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REPRESENTING
THE ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE
EN BANC HEARING ON THE PORTABILITY OF HIGH-COST UNIVERSAL SERVICE SUPPORT AND THE ETC DESIGNATION PROCESS

PANEL 1: BASIS OF SUPPORT

DENVER, COLORADO

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Competitive eligible telecommunications carriers (CETCs) serving rural telephone company service areas should receive universal service support that is based on their own embedded network costs of providing the supported services. Unlike the present system of portability, this methodology would result in "sufficient" and "specific" support for CETCs, consistent with section 254(b)(5) of the Telecommunications Act of 1996 (1996 Act, the Act). It would also promote compliance with section 254(e)'s requirement that support only be used for the provision, maintenance and upgrading of facilities and services for which the support is intended. This would provide greater assurance that consumers actually received some benefit from a competitor's receipt of support. In addition, basing CETCs' support on their own actual costs would promote efficient competitive entry in high-cost areas, since competitive carriers would no longer have perverse incentives to seek ETC status merely to receive windfall support payments. Also, utilizing the same support calculation methodology for CETCs that is used for incumbent local exchange carriers (ILECs) is consistent with the principle of competitive neutrality.

There should be cost reporting parity between ILECs and CETCs. Ideally, simplified reporting requirements should be developed for all carriers. But, in any event, CETCs should be required to

produce the same level of detail in their reporting of costs that ILECs are required to provide. Such uniformity will promote compliance with section 254(e) of the Act by all ETCs and is competitively neutral. The Commission may also wish to consider developing an average schedule-like option for CETCs that would provide these carriers with a choice between submitting their own annual cost study or relying on formulas that would simulate the embedded costs of similarly situated carriers using the same technology. The change in methodology for calculating CETCs' high-cost support should be made as soon as the Commission can develop cost reporting requirements for these carriers.

Cost calculations for all ETCs in a rural service area should be based on network costs, not per-line costs. The calculation of an ILEC's per-line support amount is just a contrivance to determine the amount of support a CETC will receive under the current portability rules. A rural ILEC's support has always been based on the actual embedded costs of constructing and maintaining its network. Likewise, a CETC's support should be based on the actual embedded costs of constructing and maintaining its network. This will ensure that every ETC receives sufficient support, but not more so, to encourage and achieve the network infrastructure investment in high-cost areas that is the purpose of the High-Cost program.

There is no basis upon which to presume that CETCs and ILECs have the same costs or that providing identical support will provide each CETC with the "sufficient," but not excessive, support called for by section 254(b)(5) of the Act. Awarding CETCs the rural ILEC's per-line support amount enables a competitor to seek and obtain ETC status only where the support will give it a competitive advantage over the ILEC. Thus, when a CETC responds to the arbitrage incentives created by the existing rules, its per-line costs are most likely lower than the incumbent's costs.

Section 254(b)(5) of the Act provides that universal service support mechanisms should be "specific." However, allowing CETCs to receive per-line support based on the ILEC's costs is not at all specific to the CETC's own costs and also ignores the fact that rural ILECs and CETCs are not at all similarly situated. For instance:

- CETCs are free to decide under what rates and terms they will offer service. Rural ILECs do not have that freedom; their rates and terms are typically regulated by state commissions under tariff.

- CETCs have the freedom to avoid building infrastructure in the highest-cost areas by reselling the rural ILEC's highest-cost loops, which it may acquire at prices reduced by the ILEC's universal service support. Competitive carriers are also not required to demonstrate their ability to provide ubiquitous service at the time of their request for ETC designation. Rural ILECs, as the recognized carriers of last resort in their service areas, have built ubiquitous, high-quality infrastructure that serves the most remote and highest-cost customers.

- CETCs can potentially be designated for a different and sometimes significantly smaller service territory than the incumbent's study area. This makes it much easier for a competitive carrier to meet the Act's prerequisites for ETC designation. In some cases it also allows the competitor to seek designation only in the segments of the ILEC's study area that have the greatest profit potential and ignore the less lucrative, higher-cost areas.

- CETCs are not held to the same service quality and reliability standards and customer billing requirements generally imposed on ILECs by state commissions.

In addition, certain high-cost support mechanisms may be inapplicable to some CETCs. For example, it would be a highly unusual coincidence for a national mobile wireless provider to need local switching support (LSS). LSS is received by rural ILECs that have less than 50,000 access lines. It recognizes that small carriers have fewer customers over which to spread the costs of switch upgrades. In comparison, a large mobile wireless provider serving throughout a state may only need one switch to serve all of the customers within the state. Thus, they have the economies of scale that the small ILECs lack. Yet, under the existing rules, a large mobile wireless ETC still receives LSS in each of the small rural ILEC service areas in which it has been designated.

Similarly, long term support (LTS) and interstate common line support (ICLS) are mechanisms designed to stabilize, reduce, and ultimately eliminate the carrier common line access rate that rate-of-return regulated ILECs charge to interexchange carriers. Neither mechanism provides rural ILECs with any additional revenues than they received prior to their implementation. Yet, mobile wireless ETCs receive LTS and ICLS, even though they do not have common line access charges that require offsetting or elimination. They are not even required to lower their end-user rates or improve their services in order to qualify for the support.

Section 254(e) of the 1996 Act requires that support be used only for the provision, maintenance and upgrading of facilities and services for which the support is intended. Since the support received by rural ILECs is based almost entirely on their own past actual investment and expense payments, or reductions in other rates, it is clear that the support has been used for the purposes for which it is intended. However, it is impossible to discern how competitors will use support based on the *incumbent's* actual spending record. A state's or a CETC's certification that support is being used for appropriate purposes is suspect, when CETCs need not capture customers, add new customers, change their rates, increase investments, improve their services, or make any other legitimate use of the payments that they receive.

For rural ILECs, high-cost support is genuine cost recovery for infrastructure that provides high-quality service to all of the customers in the service area. On the other hand, high-cost support that goes straight to the bottom line is regulatory arbitrage that conflicts with the universal service goals of the Act, unnecessarily inflates the size of the USF and needlessly raises the end-user surcharges on consumers' bills.

Many competitive carriers – particularly mobile wireless providers – have argued that it is unlawful to ask competing carriers to calculate their costs of service to qualify for support. However, section 332(c)(3) of the Act, which generally preempts states from regulating the rates and entry of mobile wireless providers, explicitly does not prohibit a state from regulating "the other terms and conditions" of commercial mobile services. In addition, nothing in section 332(c)(3) "exempts providers of commercial mobile services from requirements imposed by a State commission on all providers of telecommunications services necessary to ensure the universal availability of telecommunications service at affordable rates." If a carrier is going to receive limited federal high-cost funding, collected from the nation's ratepayers, then that carrier should be required to demonstrate above-average costs that justify the receipt of support.

In sum, providing CETCs with support based on the ILEC's costs results in exactly the sort of excessive ratepayer burden section 254(e)'s limitation on the use of support is intended to avoid. Furthermore, equal support for carriers with significantly different costs, incentives and responsibilities is

the opposite of competitive neutrality. Therefore, the Joint Board should address the unjustified support payments and uneconomic competition engendered by the current portability rules by recommending that support for CETCs in rural service areas be based on their own embedded costs.