Competitive Universal Service

Presentation to the FCC and Joint Board Staff:

Questions for the Forthcoming Notice in the "Competitive Universal Service" Proceeding

December 2002

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I. Introduction:
A. Goals of the Competitive Universal Service Proceeding

- *Consumers in rural America must not be left behind*.
  - Rural consumers are entitled to enjoy the benefits of the competitive transformation in telecommunications:
    - Broader service options;
    - Incentives for more rapid deployment of new technologies and improvement of service quality; and
    - Innovative rate plans that better serve consumers' needs.
  - Competitive ETCs are the drivers for these benefits.
  - Making support portable removes a *barrier* to competition. It does not subsidize uneconomic entry.

I.A. Goals of the Competitive Universal Service Proceeding

- *Regulators must recognize the new realities of the telecom marketplace*.
  - Growing consumer reliance on competitive wireless and wireline carriers' offerings;
  - ***Major*** increase in role of wireless carriers as contributors to the fund.
- *Improve the transparency and understanding of the universal service system and its basic principles*.
  - Fears expressed by ILECs are unrealistic and will never be realized.
  - CETCs still face difficulties in obtaining access to information about funding levels and other workings of an unduly "ILEC-centric" system.

I.A. Goals of the Competitive Universal Service Proceeding

- *Certain aspects of the current universal service system are not working well and need to be reformed*.
  - Improve the process for designating CETCs.
  - Re-examine the funding of rural ILECs and the inconsistency between the systems for funding rural and non-rural carriers.
  - Implicit subsidies should be eliminated or made explicit and portable.
- *Need for neutrality*.
  - The FCC's *Referral Order* successfully raised difficult issues in a neutral manner. The Joint Board should pursue a similar approach.

I. Introduction – B. About the CETCs

- Who we are and what we're doing
- Locations where companies are designated as ETCs and providing supported services
  - Overcoming regulatory hurdles to entry
- Our companies are expanding the competitive telecommunications options to rural consumers:
  - Types of offerings
  - Investments in telecommunications facilities
  - Technological investments
  - Recovery of costs from initially small consumer base

I. Introduction:
C. Public Policy Fundamentals

1. Portability
   - Portability means every ETC, whether ILEC or CETC, must receive the same amount of funding for serving any given customer.
   - Portability is here to stay.
     - The courts have confirmed that the 1996 Act requires it.
     - Indeed, portability is the central reason for the universal service reform mandated by the 1996 Act.
   - The question about portability is not "whether" but "how."

I. Introduction:
C. Public Policy Fundamentals

2. Competitive Neutrality
   - This fundamental principle has *not* been referred to the Joint Board for reexamination in this proceeding.
   - Competitive neutrality precludes rules that systematically treat CETCs less favorably than ILECs.
3. Transparency
   - ILECs and prospective entrants must be able to make business plans in the context of a stable regulatory system.
   - Excessive complexity and unreasonably "ILEC-centric" rules are the enemies of transparency.

I. Introduction:
D. Overview of Historical Background

- 1997 First Report and Order
  - Competitively neutral contributions to funds; Portable disbursements
- 1999 7th and 9th R&O's
  - Eliminated anti-CETC "glitch" (delay in funding)
  - Eliminated rule that ILECs lose support when CETCs add lines
- 2000 Rural Task Force – stability during a 5-year "transitional" plan
  - 15% increase in rural ILEC embedded cost-based funds
  - Retained cap on growth of funds
  - Retained portability
- CALLS and MAG Plans

I. Introduction:
D. Overview of Historical Background

- Portable Support and Competitive Neutrality
  - FCC declaratory ruling on Kansas fund
  - *Alenco* and other 5th Circuit decisions
- Designation of Competitive ETCs
  - *Texas OPUC I*
  - FCC declaratory ruling on South Dakota case
  - State decisions
- "Public Interest" in Rural ILEC Areas
  - FCC ETC designations: Wyoming, Pine Ridge, Cellular South, RCC, etc.
  - State decisions
  - Disaggregation of rural ILEC study areas

II. Inquiries – Gather Data and Analysis

A. The State of the Marketplace
   1. How is the telecommunications marketplace evolving and changing?
   2. How are competitive universal service developments affecting consumers in rural areas?

B. How Do the Current Universal Service Rules Work in a Competitive Environment?

C. Economics of Competition and Universal Service

II.A. Inquiry Into the State of the Marketplace

1. How is the telecommunications marketplace evolving and changing?
   - To what extent are consumers purchasing packages of long-distance and local minutes when they have opportunities to do so?
   - To what extent are consumers shifting their traffic from ILECs and traditional IXCs to wireless carriers and CLECs?
   - To what extent are these changes occurring in rural as well as urban areas?

II.A. Inquiry Into the State of the Marketplace

2. How are competitive universal service developments affecting consumers in rural areas?
   - What proportions of consumers in rural study areas have access to competitive alternatives to services provided by ILECs?
   - What proportions of consumers have taken advantage of those alternatives?
   - How do markets differ where CETC entry has, and has not, occurred?

II.A. Inquiry Into the State of the Marketplace

2. How are competitive universal service developments affecting consumers in rural areas? (continued)
   - In areas where CETCs have entered the market, what has been the consumer impact?
   - What were the CETC's offerings to residential, small business, and large business customers?
   - How did CETCs improve the service quality and other aspects of their offerings?
   - How did the ILECs respond to competitive entry?

II.B. How Do the Current Universal Service Rules Work in a Competitive Environment?

- How does USAC administer the current funding rules in competitive study areas?
  - How does CETC entry affect ILEC support?
  - What if the CETC uses unbundled loops from the ILEC?
- What proportion of high-cost universal service funds go to ILECs vs. CETCs?
  - What proportions of fund growth are attributable to ILECs vs. CETCs?

II.B. How Do the Current Universal Service Rules Work in a Competitive Environment?

- To what extent do ILECs continue to receive *implicit* subsidies?
  - In theory, interstate access charge revenues + universal service support = federal embedded costs of rate-of-return ILECs. How does this work in practice?
  - What is the economic impact of universal service support on CETCs?
- What are the regulatory hurdles a prospective entrant needs to jump over in order to receive ETC designation and universal service funds?

II.C. Economics of Competition and Universal Service

1. What are the marketplace dynamics of competitive entry in rural and high-cost areas? Gather information based on economic theory, and based on analysis of real-world data.
   - In the absence of subsidies, what economic and business factors affect competitive entry in rural areas?
   - What would be the impact when universal service support is available to (a) neither ILEC nor CETCs; (b) ILEC but not CETCs; (c) both ILEC and CETCs?
   - How do the answers change, if at all, when the ILEC and CETCs face different cost structures?
   - What is the impact of retail pricing regulation?
   - What is the impact of other regulatory policies, such as removal of barriers to entry (*i.e.*, certification, rural exemption, ETC designation, etc.), and availability of UNEs?

II.C. Economics of Competition and Universal Service

2. If a regulator wanted to improve "affordability" (*i.e.*, reduce prices) charged by two or more competing carriers, what principles should be followed to minimize economic distortion to competition?
   - Under what circumstances could competitive entry reduce the total amount that consumers pay in service rates plus subsidies for service?
3. What market distortions would be created by paying different amounts per customer to each ETC?
   - What market distortions would be created by supporting services from one ETC but not another?
   - If different subsidies are paid to different providers based on the individual companies' reported "costs," what incentives are created in terms of technology, "gold-plating" or overbuilding networks, etc.?
   - How does paying different subsidies affect the ability of the "invisible hand" of the market to discipline cost increases?

II.C. Economics of Competition and Universal Service

4. What are the competitive marketplace dynamics that constrain the rate levels of competitive entrants' offerings to consumers?
   - If competitive entrants that lack market power set their rates at unreasonable levels, will they succeed in attracting customers?
   - Is there any way to compare rates for CETC offerings with those of the ILECs (or of one another) given the differences in the technologies and rate structures (*e.g.*, different combinations of local and long-distance services)?
   - What would be the impact of regulation on the ability of CETCs to innovate and offer competitive packages to consumers?

III. Issues in the Referral Order: A. Rules for ETC Designation and Related Matters

1. ETC Designation
   a. Competitively Neutral Designation Procedures
   b. Competitively Neutral Substantive Criteria for Designation
2. Geographic Disaggregation of Rural Study Areas for Designation and Support Purposes

III.A. Rules for ETC Designation and Related Matters

1. ETC Designation
   a. Competitively Neutral Designation Procedures
      - Should the timing of state or FCC designation be expedited – *e.g.*, impose a 6 month limit?
      - How can the process be harmonized among states?
        - For example, could the FCC establish a uniform ETC application form that could be used by ETC applicants in all states?

III.A. Rules for ETC Designation and Related Matters

1. ETC Designation
   a. Competitively Neutral Designation Procedures
      - How can the process for state and federal support be harmonized?
        - For example, should the states use the same designation procedures for state and federal universal service programs?
      - How can the process for disaggregating rural ILEC study areas be harmonized with the designation process, and expedited?

III.A. Rules for ETC Designation and Related Matters

1. ETC Designation
   b. Competitively Neutral Substantive Criteria for Designation
      - Should the objective and competitively neutral designation criteria be clarified?
      - Should the application of the "public interest" standard that applies to rural ILEC study areas be clarified?

III.A. Rules for ETC Designation and Related Matters

1. ETC Designation
   b. Competitively Neutral Substantive Criteria for Designation (continued)
      - What guidance should be provided regarding the Act's prohibition of rate or entry regulation or "equal access" rules upon CMRS carriers?

III.A. Rules for ETC Designation and Related Matters

2. Geographic Disaggregation of Rural Study Areas
   - How is the current process of rural ILEC study area funding disaggregation, under the RTF and MAG Orders, working? How does it affect competition?
   - When rural ILEC study areas are disaggregated for funding purposes, but not for ETC designation purposes, what is the impact on competition?
   - How does funding disaggregation affect the transparency of the funding system (*i.e.*, the ability of prospective entrants to make business plans regarding market entry)?
   - Are there alternative policies to target funds to the highest-cost areas (or modifications to the disaggregation policy) that would more effectively advance the goals of competitive neutrality and transparency?

III. Issues in the Referral Order: B. Measures to Prevent Excessive Growth of the Fund

1. Reconsider the Support Methodology for All ETCs (Rural ILECs as well as CETCs)?
2. Limit Support to a Single Connection to an End-User?
3. Alternatives to a "Primary Line" Restriction?
4. Freeze Support to All ETCs in Competitive Study Areas?
   - Would these options be:
     - Competitively neutral?
     - Administratively feasible?
     - Would they keep the fund size in check?

III.B. Measures to Prevent Excessive Growth of the Fund

1. Reconsider the Support Methodology for Rural ILECs (as well as CETCs)?
   - Discussed in detail in the following section (III.C.)

III.B. Measures to Prevent Excessive Growth of the Fund

2. Limit Support to a Single Connection to an End-User?
   - *Competitive Neutrality*: How would a "single connection" rule be implemented consistent with competitive neutrality?
     - In comments on the NTCA petition, CUSC showed that competitive neutrality would be violated by proposals to
       - (i) give ILECs support regardless how many lines they provide, but support CETCs only if they are the sole service provider, and
       - (ii) presume, in cases where a consumer purchases service from more than one ETC, that only the "first" carrier receives support.

III.B. Measures to Prevent Excessive Growth of the Fund

2. Limit Support to a Single Connection to an End-User? (continued)
   - *Administrative Difficulties*: How would carriers and/or USAC determine which lines are "first" and "second" lines?
     - In a single-carrier environment, what were the administrative difficulties of different PICC charges for "first" and "second" lines that led the FCC to change this rule? Would the same problems arise here?
     - Would these difficulties be magnified in a multi-carrier environment? How could they be resolved, if at all?

III.B. Measures to Prevent Excessive Growth of the Fund

2. Limit Support to a Single Connection to an End-User? (continued)
   - *"Comparability"*: How could this approach be reconciled with "reasonably comparable" service in rural and urban areas?
   - *Customer Choice*: Could customers be asked to decide whether the ILEC or the CLEC receives the subsidy for serving them?
     - Would consumers pay the ILEC and the CETC the same rate regardless of which carrier were selected to receive the subsidy?
     - If customers experienced no economic impact as a result of their choice, how would such a choice be meaningful?

III.B. Measures to Prevent Excessive Growth of the Fund

2. Limit Support to a Single Connection to an End-User? (continued)
   - *Impact on Access to Advanced Services*: How would a restriction making support available only for primary lines affect access to information services, including advanced services, in high-cost areas?
   - *Impact on Cost Analysis*: How would a primary line restriction affect the implementation of embedded cost analyses? How would it affect forward-looking cost models
     - How would such a restriction affect the implementation of the access reform goals of the CALLS and MAG Orders?

III.B. Measures to Prevent Excessive Growth of the Fund

3. Alternatives to a "Primary Line" Restriction?
   - Support only one line per customer for each carrier providing service?
   - Split the per-line amount of support among the carriers providing service?
     - Would these options be:
       - Competitively neutral?
       - Administratively feasible?
       - Would they keep the fund size in check?

III.B. Measures to Prevent Excessive Growth of the Fund

4. "Freeze" Support to All ETCs in Competitive Study Areas? (See *Referral Order* fn.29)
   - The total amount of funding in each study area could be capped so that it grows by no more than the rate of growth in: (i) inflation, and (ii) number of households in the area.
   - The resulting total amount of support could be divided among ILEC and CETCs based on the percentage of the total number of lines served by each carrier.
   - This is similar to a proposal that the RTF recommended but that the FCC did not adopt.

III.B. Measures to Prevent Excessive Growth of the Fund

4. "Freeze" Support to All ETCs in Competitive Study Areas?
   - Possible minor modification to the RTF recommendation: Should funding be allowed to grow based on rate of increase in teledensity (penetration)?
     - This would enable support to increase as ETCs begin to provide service to formerly unserved customers.
   - Would this option be:
     - competitively neutral?
     - administratively feasible?
     - Would it keep the fund size in check?
     - How would it affect ILECs' and CETCs' incentives to compete for both "first" and "second" lines?

III. Issues in the Referral Order: C. Methodology for Support to ETCs in Study Areas with Competition

Important: The *Referral Order* (¶ 7) asks about the methodology for calculating support to *all* ETCs in competitive study areas – including ILECs as well as CETCs.

1. Alternatives to Embedded Cost-Based Support Formulas?
2. Funding CETCs Based on Their "Own" Costs?
3. Negative Auctions?

III.C.1. Alternatives to the Embedded Cost-Based Support Formulas?

- Is there a disconnect between portability and support based on the embedded cost of the ILECs?
  - If so, perhaps the embedded cost-based support system must be changed to reflect the new competitive environment.
- Embedded cost-based support is closely tied to rate-of-return regulation for the ILECs.
  - Is rate-of-return regulation still appropriate in an increasingly competitive environment?
  - Is a level playing field possible when one competitor is guaranteed a return on its investments?
  - Do some of the factors that led the FCC to eliminate rate-of-return regulation for large ILECs now apply to the smaller ILECs as well?

III.C.1. Alternatives to the Embedded Cost-Based Support Formulas?

- *Support Based on Forward-Looking Costs?*
  - In theory, ILECs and CETCs face the same forward-looking costs.
  - What forward-looking cost model should be used?
    - Can a version of the Synthesis Model (used for large ILECs) be modified for application to rural areas?
    - Can a simpler and easier-to-use approach to modeling be developed?
    - Should the goal be to model the lesser of wireline or wireless costs?
  - Can models account for economies of scale, and the impact of facilities-based entry?

III.C.1. Alternatives to the Embedded Cost-Based Support Formulas?

- *Alternative Embedded Cost Methodologies?*
  - There's nothing sacrosanct about the existing HCF, LSS, and LTS formulas.
    - If we were inventing an embedded cost-based USF today, how should it be structured?
      - Do the existing formulas create opportunities for many co-ops and other rural ILECs to charge their customers extraordinarily low rates, much lower than are charged in urban areas?
      - How does such a structure advance "affordability" or "comparability"? Would it survive scrutiny under the standard that the 10th Circuit's applied to the non-rural system?
  - How should a transition to a modified system be structured? What should the timing be?

III.C.2. Funding CETCs Based on Their "Own" Costs?

- (See CUSC and GCI comments on ACS petition.)
- Do CETCs or ILECs generally face lower embedded costs per customer?
  - The answer is not obvious – in some study areas CETCs may incur higher costs than ILECs, and in others the opposite may be true.
  - On a per-line basis, new entrants may well face higher costs. The Joint Board should seek information about this.
  - CMRS carriers and CLECs face higher costs in rural areas, just as ILECs do.

III.C.2. Funding CETCs Based on Their "Own" Costs?

- The Joint Board should also gather information on:
  - The administrative difficulty of trying to determine the "embedded costs" of unregulated carriers; and
  - The impact on the competitive marketplace of providing different amounts of support to carriers that compete with one another.

III.C.3 Negative Auctions?

- Some have expressed interest in GTE's 1996 proposal to establish support levels through a competitive bidding process.
- If the Joint Board chooses to seek comment on this, it must examine whether such a plan could be:
  - Competitively neutral; and
  - Administratively feasible.

III.C.3 Negative Auctions?

- *Could a negative auction be competitively neutral?*
  - The premise of an auction is that the winner obtains an exclusive right.
    - But the Act contemplates that numerous competing ETCs may simultaneously receive support.
    - Is there a competitively neutral solution to this conundrum?
  - Would the FCC have to adopt rules to ensure that state PUCs that administer auctions impose only *competitively neutral* conditions on participation?

III.C.3 Negative Auctions?

- *Could a negative auction be administratively feasible?*
  - Given the dynamism of the marketplace, auctions would have to be repeated frequently so as not to freeze out competitively entrants.
    - GTE proposed holding such auctions twice a year. Would this be administratively feasible?
  - As GTE recognized in its 1996 comments, an auction cannot be competitively neutral unless there's a realistic possibility that the ILEC could lose.
    - Is it realistic that an auction could be held and an ILEC could lose? Consider the disruption and other difficulties that would ensue.

Conclusion

- This is an extremely complex and important proceeding.
  - We stand ready to help.
- The Joint Board must adhere to the established, fundamental policy principles:
  - Portability
  - Competitive Neutrality
  - Transparency