Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Federal-State Joint Board on Universal Service	CC Docket No. 96-45

REPLY COMMENTS OF AT&T CORP.

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SUMMARY

Virtually every commenter in this proceeding recognizes that the current USF mechanisms cannot sustain unchecked growth in High Cost Support, and acknowledges that any growth in the USF must be in support of specific public policy objectives, rather than the unintended consequence of Joint Board and Commission inaction. And many commenters identify the same two areas of growth – increasing support for multiple lines (especially wireless lines) and ILEC revenue guarantees – identified by AT&T. The real dispute in this proceeding concerns whether these sources of growth are truly necessary to support universal service, or whether they represent excessive support that must be reined in to stabilize the fund and focus on its most critical objectives. AT&T continues to believe, and the record reflects, that the latter is the case. Support for multiple lines and guarantees of ILEC revenues (rather than service to consumers) must be curtailed.

When it deferred implementation of the Joint Board's 1996 recommendation to limit High Cost Support to a single connection to a home or business, the Commission perhaps could not have anticipated the extent to which wireless service would proliferate, the number of wireless carriers that would obtain ETC status in order to receive High Cost Support for services they were already offering – or would offer – even without High Cost Support, and the potential for skyrocketing USF support that would result. As demonstrated in AT&T's initial comments, that growth is here now. Although it is in its early stages, it is growing dramatically. And it compels the Joint Board to consider once again what has been a core question in universal service policy since 1996: does "universal service" mean connections to the PSTN at enough locations (including every home and business) to give everyone reasonable access, or does it now mean something more? AT&T believes it is the former, and its initial comments urge the

Joint Board to once again recommend that High Cost Support be limited to a single connection to a home or business. Contrary to some assertions, limiting support to a single line would be competitively neutral (all ETCs would remain eligible), would not cause "rate shock" (current ILEC study-area support would not be reduced unless ILECs lose lines to CETCs), and would actually reduce regulators' need to strictly define supported services (consumers will be able to do so themselves by "voting with their feet"). If the Joint Board nonetheless decides *not* to recommend limiting support to a single line, it should recommend instituting hard caps on all of the High Cost Support mechanisms.

AT&T's initial comments – and those of many others, including some incumbents – also show how existing High Cost Support mechanisms guarantee ILEC revenues in the face of competition. AT&T therefore urges the Joint Board to, as it did in the *RTF Proceeding* with respect to HCLS only, freeze all High Cost Support in a study area at the ILEC's per-line support once a CETC enters the market. In such cases, support would be distributed to all ETCs – both incumbent and competitive – on a per-line basis. Some ILECs, for their part, claim that providing all support on a per-line basis would be illegal, because the Act, in their view, *requires* revenue guarantees. Nothing of the sort is true. The Act merely allows ILECs – and all other carriers – a *reasonable opportunity* to recover their revenue requirement. Freezing per-line support upon competitive entry is thus perfectly legal, and would send appropriate market signals to ILECs and CETCs alike.

Several other issues raised in the initial comments also require response. First, a range of commenters from different sectors of the industry observe that universal service support should never be higher than that required to provide affordable and reasonably comparable service.

AT&T agrees, and agrees with those commenters noting that existing support may already be too high in at least some areas. The Joint Board should therefore phase out unnecessary support.

Second, several rate-of-return rural ILECs urge the Joint Board to recommend differential High Cost Support (that is, higher support for ILECs than for CETCs). This is a truly bad idea. Competitive markets can reveal and eliminate the ILEC "goldplating" and expense-padding that is encouraged by rate-of-return regulation – but *only* if all market competitors receive the same support. Differential support, by contrast, allows ILECs to shield inefficiencies from competition, a result entirely at odds with the 1996 Act. High Cost Support must remain, as it is now, portable.

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GLOSSARY

High Cost Loop Support ("HCLS")	Assists rural local telephone companies with high local loop costs. Support offsets loop costs that would otherwise be recovered through intrastate rates. *See* 47 U.S.C. § 36.601 *et seq*. Total HCLS nationwide is subject to an indexed cap.
High Cost Model Support ("HCMS")	Assists non-rural local telephone companies with high costs, based on FCC's Hybrid Cost Proxy model of forward-looking costs. Support offsets loop costs that would otherwise be recovered through intrastate rates. *See* 47 C.F.R. § 54.309.
Local Switching Support ("LSS")	Assists local telephone companies serving study areas of 50,000 or fewer access lines. Support is provided to offset a portion of the local switching costs that would otherwise be recovered through intrastate rates. *See* 47 C.F.R. § 54.301. LSS is included in calculations of a carrier's interstate rate of return.
Long Term Support ("LTS")	Assists local telephone companies subject to rate-of-return regulation that participate in NECA's Common Line Pool with loop costs allocated to the interstate jurisdiction. *See* 47 C.F.R. § 54.303. LTS is included in calculations of a carrier's interstate rate of return.
Interstate Access Support ("IAS") – also known as "CALLS Support"	Provides per line support for all ETC loops in high cost zones of study areas served by ILECs regulated under price cap regulation. *See* 47 C.F.R. § 54.800. Total nationwide IAS is capped at $650 million per year. IAS is included in calculations of a carrier's interstate rate of return.
Interstate Common Line Support ("ICLS") – also known as "MAG Support"	Provides support to offset a portion of the interstate common line revenue requirement of rate-of-return ILECs, with CETCs receiving per line support equivalent to the ILEC's support per ILEC working loop. *See* 47 C.F.R. § 54.901. ICLS is included in calculations of a carrier's interstate rate of return.

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REPLY COMMENTS OF AT&T CORP.

AT&T Corp. ("AT&T") hereby replies to the comments on the Public Notice issued by the Federal-State Joint Board on Universal Service (the "Joint Board") concerning the High Cost Support mechanism and the designation of Eligible Telecommunications Carriers ("ETCs").[1]

I. INTRODUCTION

In its initial comments, AT&T demonstrated that High Cost Support is subject to two separate areas of growth that, together, threaten the sustainability of the universal service fund ("USF"). First, the number of lines served by ETCs – particularly by wireless ETCs – is increasing dramatically.[2] Today, the overwhelming majority of the nearly 150 million consumers who purchase wireless services, many of whom live in rural areas, do so without any universal service support. The potential, however, exists for widespread certification of wireless carriers as ETCs, which could lead to runaway

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[1] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, Public Notice, 18 FCC Rcd. 1941 (2003) ("*Notice*").

[2] AT&T Comments at 5-7. For purposes of these Reply Comments, "multiple connections" is defined as anything in addition to a single connection per household or business.

growth in the USF as High Cost Support is paid out for lines that today are provided without support (or that would be provided in new service areas without support).

Wireless ETCs are not the only source of potential USF growth: aspects of several support mechanisms designed to protect Incumbent Local Exchange Carrier ("ILEC") revenues in the face of competition also cause growth. The current methods for calculating High Cost Support for rate-of-return carriers (including rural carriers) increase effective per-line support to ILECs that lose lines to competitors. Moreover, because Competitive ETCs ("CETCs") receive the same support as ILECs, increased per-line ILEC support increases CETC support as well.[3] This not only creates an "upward spiral" in USF growth as CETCs win lines from ILECs, but also both shields ILECs from competition and sends inappropriate market signals to ILECs and CETCs alike.

In its initial comments, AT&T urged the Joint Board to address both of these problems head on. To address fund growth caused by the increase in supported multiple lines, AT&T proposed that the Joint Board renew its 1996 recommendation to limit High Cost Support to a single line to a home or business.[4] And to address the upward spiral of support per line as CETCs win lines from ILECs, AT&T urged the Joint Board to recommend – as it did in the *RTF Proceeding* with respect to HCLS only – freezing *all* High Cost Support in a study area at the rate-of-return ILEC's per-line support once a

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3 *See* AT&T Comments at 17-22.

4 *Federal-State Joint Board on Universal Service*, Recommended Decision, 12 FCC Rcd. 87, 132 (1996) ("*1996 Recommended Decision*").

CETC enters the market. In such cases, support would be distributed to all ETCs – both incumbent and competitive – on a per-line basis.[5]

Virtually every commenter in this proceeding recognizes that the current USF mechanisms cannot sustain further growth in High Cost Support. And, even if current mechanisms were reformed so that they *could* sustain further growth, any such growth must be in support of clear public policy objectives, rather than the unintended consequence of Joint Board and Commission inaction. Many commenters identify the same two problematic areas of growth under the current mechanisms as did AT&T – increasing support for lines (especially wireless lines) as more wireless carriers obtain ETC designation, and high cost mechanisms that are structured to guarantee ILEC revenues in the face of competition, rather than simply supporting affordable and reasonably comparable rates for *consumers*. The central dispute in this proceeding concerns how to address these twin problems. AT&T continues to believe that the Joint Board and Commission must address these issues directly. Failure to do so will increasingly threaten the Congressional mandate to ensure rural Americans reasonably comparable service at reasonably comparable rates.

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5 *See Federal-State Joint Board on Universal Service*, Recommended Decision, 16 FCC Rcd. 6153, 6161 (2000) ("*RTF Recommended Decision*"); *Federal-State Joint Board on Universal Service*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, 16 FCC Rcd. 11,244, 11,293 (2001) ("*RTF Order*"). The Rural Task Force made its recommendation with respect to the HCLS only, but AT&T believes a per-line cap should apply more broadly to rural ILEC support under HCLS, LSS and LTS, and to support for both rural and non-rural ILECs under ICLS. *See id.* at 11,293; AT&T Comments at 23.

II. SUPPORT SHOULD BE LIMITED TO A SINGLE CONNECTION TO A HOME OR BUSINESS

In 1997, the Commission decided to defer implementation of the Joint Board's recommendation that High Cost Support be limited to a single line to a residence or business.[6] The record in this proceeding makes clear that this decision opened the door to unforeseen USF growth. The record also squarely presents the Joint Board with the core question in this proceeding: does "universal service" mean connections to the Public Switched Telephone Network ("PSTN") at enough locations (including every home and business) to give everyone reasonable access, or does it now mean something more? The choice between these competing visions of universal service carries enormous consequences for the USF – indeed, some commenters estimate that the more expansive approach urged by wireless carriers could add $2 billion annually to the fund. The Joint Board should be mindful of these consequences, and should again recommend limiting High Cost Support to a single connection to a home or business.

A. IF ALL LINES CONTINUE TO BE SUPPORTED, THE USF WILL GROW DRAMATICALLY

The initial comments in this proceeding demonstrate that growth in High Cost Support threatens USF stability. AT&T's concerns in this regard are shared by nearly every commenter in this proceeding – consumer advocates,[7] rural ILECs,[8] price-

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6 *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd. 8776, 8829 (1997) ("*First Report and Order*").

7 *See* NASUCA Comments at 1 (arguing that, "[u]nder the current ETC designation rules, in the near future there will likely be a sharp upward curve in the growth of the high-cost fund related to the issues being examined here").

8 *See*, *e.g.*, ACS of Fairbanks Comments at 24 (noting that, "[g]iven the current regulatory policy . . . the overall federal universal service fund size could easily reach $7.1 billion by 2006 . . . [and that] [s]uch growth is not sustainable"); NTCA Comments at 9-10 (arguing that "there is no dispute that corrective measures are needed to maintain universal service on a going forward basis").

cap ILECs,[9] interexchange carriers,[10] and even (if grudgingly) wireless carriers.[11] Moreover, many commenters agree with AT&T that a big part of this story is the increasing support for multiple lines as more wireless carriers obtain ETC status.[12] (Indeed, in the short time since initial comments were filed, Nextel has been designated as an ETC in Iowa.[13])

Wireless carriers claim that, because they have received only a small portion of High Cost Support in the past, and because previous growth in High Cost Support flowed largely to ILECs, support for wireless lines is not a significant factor in High Cost Support growth.[14] This misses the point. What is significant about support for multiple lines (most of which goes to wireless carriers) is not that it is large now, but that *it is growing geometrically*. OPASTCO, for example, estimates that high-cost support for all

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9 *See*, *e.g.*, Verizon Comments at 1 (noting that "[t]he size of the universal service fund is growing to levels that threaten two of the primary goals of the universal service program – sustainability of the fund and affordability of telecommunications services for all Americans").

10 *See* WorldCom d/b/a/ MCI Comments at 7 (noting that, "because MCI is concerned about the growing fund size, limiting support to primary lines may be an appropriate course of action assuming realistic solutions are developed for identifying and supporting primary lines and ensuring that competitive carriers would not be harmed").

11 *See*, *e.g.*, Sprint Comments at 5 (noting that "[t]he high-cost fund is, indeed, ballooning in size"); Western Wireless Comments at 12 (arguing that USF "growth is largely attributable to increases in ILEC funding, not CETC funding").

12 *See*, *e.g.*, NASUCA Comments at 1-2 (stating that "[a] substantial portion of [High Cost Support] growth is a result of additional funds needed to support multiple lines per customer and to support lines provided by new competitive eligible telecommunications carriers . . . , mostly wireless ETCs"); NTCA Comments at 10 (describing increases in High Cost Support in connection with a "parade of wireless carriers seeking ETC status").

13 *See NPCR, Inc. d/b/a/ Nextel Partners*, Order Designating Eligible Carrier, Docket No. 199 IAC 39.2(4) (Iowa Util. Bd., rel. May 15, 2003) (designating Nextel as an ETC), *available at* http://www.state.ia.us/government/com/util/_private/Orders/2003/0515_199iac392.pdf.

14 *See*, *e.g.*, Western Wireless Comments at Attach. D p. 8 (arguing that "CETCs are not primarily responsible for the growth of the USF . . . [and that] [w]hile CETCs have gradually increased their market share, which is entirely expected given that CETCs had no market share three years ago, distributions to CETCs still represent less than 5% of total high-cost distributions"); BellSouth Comments at 9 (stating that, "[t]hus far, only small wireless carriers have sought [high cost] support").

CETCs grew nearly ten-fold from $11 million in 2001 to an estimated $107 million in 2003,[15] with almost all of that growth (ninety-seven percent) going to wireless carriers.[16]

If this were merely a temporary ramp-up phenomenon, such growth might be less alarming. But, as the comments reflect, this growth in support appears to be just beginning. As NASUCA explains:

> The hypothesis that the high-cost fund may be at the beginning of a steep growth curve is supported by the fact that an entire industry has only recently begun qualifying for high cost support. The wireless industry may currently account for only a small part of the current needs of the fund, but that is likely to change dramatically as additional eligible wireless carriers obtain ETC designation and apply for support.[17]

Indeed, the first trickle of wireless carriers to obtain ETC designation has started what CenturyTel describes as a "gold rush," as financial pressures push those who have not yet sought ETC designation to do so.[18] These financial pressures come in part from Wall Street:[19] as NTCA observes, for a wireless carrier *not* to pursue ETC status in the current regulatory climate may well constitute a violation of management's fiduciary duty to shareholders.[20] Moreover, once one wireless competitor in a market receives

15 OPASTCO Comments at Attach. 1 p. 10 (*Universal Service in Rural America: A Congressional Mandate at Risk*, Table 3 (Jan. 2003)).

16 *Id.*

17 NASUCA Comments at 2.

18 CenturyTel Comments at 11.

19 The Joint Board referred to a Salomon Smith Barney report describing High-Cost Support as "almost all margin" for wireless ETCs. *Notice* at n. 43 (*citing* Salomon Smith Barney, *Western Wireless (WWCA): USF Provides Upside to Our EBITDA* at 1 (Jan. 9, 2003)). Salomon Smith Barney also referred to USF as "the single most important opportunity for rural wireless carriers to improve their return on capital." NTCA Comments at 16 (*citing* Salomon Smith Barney, Wireless Services, USF Subsidies May Significantly Improve Subscriber Economics for Rural Carriers, Multi-Company Note, at 1 (Jan. 21, 2003)).

20 NTCA Comments at 16.

ETC designation, other wireless carriers will face heavy competitive pressure to follow suit so as not to be placed at a USF-based competitive disadvantage.[21]

Without changes to the *status quo*, increasing wireless ETC designation (and the attendant increase in support for multiple lines) will put an enormous strain on the USF. NECA, in what one commenter describes as a "conservative estimate,"[22] projects that USF funding could reach $7.1 billion by 2006.[23] OPASTCO concurs, stating that, "if all wireless carriers nationwide were granted ETC status . . . , the annual funding level of the High-Cost program would grow by more than $2 billion."[24] The Joint Board should thus view with great skepticism wireless carrier claims that there is little to worry about.[25]

If the USF is allowed to grow in the manner predicted by NECA and OPASTCO, such growth should be the result of a deliberate policy choice, based on specifically articulated policy objectives. It should not be the unintended result of the Commission deferring a hard choice six years ago.

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[21] *See* AT&T Comments at 8; *see also* Alaska Telephone Association Comments at 12 (describing a situation in which, "once one of four wireless carriers competing in a rural study area [in Alaska] is designated as an ETC, it is almost a business imperative that the others quickly follow suit"); MUST Comments at 21 (stating that, "to the extent [small rural wireless carriers] must compete with other wireless carriers that gain ETC designation, common sense would dictate that they will seek similar designation in order to compete on a level playing field with wireless ETCs operating in the same area").

[22] ACS of Fairbanks Comments at 24 n. 78.

[23] NECA, "Trends in Telecommunications Cost Recovery: the Impact on Rural America" at 4 (Sept. 2003), *available at* www.neca.org/SOURCE/NECA_155_1155.ASP.

[24] OPASTCO Comments at 10.

[25] *See*, *e.g.*, CTIA Comments at 4 (stating that, "[i]n general, wireless CETCs . . . will likely have a minimal impact in the near future"); United States Cellular Comments at 15-16 (arguing that "there is no [growth] 'crisis' in the high-cost program," but directing the Commission to "look to other means of restricting the growth of the USF").

B. THE JOINT BOARD MUST RESOLVE THE CORE QUESTION OF WHETHER UNIVERSAL SERVICE IS REASONABLE ACCESS TO THE PSTN, OR IS NOW A PERSONAL CONNECTION REACHING EVERYONE, ANYWHERE, ANYTIME

When the Joint Board recommended in 1996 that support be limited to a single line to a household or business, it had a specific vision of the objective of universal service policy – sufficient connections to allow everyone reasonable access to the PSTN. The comments demonstrate that, by deferring the implementation of the Joint Board's recommendation, the Commission unwittingly opened the door to other, more expansive, visions of the USF's objective. The Joint Board must therefore now address once again the core question raised most starkly by Western Wireless – does "universal service" mean reasonable access to the PSTN, or is it now "connecting individuals at all times and across geography, via diverse service providers and service packages that are not necessarily limited to the basic core of universal service requirements"?[26] AT&T and others believe it is the former.[27]

Western Wireless contends that "the concept of universal service as a measure of service to physical *locations* is giving way to concepts of connecting *individuals* at all times and across geography."[28] In evaluating Western Wireless' "new vision,"[29] the

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[26] Western Wireless Comments at 3; *see also* NASUCA Comments at 3 (stating that, "[c]entral to any consideration of these issues will be the Joint Board's determination of the *essential* purposes of universal service . . .").

[27] *See*, *e.g.*, NASUCA Comments at 3 (stating that "NASUCA suggests that the original intent of universal service support was to allow all Americans to have an affordable connection to the public switched telephone network").

[28] Western Wireless Comments at Attach. B p. 2.

[29] Western Wireless characterizes its approach as "A New Vision of Universal Service." Western Wireless Comments at 10.

Joint Board should not confuse convenience with "essentiality."[30] Joint Board Commissioner Dunleavy perhaps best articulated in the *Definitions* proceeding the difference between essential services and those that are merely convenient:

> The broad-based federal universal service programs . . . at issue here are not about simply ensuring widespread deployment of services in case some customers find them beneficial. They are aimed at getting every household actually subscribed to the defined basic level of telecommunications. . . . Adding any service to the definition of universal service implies that we expect *every household* to actually subscribe to and pay for that service.[31]

Reasonable access to the PSTN is "essential" to the public interest in the sense that it has been a consistent public policy objective of the Commission and Joint Board that every household actually subscribe to basic telephone service – a minimum baseline for connectivity to the PSTN. By contrast, the Commission and Joint Board have never said that they expect every consumer to actually subscribe to "[t]he ultimate in an individual's access to the [PSTN] over time and space."[32]

Moreover, "anytime, anywhere" connectivity is a convenience that is already widely available in rural areas *without* the aid of High Cost Support.[33] And expanding

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30 *See* 47 U.S.C. § 254(c)(1)(A) (requiring the Joint Board and the Commission to "consider the extent to which . . . telecommunications services" included in the definition of universal service "are essential to education, public health, or public safety").

31 *Federal-State Joint Board on Universal Service*, Recommended Decision, 17 FCC Rcd. 14,095, 14,149 (2002) (Separate Statement of Thomas J. Dunleavy) (emphasis added).

32 Western Wireless Comments at Attach. B p. 3.

33 *See*, *e.g.*, MUST Comments at 29 (stating that, "[g]enerally speaking, universal service support to wireless carriers is 'found money'"); Idaho Telephone Association Comments at 3 (stating that "there are an average of 5 wireless carriers" in rural Iowa study areas surveyed, and that "these carriers have been offering their services since inception *without* high-cost support") (emphasis added); Montana Telecommunications Association Comments at 3 (stating that "invariably, [wireless] services are deployed prior to or without the provision of universal service support"); OPASTCO Comments at 3 (stating that "[v]irtually every member of OPASTCO has *at least* one affiliated CMRS provider serving in their territory") (emphasis in original); *see also Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Seventh Report, 17 FCC Rcd. 12,985, 13,111-13 (Appendix E, Maps 1-3) ("*Seventh Annual CMRS Report*") (showing

the definition of universal service is not the only way – or even a very good way – to increase its availability.[34] The Idaho Telephone Association describes the potential consequences of funding rural wireless infrastructure through High Cost Support: "In some study areas in Idaho . . . [there could be] up to 11 publicly funded networks in a single study area if the incumbent LEC and 10 wireless carriers were all granted eligible status."[35] To embrace Western Wireless' concept of universal service is to endorse just such a result. The benefits of whatever incremental deployment is made possible by Western Wireless's proposed expansion of universal service are vastly outweighed by the burdens that such expansion would place on the fund, contributors, and, ultimately, consumers.

C. BOTH ILECS AND CETCS SHOULD BE LIMITED TO SUPPORT FOR A SINGLE CONNECTION TO A HOME OR BUSINESS

If the Joint Board agrees with AT&T that every person is not expected to subscribe to anytime, anywhere connectivity, then universal service support must be limited to a single line to a home or business for all ETCs. Other commenters reach the same conclusion.[36] SBC, for example, observes that, "[b]y definition, a customer with a non-primary line or connection has an alternative (his or her primary line or connection) available to connect to the . . . [PSTN] and public health and safety agencies."[37] Moreover (as SBC also points out), a service is not "essential" if a reasonable alternative

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that there are very few areas in the country that have no wireless service); *id.* at 13,023 (showing that rural areas are already served by an average of over three wireless carriers).

[34] *See* AT&T Comments at 11-12 (describing a "host of non-USF solutions" available for encouraging rural wireless infrastructure deployment).

[35] Idaho Telephone Association Comments at 10-11.

[36] *See*, *e.g.*, SBC Comments at 14; NASUCA Comments at 4-8.

[37] SBC Comments at 14.

is available.[38] In other words, if "universal service" means reasonable access to the PSTN, multiple lines are not required to achieve this.

Limiting support to a single line, assuming proper implementation, is competitively neutral. Under AT&T's proposal, *all* ETCs – wireless or wireline, incumbent or competitive – would be eligible to receive support for "first lines." To the extent wireless carriers provide first-line service (as they increasingly do),[39] they would compete on an equal basis for High Cost Support. So long as all ETCs have the same *opportunity* to compete for support, limiting support to a single line is competitively neutral. (Even Western Wireless concedes that a single-line support mechanism could be designed to be competitively neutral, provided that ILECs are not *de facto* or *de jure* presumed to be first-line providers.)[40]

By contrast, ILEC suggestions that *only they* should receive support for multiple lines are blatantly *non*-neutral and anticompetitive. Verizon, for example, states that "the Commission should provide support for only those competitive ETC lines for which the ETC has obtained consumer certification that the consumer is relying solely on a competitive service for network connectivity and identifies the specific CLEC as the primary provider."[41] It also argues, however, that "[t]he Commission should

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38 *Id.* at 15 (*citing First Report and Order*, 12 FCC Rcd. at 8822-23).

39 *See* Sprint Comments at 7-9; Western Wireless Comments at Attach. C p. 3; *see also Seventh Annual CMRS Report*, 17 FCC Rcd. at 13,017 (noting that, "[w]hile firm data is difficult to come by, analysts estimate that 3 to 5 percent of wireless customers use their wireless phones as their only phone").

40 Western Wireless Comments at Attach. J pp. 6-7 (discussing "phone stamps").

41 Verizon Comments at 7.

not . . . attempt to control the size of the fund by limiting high-cost support to only 'primary' lines *when all such lines are being provided by the rural ILEC*."[42]

There is no principled basis for supporting ILEC multiple lines but not CETC multiple lines. To the extent that such proposals reflect ILEC concerns about recouping investment required to offer "first-line" service,[43] such investments are incurred by both ILEC and CETC network providers. ILECs, then, are really arguing that they – and only they – should be assured of recovering their costs in a competitive environment. This position is antithetical to the very notion of competition.[44] The Joint Board should simply reject these "heads-I-win-tails-you-lose" requests for special treatment.

AT&T agrees with NASUCA and GCI that, while shifting to a system of support based on first lines will require additional administrative mechanisms, these problems are not insoluble.[45] As both NASUCA and Western Wireless suggest, balloting could be used to designate which carrier receives support.[46] While ILEC rate structures would necessarily have to permit differentiation between supported and unsupported lines, as

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42 *Id.* (emphasis added); *see also* NTCA Comments at 7 (stating that "[n]ew regulatory policies and revised universal service portability rules must permit *rate-of-return rural carriers* to recover their investment in the total network facilities needed to provide comparable rates and services to customers living in rural and high-cost areas . . . [and that] all lines, primary and secondary, must be included when determining a *rural carrier's* embedded costs") (emphasis added); Beacon Telecommunications Comments at 2 (noting that ILECs and CETCs "have very different claims on the USFs," and that, while "there is really little that can be done to reduce" ILEC interstate revenue requirements, "the only other area for reduction is the amount paid to . . . CETCs").

43 *See*, *e.g.*, Nebraska Rural Independent Companies Comments at 22-23 (stating that, "[i]n the case of wireline service, after a new area of a community is platted, telephone feeder and distribution is engineered to serve the entire platted area with capacity for multiple communications paths to each residence or business"); OPASTCO Comments at 32 (stating that "[m]ajor components of the costs of a rural ILEC's network are fixed and, within a reasonable range of output, do not go up or down significantly as individual lines are added or disconnected by consumers").

44 In any event, as discussed below in section I.D, AT&T's proposal will not result in an immediate ILEC loss of support.

45 *See* NASUCA Comments at 6; GCI Comments at 69.

46 *See* NASUCA Comments at 6; Western Wireless Comments at Attach. J p. 7

Western Wireless suggests,[47] this would be a natural consequence of specifying the first line as the supported service. It would also give a better marketplace indication of the rates for first lines in the absence of support (and, accordingly, whether support is necessary at all to maintain affordability and reasonable comparability of rates).

D. Limiting Support to a Single Connection Will Not Cause "Rate shock"

Limiting support to a single connection to a home or business will not cause "rate shock." Indeed, AT&T's proposal was designed to eliminate even the potential for rate shock. To hear some describe it, however, limiting High Cost Support to a single connection would be a disaster for rural consumers:

- "We estimate in Washington that the price of a second connection could increase from as little as $1.00 per month in some service areas, to as much as $430.00 per month in some non-rural company service areas. Prices in areas served by rural telephone companies could increase as much as $3,000 per month in one location, and more than $100.00 per month in many locations."[48]

- "If only primary lines are supported, second lines will cost customers substantially more than primary lines. If the customer rate were increased by just the interstate support loss (assuming only primary lines are supported), they would increase by $20.00 per second line per month . . . ."[49]

- "A small business, with a single telephone line and an additional computer or fax line, has the choice of either dropping one of its essential lines or moving out of the rural area if it wants voice-grade service at a rate that is reasonably comparable to rates charged in urban areas. Forcing businesses to relocate where rates are reasonable and affordable is antithetical to universal service principles."[50]

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[47] *See* Western Wireless Comments at Attach. J pp. 6-7.

[48] Washington Utilities and Transportation Commission Comments at 15.

[49] FWA Comments at 26; *see also* Washington Independent Telephone Association Comments at 8 (expressing similar concerns).

[50] OPASTCO Comments at 37-38.

- "[Rate shock] would be especially burdensome for small businesses in high-cost areas because few businesses can function using only a single telephone line. . . . If these small businesses are forced to pay higher rates for their telecommunications services in rural areas than they would pay in urban areas, these businesses, which are important to their communities, will be tempted to move to urban, lower-cost areas where they can better manage their operating costs. In other words, the higher the costs of doing business are in rural areas, the greater the disincentive will be for businesses to invest in those areas. This will stifle economic development in high-cost rural areas."[51]

At least with respect to AT&T's proposal, this is all overblown. AT&T does not propose *eliminating* the embedded cost-based USF support that today flows to ILECs (in part because it would be difficult, if not impossible, to segregate the incremental investment associated with multiple lines from that associated with first lines). With respect to those High Cost Support mechanisms based on embedded costs, AT&T instead proposes *restating* ILEC study-area support in terms of first lines.[52] As demonstrated in its initial comments, AT&T's proposal would initially not reduce rural ILEC aggregate support at all.[53] There would thus be neither a reduction in ILECs' ability to deliver service to their customers nor a "rate shock" for second, third, or fourth lines.

When combined with a freeze on per-line support upon CETC entry, ILECs would only lose support when they lose first line subscribers. AT&T described in its initial comments how this is a competitively neutral result mirroring the outcome in a non-subsidized, non-retail price regulated competitive market.[54]

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[51] USTA Comments at 6; *see also* SBC Comments at 17 (offering solutions to potential "rate shock" from "the sudden removal of support for non-primary lines").

[52] AT&T Comments at 13. If, for example, an ILEC receives $40,000 under existing areas for a study area in which it has 9,000 "first lines" and 1,000 "additional lines," AT&T's proposal would simply restate that $40,000 over the ILECs 9,000 first lines, rather than over its 10,000 total lines. Total ILEC support for that study area would not change. *See id.* at 14.

[53] *See* AT&T Comments at 12-15.

[54] *See* AT&T Comments at 22.

Under AT&T's proposal, rural ILECs would not receive additional support associated with the installation of *future* multiple lines. But, as the Montana Telecommunications Association point out, "[r]eaching the same customer with a 'secondary' line requires only marginal additional investment after the 'primary' line is deployed."[55] NASUCA makes the same observation, and adds that, if the cost of providing second lines is very small, "continued support for such second lines may actually represent a windfall for carriers."[56] NASUCA is correct, and rural carriers should not be receiving High Cost Support for the low-cost, high-margin business of providing multiple lines.

The Alaska Telephone Association incorrectly argues that concentrating support on first lines would increase the USF because CETCs receive per-line support based on ILEC effective per-line support.[57] While it is correct that support for "first lines" would increase, support for other lines would be eliminated. The elimination of multiple-line support – particularly given the potential for unchecked growth as more multiple lines become eligible to receive support – would far outweigh any modest increase in support paid to CETC-provided first lines.[58]

E. LIMITING SUPPORT TO A SINGLE CONNECTION WILL REDUCE THE NEED FOR STRICT REGULATORY DEFINITIONS OF SERVICES

Limiting support to a single connection to a residence or business establishes a "virtual voucher"-type mechanism that minimizes the need for regulatory intervention to precisely define the supported service. Such a mechanism, which would provide a single

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55 Montana Telecommunications Association Comments at 8-9.

56 NASUCA Comments at 7.

57 Alaska Telephone Association Comments at 17.

58 *See* AT&T Comments at 15 (Table 4).

support amount for each household or business, would give customers the ability to "vote with their feet" for the most appropriate service package for them.[59] Like the "phone stamps" suggested by Western Wireless, such a mechanism would be competitively neutral, as the virtual voucher could go to any ETC chosen by the customer.[60]

The most significant advantage of a virtual voucher or phone stamps approach is that it would allow customers to select the local service package of their choice. Thus, some customers may want to have a low-priced calling plan with limited calling scope, while others may want to have a local calling plan with a broader or even national scope. In an era of bundled service packages, it will be almost impossible for regulators to distinguish between these competing packages on an apples-to-apples basis. A virtual voucher approach would make it unnecessary to do so. Similarly, a virtual voucher would not distinguish between measured service plans and unlimited usage plans, as some comments have suggested, nor would it require the Joint Board and the Commission to attempt to define minimum service quality.[61] Consumers can choose their first line supplier based on what they value – in terms of service quality, calling scope and mix of usage-based and flat-rate charges – rather than on a government predetermination of what choices they "should" value.[62]

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59 Sprint Comments at 14-15.

60 *See* Western Wireless Comments at Attach. J p. 6. *See also* Sprint Comments at 14 (discussing a similar proposal). AT&T agrees with Western Wireless that, in order for single-line support to be competitively neutral, consumers must have the choice between which ETC's service is "first-line" and which is not. *See* Western Wireless Comments at Attach. J p. 6.

61 NASUCA, for example, suggests that ETCs be required to provide unlimited local usage plans at or below the rate charged by respective ILECs. NASUCA Comments at 10.

62 A virtual voucher would also allow consumer choice with respect to equal access: allowing those customers that value equal access to select it.

Incumbents recognize this, but seem to view it as a bad thing. MUST, for example, states:

> [T]here would seem to be legitimate public policy reasons why consumers should not make [first line] designations themselves (for example, a consumer may be persuaded to make such a designation based on price alone, while policymakers may want to utilize the designation to further other goals such as encouraging or assuring certain standards of customer service).[63]

Consumer choice, however, is not a problem to be addressed by universal service. It is a goal to be encouraged. As GCI points out, consumer choice in a competitive market is the "most desirable and workable remedy to the inefficient organization and operation of many ILECs and the related imperfections created by rate-of-return regulation."[64]

F. IF THE JOINT BOARD AND THE COMMISSION DO NOT LIMIT SUPPORT TO A SINGLE CONNECTION, ALL HIGH COST SUPPORT SHOULD BE SUBJECT TO HARD CAPS

Although AT&T believes that the best way to prevent the increasing support for multiple lines from causing runaway USF growth is to limit support to a single connection, the alternative cannot be unchecked growth. Thus, if the Joint Board does not reiterate its 1996 recommendation to limit support to a single line to a home or business, it should recommend subjecting *all* High Cost Support – both to ILECs and CETCs – to hard caps.[65] Interstate Access Support for price cap carriers is already

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[63] MUST Comments at 36.

[64] GCI Comments at 22.

[65] HCLS is currently subject to an *indexed* cap, which limits total support to the previous year's total, increased by the rate of annual loop growth for all carriers. *See* 47 C.F.R. Part 36, Subpart F; *First Report and Order*, 12 FCC Rcd. at 8929-30. The cap limits only the aggregate nationwide HCLS payments to ILECs, but does not apply to payments to CETCs. Moreover, LSS, LTS, and ICLS have no such cap.

subject to a hard cap of $650 million, covering distributions both to ILECs and CETCs.[66] Similar hard caps for the remaining High Cost Support mechanisms would be another way to prevent runaway USF growth.

Hard caps could work in conjunction with increases in the "threshold" for support, as is currently the case with HCLS. If, for example, support for all ILECs and CTECs were to exceed a hard cap for a particular support mechanism, the "threshold" for study areas receiving support under that mechanism could increase by some predetermined amount.[67] Such a mechanism would automatically retarget support to the highest-cost areas by phasing out support only for lower-cost areas. At the same time, the "Safety Net Additive," which provides support for carriers making significant new investment in rural infrastructure, could remain outside the hard caps to encourage rebuilds and new investment.[68]

By implementing this type of mechanism, the Joint Board and the Commission could limit overall growth in High Cost Support, without fear that very high cost areas would be deprived of support. This would allow the FCC and the states to adjust end user rates as needed to allow ILECs a reasonable opportunity to recover their costs.[69]

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66 *See Matter of Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd. 12,962 (2002), *aff'd in part, rev'd in part, and remanded in part*, *Texas Office of Public Utilities Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied*, *Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 122 S. Ct. 1537 (2002).

67 This is the way that HCLS works today. When the amount of annual HCLS support would otherwise exceed the nationwide cap, NECA raises the Nationwide Average Unseparated Loop Cost per Working Loop, which increases the nominal amount of the threshold at which an ILEC receives HCLS support. *See* 47 C.F.R. § 36.622.

68 *See RTF Order*, 16 FCC Rcd. at 11,277.

69 Hard caps on ICLS could be implemented in conjunction with increases in the SLC cap, to enable rural rate-of-return ILECs a reasonable opportunity to recover their interstate revenue requirement.

III. THE JOINT BOARD SHOULD RECOMMEND FREEZING PER-LINE SUPPORT UPON CETC ENTRY

In its initial comments, AT&T demonstrated that, under all rate-of-return ILEC High Cost Support mechanisms other than HCMS, ILEC effective per-line support actually *increases* as ILECs lose subscribers to CETCs.[70] No party disputes this. No party disputes that this increase in effective per-line support stems from the fact that the USF guarantees ILEC revenues, regardless of the number of customers actually served. Indeed, the description of this growth spiral provided by CenturyTel – a rural ILEC – is strikingly similar to that of AT&T:

> [W]hen a CETC wins a customer from an ILEC, the ILEC's aggregate cost to maintain the network over the entire study area remains close to the same, but total costs are averaged over fewer lines, increasing the ILEC's average per-line costs in the study area. Depending on the operation of the FCC's caps, the ILEC could get additional federal per-line support for its remaining lines. In such case, the CETC would be eligible to receive support at the higher per-line level, though it may experience no change or even a decrease in per-line costs. As such, as a CETC takes market share, the cost to the ILEC can snowball as each customer gained by the CETC raises the ILEC's costs-per-line – and, consequently, *all* CETCs' per-line support eligibility – further enlarging the CETCs' windfall, the overall size of the federal high-cost fund, and, ultimately, costs to consumers.[71]

Finally, no party disputes that revenue guarantees would not occur in a non-subsidized, non-retail price regulated competitive market, where ILECs that lose customers lose all revenues associated with those customers.[72] The only dispute is between ILECs, who

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70 *See* AT&T Comments at 17-22.

71 CenturyTel Comments at 37; *see also* Montana Telecommunications Association Comments at 8 (stating that, "[u]nder current rules, if an incumbent ETC lost 'primary line' support to another ETC, the incumbent's per-line support would increase, as its fixed or embedded costs would be borne by fewer lines [and that] [t]he CETC's support therefore would 'automatically' increase, despite the fact that any additional CETC costs would be marginal"); NASUCA Comments at 13 (quoting *RTF Order*); OPASTCO Comments at 13 (describing same phenomenon); SBC Comments at 5 n.7, 11-12 (same).

72 ILECs could, in some cases, earn back some revenue through the sale of service to be resold by a CETC, or through the lease of UNEs.

think that revenue guarantees are desirable, and nearly all others commenters, who do not.[73]

AT&T believes the answer is clear: the ILEC revenue guarantees enshrined in USF mechanisms must end. As AT&T demonstrated in its initial comments, ILEC revenue guarantees: (1) are not necessary to ensure that consumer rates remain affordable and reasonably comparable; (2) inflate the universal service fund; (3) shield ILECs from competition; and (4) send inappropriate signals to both ILECs *and* CETCs.[74] Other commenters agree.[75] Dobson, for example, observes that "[t]he current system . . . flips competition on its head, creating a perverse incentive whereby ILECs receive more money when they fail competitively."[76] AT&T thus proposes that the Joint Board should – as it recommended in the *RTF Proceeding* with respect to HCLS only – eliminate revenue guarantees by freezing *all* High Cost Support in a study area at the ILEC's per-line support at the time a CETC enters the market.[77]

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73 *Compare*, *e.g.*, OPASTCO Comments at 13-14 (stating that "it is essential for the ILEC to receive increased per-line support as it loses customers to avoid stranded investment") *with* SBC Comments at 12 (stating that "the Commission's portability rules result in excessive and duplicative support payments to serve the same customer, significantly increasing the size of the fund and the cost of telecommunications services for all consumers") *and* Sprint Comments at 14 (stating that "[n]o legitimate public policy is served by rewarding an incumbent carrier that loses customers to the competition") *and* Western Wireless Comments at Attach. J p. 6 (supporting a freeze in High Cost Support upon competitive entry) *and* GCI Comments at 31-43 (describing in detail how revenue guarantees distort rural markets).

74 AT&T Comments at 17-23.

75 *See* n. 73, above.

76 Dobson Comments at 11.

77 *See RTF Recommended Decision*, 16 FCC Rcd. at 6161; *RTF Order*, 16 FCC Rcd. at 11,293. The Rural Task Force made its recommendation with respect to the HCLS only, but AT&T believes that a per-line cap should apply more broadly to HCLS, LSS, LTS and ICLS. *See id*.

Some rural ILECs, however, argue that the Commission cannot eliminate revenue guarantees because Section 254 is really an ILEC cost recovery mechanism. Beacon, for example, argues that "the costs associated with *all* of the current federal USFs" are part of ILECs' "legitimate interstate revenue requirements."[78] It continues that "[t]he fact that these interstate revenue requirements are recovered in federal USFs does not make them any less recoverable."[79] The implication is that, perhaps because they are often "carriers of last resort,"[80] rural ILECs should receive the same levels of High Cost Support regardless of whom they serve (or, indeed, regardless of whether they serve anybody at all). Such arguments are misguided, and have no basis in the Act.

Section 254(b) clearly focuses on *consumers*, not on *carriers*, as the beneficiaries of universal service. Thus, it is "consumers in all regions of the Nation" who must have access to reasonably comparable services at reasonably comparable rates.[81] Section 254 says nothing about rural carriers recovering their costs. It provides, instead, that the mechanisms "should be specific, predictable and sufficient . . . *to preserve and advance universal service*"[82] (a service provided to consumers). The Fifth Circuit in *Alenco* made this same point unmistakably clear:

> The Act does *not* guarantee all local telephone service providers a sufficient return on investment; quite to the contrary, it is intended to introduce competition into the market. Competition necessarily brings the risk that some telephone service providers will be unable to compete. The

78 Beacon Comments at 5 (emphasis added); *see also*, *e.g.*, ACS of Fairbanks Comments at 21 (arguing that "[h]igh-cost universal service is not intended to subsidize entry into rural markets; rather, it is a cost recovery program . . .").

79 Beacon Comments at 2; *see also* RICA Comments at 6 (describing the "origin of universal service as a cost recovery mechanism").

80 *See* ACS of Fairbanks Comments at 21 (stating that, "[a]s carriers of last resort, . . . rural ILECs provide service at costs that are much higher than in other areas of the nation").

81 47 U.S.C. § 254(b)(3).

82 47 U.S.C. § 254(b)(5) (emphasis added).

> Act only promises universal service, and that is a goal that requires sufficient funding of *customers*, not *providers*. So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well.[83]

Accordingly, nothing in Section 254 establishes an ILEC entitlement to support when another carrier can provide the same service at a lower price, or with lower support.[84]

Beacon and the others are therefore wrong. The Act does not mandate that ILECs recover their revenue requirement, through the USF or otherwise. In establishing just and reasonable interstate rates, the Act allows ILECs (and other competitors) a *reasonable opportunity* to recover their revenue requirements in competitive markets. A reasonable opportunity is not a guarantee of recovery. And nothing in the Act says that any recovery must come from the USF. Under AT&T's proposal, ETCs would receive High Cost Support for the lines they actually serve, and would be permitted the reasonable opportunity to recover through their interstate SLCs the remainder of their interstate common line revenue requirement (plus any intrastate costs shifted to the interstate jurisdiction under the HCLS loop expense adjustment for which they do not receive HCLS because support is distributed on a per-line basis).[85] This would enhance both universal service (by limiting strain on the fund) *and* competition (by sending appropriate signals to ILECs and CETCs).

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83 *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000) ("*Alenco*") (emphasis in original); *see also* Dobson Comments at 12 (stating that "ILECs have failed to recognize that the USF was intended to ensure basic telecommunications services for rural consumers, not to guarantee for rural ILEC providers a revenue stream").

84 *See* Nextel Comments at 11-12 (arguing that the Commission's decision in 1997 to base support in rural areas on embedded costs does "not translate into any legal right on the part of rural ILECs to collect embedded network costs through universal service assessments imposed on other carriers").

85 Safety Net and Safety Valve adjustments to HCLS could be retained to address needs for system upgrades. *See RTF Order*, 16 FCC Rcd. at 11,276-92.

IV. THE JOINT BOARD SHOULD RECOMMEND PHASING OUT UNNECESSARY SUPPORT

In *Alenco*, the Fifth Circuit warned that "excessive funding may itself violate the sufficiency requirements of the Act."[86] A range of commenters, from different sectors of the industry, take *Alenco's* admonition to heart and urge the Joint Board to recommend phasing out High Cost Support where it is not necessary to maintain affordable and reasonably comparable rates.[87] AT&T agrees, and therefore supports Sprint's proposal to limit High Cost Support to only those areas where costs are above a national affordability benchmark.[88]

Targeting High Cost Support to truly high-cost areas will, first, better ensure sustainability by eliminating excess support. There is no valid public policy reason for providing support greater than necessary to ensure that rates are affordable and reasonably comparable. As SBC observes, where carriers offer services at rates exceeding the affordability benchmark, "the carrier plainly can recover its costs through market-based rates and does not need a subsidy through universal service support."[89]

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86 *Alenco*, 201 F.3d at 620.

87 *See*, *e.g.*, GCI Comments at 3 (stating that "[h]igh cost support must be adequate to ensure that rates are affordable and reasonably comparable, but support should be the lowest amount necessary to achieve these objectives"); SBC Comments at 5-6 (urging the Joint Board, "consistent with the language of section 254 and the goals of universal service, to limit high cost support to essential services that would be unaffordable at market-based rates"); Sprint Comments at 19 (urging the Joint Board to adopt a "support mechanism whereby federal subsidies would be available only to those ETCs that charge a service price higher than a national benchmark affordable price").

88 *See* Sprint Comments at 19. Sprint suggests that $22, the national average rate paid by customers in urban areas for local service, would be an appropriate benchmark. Sprint's discussion of the higher prices paid by its customers in Wyoming, *see id.* at 17, suggests that $22 may be too low for a national benchmark. *See also*, *e.g.*, Comments of SBC Communications, CC Docket No. 96-45, at 15-16 (filed Dec. 20, 2002) (proposing an "affordability benchmark" for universal service support based on the median household income in a particular geographic area, such as a county).

89 SBC Comments at 8.

The record establishes the likelihood that carriers in at least some areas receive support far beyond what is really needed. Sprint observes that there is a wide disparity among states in local rates, with one Sprint company in Wyoming charging a local rate of $28 per month while another Sprint LEC in North Carolina charges $6.74 per month.[90] Moreover, as Sprint notes, "[t]here is no evidence to suggest that the $28 charged in rural Wyoming exceeds an 'affordable' rate, since the most recent data show that 94.8 percent of all households in Wyoming have telephone service."[91] And even if some affordability concerns were to remain at the margins, the Joint Board and the Commission could easily adjust the Lifeline threshold. As Sprint concludes, "[t]here is nothing inequitable in asking financially able customers to pay a price that recovers more of the costs of service" before an ETC turns to the customers of other service providers for subsidies.[92]

Recent Commission statistics lend further credence to the notion that residential consumers can often afford to pay more for communications services than regulators have assumed. Household expenditures for telecommunications services have increased dramatically since 1995, with the average household now spending over $83 per month on telecommunications, up almost $25 from 1995.[93] Consumers are showing that they can bear a greater proportion of the costs of their own service. Furthermore, the fact that wireless subscribership also continues to increase dramatically (with the vast majority of subscribers being served without any High Cost Support) demonstrates that, in many

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[90] Sprint Comments at 16.

[91] *Id*.

[92] *Id*. at 17-18.

[93] Industry Analysis Div., FCC, *Statistics of the Long Distance Telecommunications Industry,* Table 13 (May 2003). Less than $13 per month now goes to wireline interexchange carriers. *Id*. In 1995, average household telecommunications expenses were $57.50 per month. *Id.*

areas, affordable and reasonably comparable service may be possible without any subsidies at all.[94]

Finally, better-targeted universal service support would reduce barriers to entry. Regardless of how well-crafted support mechanisms are, universal service subsidies always distort the market at least to some extent. As GCI explains, this is the case "because only ETCs can receive support."[95] Even assuming a relatively straightforward ETC designation process (not always a realistic assumption), the processes itself, and the potential for unequal subsidization of competitors in the same market, constitute significant barriers to entry. Eliminating unnecessary support will minimize these barriers.

V. THE JOINT BOARD SHOULD NOT SHIELD ILEC INEFFICIENCY THROUGH DIFFERENTIAL HIGH COST SUPPORT

The Joint Board should decline to adopt ILEC suggestions that universal service support for ILECs should be higher per line than that provided to CETCs. Differential per-line universal service support prevents competition from promoting more efficient ILEC operations, and allows rate-of-return ILECs to continue to enjoy the benefits of "goldplated" investments and padded expenses without any market-based discipline. Such an approach, perversely, would transform the universal service support mechanisms into vehicles to frustrate the central goal of the 1996 Act.[96]

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[94] *See id.*; *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Seventh Report, 17 FCC Rcd. 12,985, 13,017 (2002).

[95] GCI Comments at 28.

[96] *See* Joint Explanatory Statement of the Committee of Conference, H.R. Rep. No. 104-458 (104th Cong., 2d Sess.) at 1 (1996) (preamble) (discussing the establishment of a "pro-competitive, de-regulatory national policy framework" designed to promote services to all Americans "by opening all telecommunications markets to competition").

Notwithstanding self-serving protests by rate-of-return ILECs to the contrary, there is no economic basis on which to assume that rate-of-return regulation leads to efficient investment and expense management. As the Commission has recognized for over a decade, rate-of-return regulation creates incentives to goldplate investment and to pad expenses. In 1989, the Commission stated that, "rather than encourage socially beneficial behavior by the regulated firm, rate of return [regulation] actually discourages it."[97] It elaborated:

> The distorted incentives created by rate of return regulation are easily illustrated. In a competitive environment, where prices are dictated by the market, a company's unit costs and profits generally are related inversely. If one goes up, the other goes down. Rate of return regulation stands this relationship on its head. Although carriers subject to such regulation are limited to earning a particular *percentage* return on investment during a fixed period, a carrier seeking to increase its dollar earnings often can do so merely by increasing its *aggregate* investment. In other words, under a rate of return regime, profits (i.e., dollar earnings) can go up when investment goes up. This creates a powerful incentive for carriers to 'pad' their costs, regardless of whether additional investment is necessary or efficient. And, because a carrier's operating expenses generally are recovered from ratepayers on a dollar-for-dollar basis, and do not affect shareholder profits, management has little incentive to conserve on such expenses. This creates an additional incentive to operate inefficiently.[98]

Competitive pressures, by contrast, reveal and correct the very inefficiencies encouraged by rate-of-return regulation.[99]

Rural ILECs, however, clearly don't like the discipline of a competitive market.[100] (Indeed, some come right out and say that the very problem with High Cost Support

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97 *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd. 2873, 2889 (1989).

98 *Id.* at 2889-90 (emphasis added).

99 *See* GCI Comments at 22-24.

100 *See*, *e.g.*, MUST Comments at 11 (stating that, "[i]n rural areas, Congress recognized repeatedly in the Telecommunications Act that the benefits of competition were far more speculative than in the urban areas"); CenturyTel Comments at 9 (bemoaning the fact that "[t]he impact of competition has already become part of [its] internal cost/benefit analysis in assessing investment opportunities");

portability is that it can "promote competition."[101]) They therefore propose supporting ILECs and CETCs based on each carrier's respective costs, rather than by a single, "portable" amount based on ILEC per-line support.[102]

Allowing incumbents to shield their inefficiencies in this manner would be a terrible idea. In an unsubsidized market, if one firm is less efficient than another, the more efficient firm has a strong incentive to find further efficiencies rather than ceding a permanent cost advantage to its rival. BellSouth – an incumbent itself – explains:

> The current [portable] methodology provides an incentive for both the incumbent and competitive ETCs to operate more efficiently. If a competitive ETC is able to serve a customer's line at a much lower cost than the incumbent, that ETC may be able to charge lower rates thereby winning customers away from the ILEC. The potential loss of customers would motivate the incumbent to conduct its business in a more efficient manner.[103]

A competitive market thus gives the more efficient provider the ability to underprice its less efficient rival, even if only incrementally, in order to attract greater share. As GCI

ACS Fairbanks Comments at 18 (stating that "the public interest may be best served by providing support to a single carrier operating as the carrier of last resort"); ICORE Comments at 5 (complaining that [w]ireless providers . . . use a technology which avoids most of the substantial costs associated with physical loop plant . . . [and] enjoy economies of scale and scope in switching and other areas that are unknown to small, rural ILECs"); NTCA Comments at 11 (arguing that addressing whether current rules "promote efficient competition in high-cost areas . . . will only lead the Board down the same wrong course that has resulted from the Commission's misguided focus").

The Rural Independent Competitive Alliance ("RICA"), claims that it faces a shortfall in revenues "because some interexchange carriers (IXCs), principally AT&T, refused to pay the CLECs' tariffed access charges," and goes on to attack the Commission's *MAG Order* as "not result[ing] in an adequate or predictable revenue stream." RICA Comments at 3-4. The Joint Board should ignore RICA's warmed-over complaints about the transition to competitive markets. As the Commission has repeatedly recognized, per-minute access charges to recover non-traffic sensitive costs are economically inefficient and violate Section 254(e)'s prohibition on implicit subsidies – a prohibition which courts have interpreted to mean "any implicit subsidies whether on a permissive or mandatory basis." *See*, *e.g.*, *Multi-Association Group (MAG) Plan For Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers* 16 FCC Rcd. 19,613, 19623 (2001) ("*MAG Order*"); *Comsat v. FCC*, 250 F.3d 931, 939 (5th Cir. 2001).

101 ACS of Fairbanks Comments at 17.

102 *See id.* at 10.

103 BellSouth Comments at 8.

points out, this tends to drive prices over the long run toward the costs of the most efficient provider.[104]

Providing differential per-line support to ILECs and CETCs, however, eliminates a competitive market's ability to promote efficiency. As Sprint observes, "[a] policy of different levels of support to different firms in a market would have the effect of punishing a competitor for being efficient – *and rewarding an incumbent for being inefficient.*"[105] If an ILEC is less efficient than a CETC but can "cloak" this inefficiency through receipt of greater universal service support, customers receive no market-based signal that it would be more socially beneficial (in terms of total consumer welfare) to select service from the CETC.[106] Differential support for ILECs and CETCs would thus deprive the market of each carrier's superior skill, knowledge, and foresight, because it would deprive more efficient carriers of the benefits of their efficiency.[107]

Other arguments against portable support are unavailing. MUST, for example, argues that providing equal support to all ETCs in the same market will create a race to the bottom with respect to service quality.[108] This argument appears premised on an assumption that rural Americans, unlike their urban counterparts, do not value service quality, and will be driven entirely by price in their purchasing decisions. MUST does

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104 GCI Comments at 47.

105 Sprint Comments at 11 (emphasis in original).

106 *See* GCI Comments at 46-49.

107 *See*, *e.g.*, *id.*; Sprint Comments at 11.

108 MUST claims this would work as follows: "[W]hen an inferior network is funded based on the costs of a superior network . . . the inferior network provider can use the funding to reduce prices in order to offset the quality advantages of the superior network. This threatens the provider of the superior network because he must either cut prices or raise quality even higher. But if he raises the quality even higher, his inferior competitor gets support based on the costs of providing that higher quality, which the competitor can use to further cut prices. For these reasons, providing support to an inferior wireless CETC based on the costs of the superior network of a small, rural wireline incumbent threatens the continued viability [of] the incumbent." MUST Comments at 23.

not explain why rural Americans should be expected to be more tolerant of poor service quality than urban Americans.[109] Moreover, if consumers really do value service quality less than price, then ILEC networks are substantially goldplated – that is, they provide service above the level consumers desire. In any event, if the Joint Board and the Commission believe service quality standards are needed, those can and should be stated transparently in the supported service's definition, rather than reverse-engineered through differential support (which provides no assurance that the additional support will actually result in higher service quality).

Finally, as several commenters point out, portable support does not necessarily mean support based on ILEC costs.[110] AT&T agrees with the Rural Cellular Association that, ultimately, the best solution will be to support both ILECs and CETCs based on *the most efficient carrier's* costs.[111] This would eliminate unnecessary support, easing burdens on the fund. It would also force ILECs to drive their embedded costs toward forward-looking rates.

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[109] Indeed, as discussed in Section I.E, above, one of the benefits of limiting High Cost Support to a single line, but making all ETCs eligible to compete for that support, is that it allows *customers*, not the government, to choose among different combinations of price, service quality, and the like.

[110] *See, e.g.,* GCI Comments at 45; Western Wireless Comments at 17 (proposing basing support on forward-looking costs).

[111] *See*, *e.g.*, Rural Cellular Association Comments at Exh. 1 p. 16 (Don Wood, *Effective Long Run Management of the High-Cost Universal Service Support Mechanism*) (stating that "[a]s a competitor's network buildout reaches completion in a given geographic area, the benchmark should change to reflect the costs of a low-cost provider . . . [which would] create the correct incentives and send the correct signals to the marketplace"). AT&T does not, however, agree with the Rural Cellular Association's suggestion that, in the early years of a wireless carrier's build-out, support should be higher. The most-efficient carrier standard should apply at all times.

CONCLUSION

The initial comments in this proceeding make clear that the universal service fund faces a crisis, and that preservation of the *status quo* is not a reasonable option. AT&T therefore urges the Joint Board to act expeditiously on the recommendations contained in its Comments and these Reply Comments.

Respectfully submitted,

AT&T CORP.

/s/__________________________________

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