

**Before the
Federal Communication Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Review of Regulatory Requirements for)	CC Docket No. 01-337
Incumbent LEC Broadband)	
Telecommunications Services)	

**Comments Of:
Fred Williamson and Associates, Inc. (“FW&A”)
On behalf of:**

**Chouteau Telephone Company, an Oklahoma ILEC
H&B Telephone Communications, Inc., a Kansas ILEC
Moundridge Telephone Company, Inc., a Kansas ILEC
Pine Telephone Company, Inc., an Oklahoma ILEC
Pioneer Telephone Association, Inc., a Kansas ILEC
Totah Telephone Company, Inc., a Kansas and Oklahoma ILEC
Twin Valley Telephone, Inc., a Kansas ILEC
(Collectively, “ILECs”)**

BACKGROUND

The ILECs are small rural LECs who have an interest in the outcome of this proceeding because they provide broadband facilities and services to customers in their service areas. Deployment of broadband services in small rural areas is much more costly per subscriber than deployment in non-rural areas. This is primarily due to the low population density that exists in rural areas. The broadband services the ILECs provide are primarily interstate services whose rates are governed by the National Exchange Carrier Association (NECA). Revenues for small rural LECs' interstate broadband services are remitted to the NECA pool, and costs for the broadband services are assigned to and recovered from the NECA pool. Deployment of broadband services in many small rural areas at reasonable rates would not be possible without those LECs having the ability to recover the associated costs from the NECA Pool.

SUMMARY OF COMMENTS

If the FCC decides to deregulate or detariff broadband services, FW&A and the ILECs it represents recommend that it adopt a two-path approach, one for price-cap LECs and one for rate of return LECs. Assuming the FCC finds that the large price-cap LEC's largely urban markets for broadband services is sufficiently competitive to deregulate or detariff their broadband services, and if these LECs meet certain conditions, FW&A would support this deregulation in order to insure that price-cap LEC providers of broadband services are on an equal competitive footing with other urban cable, satellite and competitive LEC (CLEC) providers of these services.

Hopefully, this will reduce the regulatory burdens of the price-cap LECs and provide further incentive for these LECs to deploy broadband services on a reasonable and timely basis as directed in section 706 of the Act.

The FCC should not, however, consider deregulation of small rate of return ILECs that serve the rural broadband service market at this time. Rate of return ILECs serve significantly different markets than do price-cap LECs and require the continued support of the NECA pool to achieve the goal of section 706 of the Act in the rural areas they serve. As recognized by the FCC in their recent report to Congress, broadband services are being deployed in rural America, but at a pace that may be slowing. Most rural areas cannot support multiple wireline broadband providers primarily due to the significant costs associated with deployment.¹ To promote more aggressive deployment of broadband facilities and services in rural areas and to incite small rural rate of return LECs to continue making the substantial investments necessary to provide broadband services in the rural areas they serve, the Commission should consider different treatment for non-rural and rural LECs.

¹ In the matter of an inquiry concerning the deployment of advanced telecommunications capability to all Americans in a reasonable and timely fashion, and possible steps to accelerate such deployment pursuant to Section 706 of the Telecommunications Act of 1996, Third Report, released February 6, 2002. In paragraphs 113 and 114 of this Report, the FCC states, "...investment in rural areas appears to be slowing. For example, a recent survey identified several major barriers to expanding advanced services in rural areas, including: the length of the loop; the high cost of deployment; low demand by customers; and the lack of cost-effective scaled for smaller companies."

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QUESTIONS POSED BY THE COMMISSION

1. *RELEVANT MARKET FOR BROADBAND SERVICES:*

The Commission asks parties to identify the relevant product markets that include incumbent LEC-provided broadband services, including all reasonably substitutable services offered over other platforms such as cable, wireless and satellite. The Commission notes that traditionally it has identified two broad categories of markets for telecommunications services: (1) The mass market, comprised primarily of residential users; and (2) The business market, comprised of medium and large business users. As part of this analysis, the Commission asks parties to comment on:

- a) Whether broadband services that are marketed to small and medium enterprises (SMEs) and to small or home offices (SOHOs) constitute separate product markets?

- b) Whether retail broadband services sold directly to end users should be considered as separate markets from wholesale broadband services that are sold as inputs to other firms that offer services to end-user customers?

- c) Whether broadband services sold on a stand-alone and those sold as part of bundled service packages are separate product markets?

- d) Whether lower speed, circuit switched services are viewed as substitutes for higher-speed broadband services and whether the cross-elasticity of demand by

residential customers is sufficiently high that narrowband services will constrain any supra-competitive pricing by broadband service providers?

In response to these questions, FW&A believes that the Commission should recognize that the market for broadband services provided by small rate of return LECs is significantly different than the markets for broadband services provided by price-cap LECs.

A. Urban Markets Served By Price-Cap LECs

Price-cap LECs as well as their competitors (CLEC, cable, satellite, wireless), offer broadband services in urban areas where customer concentrations make the costs to provide the broadband services economically feasible. In these urban areas, there are sufficient customer concentrations to constitute or create separate retail markets for large business, residential or mass market and the emerging SME and SOHO market.² Customers, whether business (large or SME or SOHO) or residential, often have choices of broadband service providers in urban areas. Where economically and technically feasible, incumbent price-cap LECs have deployed fiber and upgraded facilities in order to provide these services. Likewise, cable providers have often upgraded their facilities and changed from analog to digital service in order to offer broadband services to their customers. Urban customers may also have the option to purchase broadband telecommunications services from satellite or wireless providers. Consequently, from an urban consumer's perspective, and from the provider's perspective, there are separate

² SMEs and SOHOs are an emerging market largely due to the freedom that use of a computer and the Internet allow. Business can be conducted from any location where there is high speed or dial-up Internet access.

markets for large business, smaller SME and SOHO business and mass-market residential service.

Currently, competitors to the price-cap LECs are likely to be somewhat different in each of these markets. In the large business market, because the business is likely located in a business center, satellite, wireless, and possibly cable providers are the competitors to the price-cap LEC. In this market, large business users likely do not view dial-up access as a substitute for high-speed broadband service. It is also likely that the choice to purchase stand-alone broadband service versus this service packaged with other services is a distinct market decision for large business customers. Large business customers may also purchase wholesale broadband services from the price-cap LEC as inputs to their own broadband networks and thus may view the wholesale and retail broadband markets separately.

In price-cap LEC service areas, broadband service competitors for small and medium size businesses, which are likely to be located in suburban areas or residential homes rather than a large business center, are likely to be cable providers as well as wireless and satellite providers of broadband services. As with large business users, small and medium sized businesses are not likely to view dial-up access as a substitute for high-speed broadband service. Unlike the large business customer, however, the choice of a small or medium sized business to purchase stand-alone broadband service versus this service packaged with other services, is likely a distinct market decision. Small and medium sized business customers are also unlikely to purchase wholesale broadband

services from the price-cap LEC, and thus SMEs and SOHOs may not consider wholesale and retail broadband services provided by broadband competitors as separate markets.

The predominant competitor to price-cap LECs in the urban residential mass market is likely to be the cable provider. In the residential broadband markets, unlike the large, medium and small business markets, it is likely that consumers view dial-up access as a substitute for high-speed broadband access. It is also likely in the residential market that consumers view broadband products sold on a stand-alone basis as a separate product market. The economic choice to purchase high-speed broadband service, whether sold separately or as part of a package of services, is still a significant and stand-alone decision for most residential consumers. Finally, residential urban consumers are unlikely to purchase wholesale broadband services and thus are unlikely to consider this a separate residential market.

B. The Rural Market Served By Small Rate of Return LECs

The rural broadband market served by small rate of return LECs is significantly different from the largely urban markets served by large price-cap LECs and their competitors. This market, (rural broadband), should be differentiated from the urban broadband markets and dealt with separately by the Commission.

Small rate of return LEC markets are diverse and a few may contain a small number of large businesses. Some of these LECs may also serve suburban areas. However, the large majority of small rate of return LECs serve residential and small business customers located in sparsely populated, high cost rural areas. “In every state, the population

density per square mile served by a rural carrier is substantially less than for non-rural carriers. Nationally, the population density in areas served by rural carriers is only about 13 people (persons) per square mile. This compares to a national average population density of 105 people per square mile in areas served by non-rural carriers.”³

Other characteristics of rural areas served by small rate of return LECs identified in the Rural Task Force paper⁴, that distinguish the rural LEC broadband market from the largely urban markets served by large price-cap LECs are:

- Rural carriers have relatively high loop costs because of the lack of economies of scale and density.
- Compared to non-rural carriers, the customer base of rural carriers generally includes fewer high-volume users, depriving rural carriers of economies of scale.
- Rural carriers frequently have substantially fewer lines per switch than do non-rural carriers, providing fewer customers to support high fixed network costs.
- Total investment in plant per loop, as well as plant specific and operations expenses, is substantially higher for rural carriers compared to non-rural carriers.
- The average household income for customers in rural carrier service areas is 20 percent lower than that of non-rural urban carriers.

Unlike the largely urban price-cap LEC markets, the small rural LEC broadband market is characterized by low consumer population densities in town and community centers,

³ The Rural Difference, Rural Task Force White Paper 2, January 2000, page 20. A NECA study contained in a “NECA Rural Broadband Cost Study” finds similar differences between rural and non-rural LEC household densities, “...the average density of households in NECA’s rural LEC exchanges (Telecom Act of 1996 Definition) is 4.95 per square mile. This is roughly the same household density as the 5.95 per square mile for all rural exchanges in the 48 contiguous states plus Hawaii. In comparison, the density for all non-rural exchanges is 52.34, a roughly ten to one difference.”

the absence of large businesses in most small serving areas and high costs to serve the broadband market.⁵ Adding to the challenge of offering broadband service in small rural LEC serving areas is the fact that computer and Internet penetration tends to be lower in rural areas.⁶ Because of these differences between the rural LEC market and urban price-cap markets, there is essentially one broadband market in the small LEC areas. There is no mass residential market because residential customer densities are so low and, consequently, residential and small and medium sized businesses can be viewed as one market. Residential customers, and to a lesser extent, small and medium sized businesses are likely to view dial-up access as an alternative to high-speed access depending on the relative pricing of the services. In a similar vein, both groups of customers are likely to view the choice of a stand alone broadband service versus broadband sold as part of a package of services as a distinct economic choice.

The rural market is also characterized by an absence of significant intramodal and intermodal broadband competition in the residential and small and medium sized business market. This is quite likely due to the sparse population and the high cost characteristics that exist in the rural service areas. Few competitive LECs provide voice or data operations in areas served by rural LECs. Cable providers may be present within the city limits of smaller towns, but often, due to the significant costs and low consumer densities, these providers have not upgraded their facilities to enable them to provide

⁴ Id., pages 9 to 13.

⁵ "...the estimated bill for completing the job [of wiring rural America for broadband service] is enormous, about \$10.9 billion....There are a number of factors which typically increase the cost of serving customers in rural areas, such as the large size of exchange areas, low line density, and scattered distribution of telephone customers. The exchanges of rural companies in NECA's Common Line pool cover 35% of the land area of the 48 contiguous states plus Hawaii, but serve just under 6% of 1990 households or roughly 5% of 1998 USF loops." NECA Rural Broadband Cost Study, information in brackets added for clarity.

⁶ National Telecommunications Information Administration (NTIA) survey entitled "Falling Through the Net: Defining the Digital Divide", July 1999.

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broadband service. The high costs associated with deploying broadband service in rural areas, coupled with the low numbers of potential customers, combine to make it difficult to provision broadband services in rural areas at rates comparable to those available in urban areas. Incumbents and competitors alike face this challenge. Satellite and wireless providers have focused little attention on rural areas. Where satellite and wireless broadband service is available, it is relatively expensive and often the transmission speeds are inferior to wireline-based offerings.

All of these factors (low residential and business consumer densities, high costs per line, absence of significant broadband competition, etc.) indicate that the Commission should consider the broadband market served by rural rate of return LECs as a separate market and differentiate it from the largely urban broadband markets served by price-cap LECs.

2. RELEVANT GEOGRAPHIC MARKET FOR BROADBAND SERVICES:

The Commission asks parties to comment on the appropriate geographic market for each of the product markets for broadband services. In particular, the Commission asks if the geographic market is:

- a) The local service area?
- b) The incumbent LEC service area?
- c) All consumers facing the same competitive choice (customer aggregation)?

A. Urban Geographic Markets Served By Price-Cap LECs

FW&A believes that the relevant geographic market for price-cap LECs should be the price-cap LEC's service (study) area as proposed by SBC. . Evaluation based on study areas is a reasonable approach and fits well with the level of regulatory oversight that currently exists for LECs' interstate services. The local service area is likely too small a market area because it would establish numerous broadband market areas based on the exchange boundaries or expanded local calling areas of the price-cap LEC. Any market-based evaluation on the basis of local service areas is likely to be complex and difficult to track. A local service area definition likely would not coincide with the serving areas of broadband competitors. The customer aggregation approach to establishing geographic broadband market areas is also unworkable because differing intramodal and intermodal competitors (CLEC, cable, satellite and wireless) to the price-cap LEC would create differing and often conflicting geographic market areas. Although broader than the Commission's current definition of the geographic market for broadband, use of the price-cap LEC service area as a new geographic market definition will better coincide with the serving areas of all competitors faced by a price-cap LEC. If this redefinition is too broad for the FCC, the service area of a price-cap LEC could be subdivided into urban/suburban (where it is likely that both the price-cap LEC and its competitors are offering broadband services) and rural areas (where it is unlikely that either the price-cap LEC or its competitors are offering broadband services). Although it would be difficult to keep track of this subdivision, it could be accomplished based on the exchange or local calling area information maintained by the price-cap LEC.

B. The Rural Geographic Market Served By Small Rate of Return LECs

The entire geographic market for rural rate of return LECs is characterized by low consumer population density, high costs and an absence of significant intramodal and intermodal competition. These characteristics indicate that the entire study area of the rural rate of return LEC should be considered a broadband market by the Commission. The Commission could continue to utilize the exchange boundary or local calling area to define the relevant geographic market, but FW&A believes that for the areas served by the rural rate of return LECs, a simpler definition using the rural LEC's study areas would be appropriate.

3. MARKET POWER:

The Commission requests comments on whether the incumbent LEC possesses individual market power and is likely to be able to exercise such power to:

- a) Use its market position (market share, supply and demand substitutability, etc.) to allow it to restrict its output in order to raise prices (usually requires a large market share).
- b) Improperly exercise its local exchange and exchange access market power to disadvantage competitive suppliers of broadband services through cross-subsidization, charging higher prices to the competitor for essential inputs, providing poorer quality interconnection, etc.

The Commission also asks for responses to the following questions:

Does the existence of actual or potential competitors, regardless of the platform used to deliver broadband services (cable, satellite or wireless), constrain an incumbent LEC's ability or incentive to discriminate in either or both of these two ways?

Do current statutory (Act section 251c wholesale regulations) and regulatory requirements limit the market power of incumbent LECs?

A. Market Power of Price-Cap LECs

In the price-cap LEC service areas, there is both intramodal and intermodal competition for broadband service. Because of this competition and because of the existence of statutory and regulatory wholesale requirements, it is unlikely that a price-cap LEC can use its market position to restrict output in order to raise prices or disadvantage competitive suppliers through cross subsidization, charging higher prices for essential inputs, etc. The statutory wholesale requirements and the related Commission rules insure that intramodal competitors are not discriminated against when competing with price-cap LECs. The existence of significant intermodal competition also insures that a price-cap LEC cannot restrict output and raise prices without risking the loss of market share to these competitors.

B. Market Power of Small Rural Rate of Return LECs

Although most small rural rate of return LECs do not face significant intramodal or intermodal competitors at this time, their market power to charge unreasonable prices for broadband services or to disadvantage broadband competitors is constrained by:

- The existence of intermodal competitors that could enter the rural broadband market.
- The Act’s statutory requirement that “Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.”⁷

In practice, the Act’s comparability requirement, which constrains the broadband rate of the rural rate of return LECs to a level reasonably comparable to the rate charged in urban areas, is accomplished by most small rate of return LECs by charging the NECA rate levels for broadband services. Participation in the NECA pool and the use of its broadband rate levels (which are set at a level which is reasonably comparable to those in urban areas) insures that small rate of return LECs do not charge consumers unreasonably high broadband rate levels. Constraint on market power is also exercised by the existence of intermodal competitors. If prices for broadband service were set at unreasonably high levels by the rural rate of return LEC, consumers would find it more favorable to purchase satellite broadband service and where available, wireless broadband service. High rural rate of return LEC broadband prices could also incite rural cable providers to upgrade systems in order to provide broadband services.

⁷ Federal Telecommunications Act of 1996, Section 254(b)(3).
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APPROPRIATE REGULATORY REQUIREMENTS

The Commission asks the parties to comment on what regulatory requirements, if any, should govern the provision of broadband services.

a) Would reduced regulation of broadband services provided by incumbent LECs, regardless of the extent of existing competition, foster competition and the deployment of broadband facilities used in the provision of many of these services?

b) Would deregulation or reduced regulation further the efforts to fulfill the goals of section 706 of the Act, which directs the Commission to “encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans”?

c) Should incumbent LECs be classified as non-dominant in the provision of broadband services? Is it possible to classify a carrier as non-dominant with respect to certain services (i.e., broadband), when it remains dominant with respect to others (i.e., exchange and exchange access)?

d) Should an incumbent LEC’s corporate structure (use of separate affiliates) be a relevant consideration in the evaluation of the need for dominant carrier regulation of broadband services?

e) Do the statutory safeguards applicable to incumbent LECs under section 251 of the Act (collocation, unbundling, and resale), reduce the need for dominate carrier regulations or existing competitive safeguards?

f) Do existing regulations inhibit or stimulate the deployment of broadband services? What reductions in existing regulations are warranted?

g) Is the development of various broadband service categories at differing stages of evolution? Does this difference warrant different regulatory treatment?

A. Appropriate Regulatory Requirements For Price-Cap LECs

Large price-cap LECs are unlikely to be dominant carriers in the provision of broadband services in the largely urban areas they serve. Intermodal competitors typically have a more dominant market position and constrain the ability of the price-cap LEC to charge unreasonable prices. Additionally, the Act's statutory requirements (Section 251) and the Commission's regulatory requirements constrain a price-cap LECs ability to deter intramodal competition. Because significant intermodal competition exists in each of the possible urban price-cap broadband markets (residential, large, medium and small business) as well as possible submarkets, it is unnecessary for the Commission to develop separate regulatory requirements for each market. Instead, FW&A believes that the following regulatory changes can be implemented for price-cap LECs in each of these urban markets by the Commission:

- If the broadband service is offered by an affiliate of the price-cap LEC, it could be deregulated and not subject to Commission regulations as long as the affiliate price-cap LEC continues to be subject to the Act's statutory (Section 251) and the Commission's wholesale regulatory requirements.
- If the broadband service is offered by the price-cap LEC or if an affiliate's broadband service is bundled with the price-cap LEC's non-broadband services, the Commission could deregulate the price-cap LEC's broadband or the affiliate's bundled broadband service as long as:
 - a) The price-cap LEC operates under incentive regulation in both jurisdictions with no rate of return based low-end adjustments and any universal service funding received by the price-cap LEC is not based on embedded rate of return costs. This requirement will eliminate any complexities associated with cost allocations associated with the deregulated broadband services.
 - b) The price-cap LEC continues to be subject to the Act's statutory (Section 251) and the Commission's wholesale regulatory requirements in order to insure that intramodal competitors are not competitively disadvantaged.
- If the broadband service is offered by the price-cap LEC or if an affiliate's broadband service is bundled with the price-cap LEC's non-broadband services, but the LEC is not under incentive regulation in both jurisdictions or retains the ability to receive rate of return (embedded cost) low end adjustments or universal service funding in either jurisdiction, the Commission could deregulate the price-cap LEC's broadband or the affiliate's bundled broadband service as long as:

- a) The price-cap LEC continues to apply Commission Part 64 rules to segregate regulated from non-regulated costs.
- b) The price-cap LEC continues to be subject to the Act's statutory (Section 251) and the Commission's wholesale regulatory requirements in order to insure that intramodal competitors are not competitively disadvantaged.

B. Appropriate Regulatory Requirements For Rate Of Return LECs

Rural rate of return LECs, unlike their urban price-cap LEC counterparts, are likely to be the only ubiquitous provider of broadband services to all consumers in the areas they serve. Low consumer density and the high cost to provide not only broadband, but also existing services, and not the market power actions of the rural LEC, have deterred competitors, both intramodal and intermodal, from entering the rural rate of return LEC market. Satellite and wireless providers may provide broadband service to the occasional customer and cable providers may, if they spend the funds to upgrade facilities, provide service within town boundaries, but not beyond those boundaries in rural areas. As a consequence, the only provider that is likely to expend the funds necessary to bring advanced services, including broadband, to all customers (within and outside of town boundaries) in the rural areas they serve is typically the small, rate of return, incumbent LEC.

As discussed previously, FW&A believes that there is a single market for broadband services provided to customers (residence or business) in rural rate of return LEC areas. That market encompasses the rate of return LEC's service or study area. If the

Commission decides to deregulate the urban price-cap LEC broadband markets, it should not extend this deregulation to small rural rate of return LEC broadband markets (and possibly to the rural exchanges served by the price-cap LECs) at this time. Small rural rate of return LEC broadband services should remain regulated at this time for the following reasons:

- The continued ability to assign broadband costs to the NECA pool insures that pool cost averaging will continue to allow small rate of return LECs to economically provision broadband service. Without the pool, providing reasonably priced broadband service in rural rate of return LEC service areas would not be financially feasible.
- In the absence of significant intramodal or intermodal broadband competition in small rural rate of return LEC areas, the FCC can continue to insure that NECA broadband rates remain affordable for rural consumers and remain reasonably comparable to those in urban areas as required by the Act.

CONCLUSION

The Commission could deregulate price-cap LEC urban broadband markets if certain criteria are met. The rural rate of return LEC broadband market, however, is characterized by low consumer density, high costs and an absence of significant intramodal or intermodal competition. Including broadband costs in the NECA pool and regulation of broadband services for small rural rate of return LECs must be continued in order to insure a predictable and stable environment which will encourage small rural LECs to continue making the significant investments which are required to deploy

advanced services to their entire service area, while maintaining reasonable broadband rate levels.

Respectfully submitted on behalf of the ILECs by,

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