service Assurance proposal will not require major audits. It could be treated more or less like a bank or better, a “telephone credit union.” TCG will happily pay into this “telephone credit union” to benefit consumers who are designated Universal Service Assurance beneficiaries.

Point Three: Target the subsidies.

Every residential telephone customer in the United States does not need to be subsidized! Why, just imagine for a moment that the commodity we are talking about is not local telephone service -- but gasoline.

Gasoline is certainly an essential commodity. Does this mean that every household should get subsidized gasoline? The Soviet Union tried this for the last seventy years.... It didn’t work there then and it wouldn’t work here now.

And should all businesses pay more for gasoline so that households can pay less? Buses are common carriers: does anyone argue that a bus ticket should cost more when I ride to a board meeting than when I ride to the barber shop?

If the cost of an essential service or product is too high for some consumers to pay, an explicit subsidy -- not complex “shell games” -- is proper social policy.

To make a competitive telecommunications policy and a Universal Service policy work together, they should have the same goals: economic efficiency and consumer choice. Subsidies are efficient when they keep subscribers on the network who otherwise could not afford access.
Who are those subscribers? They are individuals or households with income far below average, and subscribers of telephone systems whose costs are far above average.

Let me be clear: TCG will gladly contribute to a Universal Service fund that supports specific, designated consumers.

**Point Four:** Universal Service Assurance must be directed at a simple objective—connectivity.

The more subscribers there are on the network, the better off all subscribers are. And so are all carriers. But beyond simple access or dial tone (touch tone included, where it is available), the cost of subsidizing Universal Service will skyrocket if "bells and whistles" are included. It is inefficient to subsidize a level of technology for which consumer demand does not exist.

I think that most consumer advocates agree with this point as well: they fear, rightly, that the more bells and whistles that go into Universal Service, the more residential ratepayers across the board will have to pay. Dial tone is the service that should be universally available at reasonable rates.

**Point Five:** every carrier providing "Universal Service" to a subsidized consumer must have equal access to the Universal Service Fund.

This equal access is the critical link between competition and Universal Service because it encourages consumer choice. If carriers have equal access to the subsidy, they will compete as vigorously for subsidized customers as they do for any other consumer.

And even if only one carrier serves residential consumers, including subsidized customers, that carrier will have all the revenues to do so even if larger users have chosen to use another carrier.

Let me draw a scenario for you. Here are the conditions: suppose in a rural territory on the Ohio border there is a large business user who wants TCG's high capacity private line service. Suppose that user now pays the telephone company for a hi-cap circuit $50 more per month than the "telco's" costs. Also suppose the telephone company serves some farmers at a rate of $15 per month, but the claimed "cost" of that service is $50 per month. The conventional wisdom put forth by the telcos is that the hi-cap circuit contributes to a $35 "subsidy" for the farmer.
Even though the telco may get high cost fund subsidies now, it will squawk if TCG takes any of its revenue away. And the telco will claim that I am eroding the source of subsidy for the small farmers.

But, if that Ohio telco can still get $35 per month from the Universal Service Assurance Fund for each small farmer it serves, it can still charge them $15. Even if the large business user exercises its freedom of choice by selecting TCG’s hi-cap service. In other words, one consumer’s gain is not another consumer’s loss.

And here’s where equal access to subsidies really pays off for consumers. Let’s say that an entrepreneur with a wireless loop could provide local telephone service to the farmer at a cost to the provider of $45 per month. With equal access to the $35 subsidy, then, the wireless provider can sell service to the farmer for only $10, not $15. Now the farmer has a choice.

And as soon as a competitor tries to attract those small farmers to its service, I would be willing to bet that the serving telephone company there will cut its costs and lower its prices. So all consumers in the rural area will fare even better, no matter which carrier serves them.

**The Sixth and Final Point:** seamless interconnection and interoperability between competing local networks is essential.

Without seamless interconnection, the competition won’t be able to deliver efficiency and choice to consumers. TCG’s “Nine Points”¹ as outlined on our calendar cards, identifies the essential interconnections.

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¹ TCG has published wallet calendar cards for the past three years which outline the essential operational prerequisites for effective local exchange service competition.

1. Central Office interconnection arrangements
2. Connections to unbundled network elements
3. Seamless integration into LEC interoffice networks
4. Seamless integration into LEC signalling networks
5. Equal status in/control of network databases
6. Equal rights to and control over number resources
7. Local telephone number portability
8. Reciprocal inter-carrier compensation arrangements
9. Cooperative practices and procedures
Let me summarize:

TCG is willing to pay its fair share of a Universal Service Assurance program. I believe that all CAPs share this view.

A "fair share" is a contribution based on market presence. All telecommunications common carriers should pay into the Universal Service Assurance Fund on a similar basis.

They must pay in cash, not in kind, because it is not possible to properly value in-kind contributions. The cash must be deposited in a fund that is professionally administered, independent of any telecommunications carrier.

Every local telecommunications carrier must have the right to draw from the fund if it provides a subsidized service. The consumer's selection of a carrier triggers the carrier's access to the Universal Service Fund, on the consumer's behalf.

The service subsidized is dial tone. The customers subsidized are either income qualified or high-cost area qualified.

Conclusion

I don't think anyone here who has been witness to the immense changes that have altered the telecommunications landscape can say that an end is in sight.

On the contrary. New technologies, new regulations and new opportunities make telecommunications the most dynamic industry in the nation.

What I am suggesting here is that like the technologies and regulations that served us so well for so long, time has overtaken and made obsolete the policies that govern the Universal Service System today.

A new model is needed that draws upon and amplifies the strengths of a competitive marketplace, the entrance of new players and new technologies.

TCG looks forward to a system that subsidizes access to local telephone service by anyone who can't afford to pay the full cost of such access. What we seek is a fair and equitable system that does not simply take revenues from our coffers and deposit them in the local telephone company's pot -- and at the same time deny us the opportunity to compete for those same subsidies.
TCG supports the goal of Universal Service -- the distinguished tradition of assuring access. I only ask that TCG and companies like us be given the opportunity to contribute and compete for the benefit of those least able to compete.

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"CompLECs and Universal Service Assurance" is the seventh in TCG's Issue Paper series.

Other TCG Issue Papers:

The "Pot Bay": Several BOCs Attempt to Obstruct Interconnection... Again (June 1993)

Telco Fiber Fiascos: Will Accelerated Infrastructure Programs Be the Next Nuclear Power Plant Debacles? (July 1993)

The "Pot Bay": Phase II Ameritech Takes a Step in the Right Direction (November 1993)

Universal Service Assurance: A Concept for Fair Contribution and Equal Access to Subsidies (December 1993)

The Unlevel Playing Field: Asymmetric Market Power Demands Asymmetric Regulation (March 1994)

Whither the CAPs? (June 1994)

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