

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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

COMMENTS OF GENERAL COMMUNICATION, INC.

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SUMMARY

The Joint Board seeks comment in four primary areas: (1) whether the Commission should retain a universal service support mechanism for rural carriers based on embedded costs, or whether it should transition such carriers to a mechanism based on forward-looking costs, similar to the mechanism for non-rural carriers; (2) whether Competitive Eligible Telecommunications Carriers (“CETCs”) should continue to receive support based on the incumbent local exchange carrier’s (“ILEC’s”) per line support; (3) whether the Commission should revisit the definition of “rural telephone company” for universal service support purposes; and (4) whether to retain or modify Section 54.305 of the Commission’s rules, which concerns the amount of universal service support for transferred exchanges.

As a threshold matter, it is important to recognize that the scope of this proceeding is quite narrow. The Commission has only asked the Joint Board to determine the appropriate high cost universal service mechanism to succeed the five-year plan adopted by the *Rural Task Force Order*. This implicates High Cost Loop Support, and the Safety Net Additive and Safety Valve Support created by that order. The Joint Board also seeks comment on changes to Local Switching Support. What is common among all four of these mechanisms is that they represent support for costs that are either separated into the intrastate jurisdiction, or would be separated into the interstate jurisdiction but for separations adjustments made in connection with a specific universal service mechanism. Hence, Interstate Access Support and the Interstate Common Line Support – mechanisms that are part and parcel of the Commission’s interstate access charge regime – are outside the scope of this proceeding.

Furthermore, the Commission should defer completion of this proceeding pending the Commission’s resolution of the Intercarrier Compensation Forum (“ICF”) proposal filed on

October 5, 2004. There is substantial overlap between the ICF proposal and the issues in this docket. For instance, it makes little sense to harmonize rural and non-rural support for intrastate high cost loops, but not to address additional intrastate costs that would be encompassed within universal service if the Commission adopts the ICF Plan. The Commission and the Joint Board would, in essence, have to repeat any harmonization again, taking into account the additional support. Moreover, the Commission and the Joint Board should recognize that there is only a limited amount of regulatory change that industry participants can assimilate at one time. It is a much higher priority for the Commission to reform intercarrier compensation. Accordingly, the transition plan called for by the ICF Plan should take precedence over the steps upon which the Joint Board seeks comment.

Nonetheless, to the extent that the Commission does move forward with this proceeding, the Commission should remain focused on consumers, and not competitors, in effectuating Congress' universal service goals. To be consistent with Congress' fundamental, pro-consumer focus, GCI recommends that the Joint Board and the Commission follow three, inter-related principles. First, universal service programs for rural, insular and high cost areas must create incentives for the deployment of rural infrastructure. Second, to the extent possible, the incentives to develop rural infrastructure should be market driven, not centrally planned. In other words, universal service support should be harmonized with the Telecommunications Act of 1996's pro-competitive goals. Third, universal service support must be sustainable.

GCI's experience in Alaska demonstrates how, consistent with these principles, competition and universal service can work together to benefit consumers in rural, insular and high cost areas. GCI competes with the ILECs in Anchorage, Fairbanks and Juneau, Alaska's three largest markets. GCI competes with the ILEC on price, resulting in savings of \$24 million

for Anchorage consumers alone since 1997. But GCI also has introduced innovative services and service packages that were not previously made available to consumers by the ILEC. As a result, even consumers living in areas that are not served by GCI have benefited from its presence in the Alaska market, as the ILEC has introduced advantageous service “bundles” in anticipation of GCI’s market entry. Indeed, GCI’s market experience is entirely consistent with economic theory, which predicts that competition – and not command-and-control model of regulatory pre-selection of a universal service provider – is the best way to ensure that rural America can, on a sustainable basis, receive access to reasonably comparable telecommunications services at just, reasonable, affordable and reasonably comparable rates.

Accordingly, the Joint Board should take no action that would result in different CETC and ILEC per line support amounts whenever the CETC is offering a service that is a substitute for the ILEC’s landline telephone exchange service for a substantial portion of the communications within a study area. Providing competitive ETCs a different level of high cost support from that received by the incumbent when both are providing substitute services will harm consumers by substantially blunting market incentives for price reductions, service improvements, and innovation. Calculating high cost support by the same ruler is the only means to replicate the price signals that would occur in a competitive market. Hence, providing the same level of support is entirely consistent with the principle of competitive neutrality. Moreover, providing all ETCs providing substitute services in a market with the same level of support results in sufficient support, consistent with the requirements of Section 254(e) of the 1996 Act, when sufficiency is properly measured from the *customer’s*, and not the carrier’s, perspective.

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GLOSSARY

<p>High Cost Loop Support (“HCLS”)</p>	<p>Assists rural local telephone companies with high local loop costs. Support offsets loop costs that would otherwise be recovered through intrastate rates. <i>See</i> 47 U.S.C. § 36.601 <i>et seq.</i> Total HCLS nationwide is subject to an indexed cap.</p>
<p>High Cost Model Support (“HCMS”)</p>	<p>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. <i>See</i> 47 C.F.R. § 54.309.</p>
<p>Interstate Access Support (“IAS”) – also known as “CALLS Support”</p>	<p>Provides per line support for all ETC loops in high cost zones of study areas served by ILECs regulated under price cap regulation. <i>See</i> 47 C.F.R. § 54.800. Total nationwide IAS is capped at \$650 million per year.</p>
<p>Interstate Common Line Support (“ICLS”) – also known as “MAG Support”</p>	<p>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. <i>See</i> 47 C.F.R. § 54.901.</p>
<p>Local Switching Support (“LSS”)</p>	<p>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. <i>See</i> 47 C.F.R. § 54.301.</p>
<p>Long Term Support (“LTS”)</p>	<p>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. <i>See</i> 47 C.F.R. § 54.303. LTS for non-rural ILECs is transitioning to ICLS.</p>

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COMMENTS OF GENERAL COMMUNICATION, INC.

General Communication, Inc. (“GCI”) submits this response to the *Public Notice* issued by the Federal-State Joint Board on Universal Service (“Joint Board”) seeking comment on certain of the Federal Communications Commission’s rules relating to high cost universal service support mechanisms for rural carriers. The Joint Board seeks comment on four primary issues: (1) whether the Commission should retain a universal service support mechanism for rural carriers based on embedded costs, or whether it should transition such carriers to a mechanism based on forward-looking costs, similar to the mechanism for non-rural carriers; (2) whether CETCs should continue to receive support based on the ILEC’s per line support; (3) whether the Commission should revisit the definition of “rural telephone company” for universal service support purposes; and (4) whether to retain or modify Section 54.305 of the

Commission's rules, which concerns the amount of universal service support for transferred exchanges.¹

I. THE FCC REFERRAL AND JOINT BOARD NOTICE ARE LIMITED TO HIGH COST LOOP SUPPORT, SAFETY NET, SAFETY VALVE, AND LOCAL SWITCHING SUPPORT.

In the first instance, GCI notes the limited scope of this proceeding. In its *Referral Order*, the Commission asked the Joint Board to “review the Commission’s rules relating to the high-cost universal service support mechanisms for rural carriers and to determine the appropriate rural mechanism to succeed the five-year plan adopted in the *Rural Task Force Order*.”² The only mechanisms addressed in the *Rural Task Force Order* were High Cost Loop Support, and the Safety Net Additive and Safety Valve Support created by that order.³ The Joint Board’s *Public Notice* also seeks comment on changes to the Local Switching Support mechanism, in the context of seeking comment on the appropriate methodology for calculating support.⁴ What is common among all four of these mechanisms is that they all represent support for costs that are either separated to the intrastate jurisdiction, or would be separated to the intrastate jurisdiction but for separations adjustments made in connection with a specific

¹ See Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission’s Rules Relating to High-Cost Universal Service Support, Public Notice, CC Docket No. 96-45 (rel. Aug. 16, 2004) (“*Public Notice*”).

² *Federal-State Joint Board on Universal Service*, Order, FCC 04-125 (rel. June 28, 2004) (“*Referral Order*”).

³ *Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order and Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, 16 FCC Rcd 11244 (2001) (“*Rural Task Force Order*”).

⁴ *Public Notice* at ¶¶ 46-47.

universal service support mechanism, such as the rural incumbent LEC loop cost expense adjustment.⁵

Neither the *Referral Order* nor the Joint Board's *Public Notice* addresses the Interstate Access Support ("IAS") mechanism (also known as "CALLS support") and the Interstate Common Line Support ("ICLS") mechanism (also known as "MAG support"), and thus both of these mechanisms lie outside the scope of this proceeding. The distinction implicitly drawn by the Commission and Joint Board is subtle, but significant. Unlike High Cost Loop Support, Local Switching Support, Safety Net Additive and Safety Valve Support, IAS and ICLS are part and parcel of the FCC's interstate access charge regimes for price cap and rate-of-return LECs, respectively. Changes to IAS and ICLS would require changes to the Commission's access charge regulations as well, which are also not within the scope of this proceeding.

II. THE JOINT BOARD SHOULD DEFER THIS PROCEEDING PENDING COMPLETION OF THE FCC'S CONSIDERATION OF THE INTERCARRIER COMPENSATION FORUM'S PROPOSAL FOR UNIFIED INTERCARRIER COMPENSATION REFORM.

On October 5, 2004, the Intercarrier Compensation Forum filed with the Commission its full proposal for unified intercarrier compensation reform.⁶ Because that proposal would expand significantly the amount of support provided from federal universal service support mechanisms for the recovery of jurisdictionally intrastate costs, it does not make sense to proceed with this referral until the Commission has acted with respect to the ICF Plan.

⁵ See 47 C.F.R. § 36.601 *et seq.*

⁶ Letter of Gary M. Epstein, Counsel to the Intercarrier Compensation Forum, to Marlene Dortch, Secretary, FCC, WCB Docket No. 01-92 (filed October 5, 2004) ("*ICF Plan*").

As discussed above, the *Referral Order* and *Public Notice* seek comment with respect to those existing programs within the High Cost Fund that support intrastate switching and loop costs, and whether such mechanisms should be based on forward-looking economic costs, as is the case for non-rural LECs, or on embedded costs, as is the case today for rural LECs. The *Referral Order* and *Public Notice* also seek comment on the appropriate definition of “rural” for universal service support purposes.

The ICF Plan, however, would create an additional fund, the Transitional Network Recovery Mechanism (“TNRM”), for carriers that are “Covered Rural Telephone Companies” as defined in the ICF Plan⁷ (which differs from the definition of “rural” in Section (3)(37) of the Act).⁸ For price cap LECs, this fund is based, *inter alia*, on price cap revenues, and for rate-of-return carriers, it is based, *inter alia*, on the ILEC’s switched access revenue requirement. A portion of this TNRM support would represent recovery of intrastate costs previously recovered through intrastate access charges, and other intrastate intercarrier compensation.

Furthermore, the ICF Plan contains specific provisions that address some of the Commission’s and Joint Board’s previous policy concerns. For example, as part of its integrated comprehensive proposal, the ICF Plan proposes that CETC support – which would continue to be linked to ILEC support per line – would not increase solely because an ILEC lost lines to a competitor.

⁷ The ICF Plan also creates a second fund, the Intercarrier Compensation Recovery Mechanism, for carriers that are not “Covered Rural Telephone Companies” under the ICF Plan.

⁸ 47 U.S.C. § 153(37).

The overlap between the ICF Plan and this proceeding makes it prudent to defer completion of this proceeding pending the Commission's resolution of the ICF proposal. It makes little sense to work to harmonize rural and non-rural support for intrastate high cost loop costs, but not to address additional intrastate costs that would be encompassed within universal service if the FCC adopts the ICF Plan. The FCC and Joint Board would, in essence, have to repeat any harmonization again, taking into account the additional support.

Moreover, the Commission and Joint Board should recognize that there is only a limited amount of regulatory change that industry participants and consumers can assimilate at any one time. It makes little sense to expend that tolerance of change on harmonizing rural and non-rural high cost support for intrastate loop costs, when the larger and related issue of resolving intercarrier compensation is pending. It is a more urgent priority for the Commission to reform intercarrier compensation, to move away from the current multiplicity of interstate and intrastate mechanisms that have different rules for financial responsibility for interconnection, widely varying rates for termination of traffic, and radically distinct rate structures (access v. reciprocal compensation), to a system that will rationally treat all traffic exchanges in a similar manner, and preserve and enhance universal service. The transition called for by the ICF Plan should take precedence over the steps upon which the Joint Board seeks comment in the *Public Notice*.

III. THE COMMISSION'S AND JOINT BOARD'S HIGH COST UNIVERSAL SERVICE POLICIES SHOULD CONTINUE TO BE FOCUSED ON CONSUMERS, NOT PROVIDERS.

To the extent the Joint Board continues to move forward with this proceeding during pendency of the ICF Plan, the Joint Board should remain focused on consumers, not providers, in effectuating Congress' universal service goals. In enacting the Telecommunications Act of 1996, Congress explained the fundamental goals behind its universal service policy:

Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.⁹

As this language makes clear, Congress intended that universal service programs would provide citizens living in rural areas opportunities comparable to urban citizens to purchase high-quality telecommunications and information services. Moreover, Congress directed the Commission and the Joint Board to ensure that the rates for these services are “just, reasonable and affordable”¹⁰ and that there would be “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.”¹¹ As this language demonstrates, however, Congress’ focus was “*customers, not providers.*”¹²

The existing rules for high cost support should be amended where they do not serve these objectives of delivering to rural America access to affordable and reasonably comparable telecommunications and information services on a sustainable basis. To be consistent with Congress’ fundamental, *consumer-focused* goals, GCI recommends that the Joint Board and the Commission follow three inter-related principles. First, universal service programs for rural, insular and high cost areas must foster and preserve incentives for the development of rural infrastructure. Without the deployment of facilities needed to deliver next-generation products and services, rural consumers will not have access to the same level of services as their urban

⁹ 47 U.S.C. § 254(b)(3) (emphasis added).

¹⁰ 47 U.S.C. § 254(b)(1).

¹¹ 47 U.S.C. § 254(b)(5).

¹² *Alenco v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000) (emphasis in original).

counterparts. Universal service programs should preserve incentives for investment in rural infrastructure by supporting the efforts of service providers that make reasonable infrastructure investments. Indeed, incentives for infrastructure investment are critical for rural Americans to participate in the wave of Internet Protocol (“IP”) technologies that are being built throughout the nation.

Second, however, to the extent possible, the incentives to develop the rural infrastructure should be *market-driven, not centrally planned*. To do this, universal service support should be harmonized with the Act’s pro-competitive goals. Universal service programs should not be used to artificially create competitive markets, nor should they be used to stifle their development. Competition encourages all service providers to develop innovative new services and service packages, and to experiment to find the most cost-effective technology or technologies to deliver those services to the public. Competition creates incentives to increase service quality and reduce rates. When competition is possible, the net result is that rural consumers will receive better service at a lower price. Accordingly, universal service subsidies should not provide advantages to either the incumbent or the new entrant that would stifle the innovation of both the advantaged and disadvantaged provider, nor should it provide greater support to one technology over others used to deliver the same services. Instead, universal service support must be distributed in a competitively neutral manner that promotes Congress’ goal of bringing the benefits of competition to *all* markets, including rural markets, by preserving the incentives for carriers competing on equal footing in terms of opportunity for support to distinguish themselves based on prices and offerings. As the Commission recognized in 1997, “universal service support mechanisms and rules [should] neither unfairly advantage nor

disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.”¹³

Third, the support provided must be sustainable. Today, for example, universal service programs are under scrutiny because of the explosive growth of the high cost USF.¹⁴ Although the vast majority of the growth is attributable to rebasing of the High Cost Loop Support in the *Rural Task Force Order*, and implementation of the new access-related support from the *CALLS Order* and the *MAG Order*,¹⁵ the high cost program has been the focus of attention because of

¹³ *Federal State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8801 (¶ 47) (1997) (“*First Universal Service Report and Order*”).

¹⁴ See *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, CC Docket No. 96-45 (released February 7, 2003).

¹⁵ The *CALLS Order* created the Interstate Access Support mechanism, which is capped at \$650 million per year. *Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, Order on Remand, 18 FCC Rcd 14976, 16982 (¶ 10) (2003) (“*CALLS Order*”). The *MAG Order*, created Interstate Common Line Support, which is uncapped and, as of the fourth quarter 2004, was distributing \$562.5 million annually. *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation; Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, Report and Order in CC Docket 98-77, Report and Order in CC Docket 98-166, 16 FCC Rcd 19613, 19621-19622 (2001) (“*MAG Order*”); see also Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2004* at 33 (October 31, 2003) available at: <http://www.universalservice.org/overview/filings/2004/Q1/1Q2004%20Demand%20Est%20FilingTEXTFINAL.pdf>.

The *Rural Task Force Order* “re-based” the High Cost Loop Support, which increased support to ILECs under that mechanism by approximately \$118.5 million. 16 FCC Rcd at 11273 n. 171.

growth in support to wireless ETCs – and the potential for even greater future growth if more wireless carriers seek designation as an ETC. There is no question that consumers have responded dramatically to the availability of wireless services in rural areas. But at present, the High Cost Fund goes far beyond supporting basic single-party voice service to every home and business, and would support multiple connections to every man, woman and child. Furthermore, when support is provided, incentives need to be maintained for all providers to deliver service efficiently.

It is important to recognize that these principles are inter-related and mutually supporting. Limiting universal service support solely to ILECs – as many ILECs propose under many different guises – limits rather than incents the deployment of rural infrastructure. As discussed further below, GCI’s history demonstrates that when monopolists are the only entities allowed to serve rural areas, rural consumers get only as much service as the monopolist chooses to deliver. When competition is allowed, competition – and even the threat of competitive entry – incents the incumbent monopolist to improve the rural infrastructure and service to rural consumers.

IV. ALASKA’S EXPERIENCE SHOWS THAT COMPETITION AND UNIVERSAL SERVICE CAN WORK TOGETHER TO BENEFIT CONSUMERS

GCI’s experience in Alaska illustrates how competition and universal service can work together to benefit consumers in rural ILEC study areas, consistent with the goals embodied in Section 254. GCI is a diversified telecommunications company that offers competitive local telephone service – along with long distance, cable, and high-speed and dial-up Internet access services – to customers in Anchorage, Fairbanks, and Juneau. In GCI’s local service areas, the ILECs are Alaska Communications Systems Group, Inc. and its operating subsidiaries, ACS of Alaska, Inc., ACS of Anchorage, Inc., ACS of Fairbanks, Inc., and ACS of the Northland, Inc.

(collectively “ACS”). ACS is a rate-of-return ILEC. It also is designated as a “rural telephone company” pursuant to 47 U.S.C. § 153(37) with respect to all of its operations other than Anchorage.¹⁶

GCI serves both the business and residential markets and has been designated an ETC by the Regulatory Commission of Alaska (“RCA”). GCI competes head-to-head with ACS, offering services of the same or better quality. Rather than offering a limited range of products that merely complement ACS’ services (*e.g.*, wireless service or high-speed Internet access), GCI provides a full range of services that fulfill all of its customers’ telecommunications needs. GCI’s entry thus provides consumers with the type of choice envisioned by the 1996 Act, and has delivered lower prices, better service packages, and advanced services to both rural and non-rural markets.

Since 1997, when GCI entered the competitive local exchange business in Anchorage (Alaska’s lone “non-rural” market), consumers in Anchorage alone have saved in excess of \$24 million in local rates. In November 2001, when ACS persuaded the RCA to grant it both a retail rate and a UNE price increase in Anchorage, GCI held the line and did not increase its own retail rates. Consumers, in turn, voted with their pocketbooks, showing overwhelming support for competition: GCI now serves close to 50 percent of Anchorage residential and business customers combined. GCI also introduced innovative services and service packages that were not previously available to customers. For example, upon entry, GCI offered a Value Package for residential customers in Anchorage, saving them more than 40 percent compared to the incumbent’s rates for local service and the most frequently used calling features (Caller ID and

¹⁶ However, if all of ACS’ study areas in Alaska were consolidated, ACS would not meet the definition of a “rural telephone company” in 47 U.S.C. § 153(37).

Call Waiting). GCI also made offerings including features that ACS (and its predecessor ATU) had, but did not actively market, including Selective Call Forwarding, Selective Call Acceptance, Selective Call Rejection, and Selective Distinct Alert.

Business customers also benefited from these and other innovations, particularly in Alaska's rural markets. For example, before GCI entered Juneau, businesses there were not able to purchase fractional T-1 services and Fast Track Primary Rate ISDN services. GCI introduced these services when it entered the market. The ILEC then revised its product offerings in response to GCI's entry in Fairbanks and Juneau.

Even in those markets which GCI has not entered, but where there has been the threat of competitive entry, the ILEC has preemptively moved to improve its offerings and services. Indeed, there is an extremely high correlation between those communities in which the RCA had lifted ACS' "rural exemption" from the requirements of Section 251(c),¹⁷ and those areas in which ACS offers consumers advantageous bundles. Where competition is a possibility, bundles are offered; where competition is barred by regulation, ACS does not offer its favorable bundles.¹⁸

This experience with local competition in rural areas is not unique. Indeed, it is just the latest iteration in GCI's history of a running battle against incumbents that seek protection from competition under the guise of protecting universal service. When GCI first entered the Alaska long distance markets, it was precluded by FCC and Alaska rules from serving the Alaska

¹⁷ See 41 U.S.C. § 251(f).

¹⁸ See Exhibit A (showing ACS' competitive response to GCI).

Bush.¹⁹ At that time, Alascom, the monopoly long distance provider in the Bush, argued that Bush communities were only capable of supporting a single earth station and that construction of duplicate facilities therefore would not serve the public interest.²⁰ Accordingly, the Commission adopted the Alaska Bush Policy which precluded licensing additional satellite earth stations for interstate MTS service in the Bush on the grounds that “duplicative proposals for facilities in the Alaska Bush communities are mutually exclusive because one facility could provide all the services provided by either party, and there was no public interest benefit in the construction of duplicate MTS facilities.”²¹

Of course, the regulatory assessment of the risks and benefits of competitive entry proved false. In 1995, both the then-Alaska Public Utilities Commission and the FCC granted GCI waivers to allow the construction and operation of duplicate earth stations in 50 Bush communities.²² Instead, when GCI was finally allowed to enter the Bush, albeit on a limited basis, service improved and retail rates fell.²³ Instead of relying on ancient analog satellites that “double-hopped” all calls between Bush locations, GCI launched the first Demand Assigned Multiple Access (“DAMA”) satellite to serve Alaska, which switched Bush long distance traffic in the air, eliminating the “double-hop” with an immediate improvement in service quality.²⁴

¹⁹ *See Policy for Licensing Domestic Satellite Earth Stations in the Bush Communities of Alaska*, 18 FCC Rcd 16874, 16875 (2003).

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 16876.

²³ *Id.* at 16877.

²⁴ *Id.* “‘Double hop’ refers to a call that requires two satellite hops to complete. The earth station technology that was used before DAMA required all traffic to or from an Alaska Bush location to first be transmitted to a satellite, then to Anchorage, Fairbanks or Juneau for

Remarkably, until GCI was allowed to enter the Alaska Bush in the late 1990s, a consumer could not reliably send a fax from Bush locations, and data service was virtually non-existent.

As demonstrated by former FCC Chief Economist David Sappington in his paper, “Harnessing Competitive Forces to Foster Economical Universal Service,” economic theory supports the conclusion, drawn from GCI’s experience with local and long distance competition, that competition will foster universal service, rather than detract from it.²⁵ As Dr. Sappington describes, regulatory pre-selection of a single universal service provider (which Dr. Sappington calls the “*de jure* monopoly approach”) can satisfy the Act’s universal service goals²⁶ only under very stringent and unrealistic circumstances, including:

switching, even for calls not destined for those markets, and then transmitted a second time to a satellite for transmission to the call’s final destination. This resulted in signal delay and frequency echo, rendering facsimile transmission unreliable and data transmission impossible.” *Id.*

²⁵ See David E. M. Sappington, “Harnessing Competitive Forces to Foster Economical Universal Service” at 11 (originally filed in CC Docket No. 96-45 on Dec. 19, 2003) (“*Sappington*”) (attached as Exhibit B).

²⁶ Dr. Sappington evaluated both monopoly and competitive approaches to universal service with respect to five statutory goals for universal service policy:

- Telecommunications and information services that are “reasonably comparable” to the services available in urban areas should be available in rural areas.
- The rates for these services should be “affordable.”
- The rates for these services should be “reasonably comparable” in urban and rural regions.
- The service rates and any associated support should be just and reasonable. Support should be sufficient to render the supply of the services financially attractive. However, the total regulated revenue, consisting of universal service support and revenue from end users and other carriers, also should not be excessive.
- The mechanisms to support universal service should be “specific, predictable and sufficient.”

Id. at 5.

- Regulators must be able to identify and select the least-cost supplier of the supported services in every relevant geographic area, including knowing how the production technologies and associated costs of potential suppliers will change *over time*.
- Regulators must be able to act on their (unrealistically) extensive knowledge, and to resist all pressure to select politically powerful, entrenched suppliers rather than least-cost suppliers.
- Regulators must be able to induce the selected monopolist to operate its prevailing technology as efficiently as possible over time.
- Regulators must be able to induce the monopolist to continually discover and implement more efficient technologies that enable the production of high-quality, innovative services at ever-lower costs.
- Regulators must be able to determine the most efficient geographic scope of operations for each *de jure* monopolist, rather than simply accepting the historical ILEC boundaries.
- Regulators must be certain that economies of scale are pervasive within each of the identified geographic service areas.²⁷

“Because information of this scope and quality is not available to regulators in practice,” Dr.

Sappington concludes that regulatory preselection of a single universal service provider “is not an appropriate mechanism for pursuing [the Act’s] universal service goals.”²⁸

Dr. Sappington contrasts regulatory preselection of a single universal service provider with a competition-based approach to universal service policy. As Dr. Sappington finds, in contrast to regulatory preselection of a single universal service provider, “the competitive approach allows the market continually to identify the most efficient suppliers of supported telecommunications services, to provide appropriate incentives to those supplies and their competitors alike, to deliver universal services at minimum cost, and to continually reduce the

²⁷ *Id.* at 7-9.

²⁸ *Id.* at 18.

costs and improve the quality of telecommunications services.”²⁹ In particular, in the command-and-control model of regulatory preselection of a universal service provider, there has never been a successful way to induce the preselected monopolist to continue to innovate and introduce new products, services, and service packages. In contrast, competition “motivates industry suppliers continually to reduce their operating costs and develop innovative, high-quality services,” including “superior services as well as lower costs.”³⁰

Thus, both GCI’s experience and economic theory support the conclusion that competition is the best way to ensure that rural America can, on a sustainable basis, receive access to reasonably comparable telecommunications services at just, reasonable, affordable and reasonably comparable rates. Doing so delivers tangible benefits to residential and business consumers, and ensures that advanced services are deployed and marketed.

V. THE AMOUNT OF HIGH COST SUPPORT SHOULD BE THE SAME FOR ALL PROVIDERS OF *SUBSTITUTE* SERVICES, REGARDLESS OF THE BASIS FOR ILEC SUPPORT

The *Public Notice* seeks comment on whether high cost support for competitive ETCs should be calculated on a basis other than ILEC per line support, specifically the competitive ETC’s own costs.³¹ The Joint Board should take no action that would result in different competitive ETC and ILEC per line support amounts, whenever the competitive ETC is offering a service that is a substitute for the ILEC’s landline telephone exchange service for a substantial portion of the communications within the study area. When the ILEC and CETC are offering substitute services, supporting rural ILECs based on ILEC embedded costs and competitive

²⁹ *Id.*

³⁰ *Id.* at 19 and 22 n.20.

³¹ *See Public Notice* at ¶¶ 36-37.

ETCs on any basis other than ILEC support per line would skew the market from the results that would be obtained without such support. It would also lead to excessive support in violation of Section 254(e).³²

GCI is agnostic among the different bases for determining universal service support to offset an ILEC's costs that would otherwise be recovered through intrastate rates. Such support could be determined according to a forward looking economic cost model, the ILEC's embedded costs, the CETC's embedded costs, or the lower of any combination of these different cost bases. But however the support payment determined, it *must be the same* for all market participants that provide substitute services.

This is the scheme that was built into the FCC's rule 54.307 in the *First Universal Service Report and Order*. Under that rule, a CETC "shall receive universal service support to the extent that the competitive eligible telecommunications carrier captures the subscriber lines of an incumbent local exchange carrier (LEC) or serves new subscriber lines in the incumbent LEC's service area."³³ When a CLEC offering a substitute won a line from the ILEC, the ILEC was supposed to lose an equal amount of support.³⁴

However, where a CETC is not offering a *substitute* for the ILEC's service, but instead offers a *complement* to the ILEC's service, there is no pro-competition rationale for paying the CETC providing *complementary* service the same support as the ILEC. In that case, it may be

³² 47 U.S.C. § 254(e).

³³ 47 C.F.R. § 54.307(a).

³⁴ See 47 C.F.R. § 54.307(a)(2)-(4). The FCC and USAC have never implemented the provisions of this rule requiring ILEC support to be reduced. As a consequence, the ILEC receives support for being *able* to serve a particular customer, but the CETC only receives support when it *actually* serves a particular customer.

appropriate for the Joint Board and the Commission to adopt a different method of determining support for any ETC providing *complementary* service, rather than a *substitute* service.

A. Providing Competitive ETCs Less Support than ILECs for a Substitute Service Subverts Market Efficiency and Serves Only to Shield Revenues from Competition.

As Dr. David Sappington explained to the Commission, differential support for ILECs and competitive ETCs with respect to substitute services would deprive the market of each carrier's superior skill, knowledge and foresight, because it would deprive more efficient carriers the benefits of their efficiency.³⁵ Such a mechanism would thus prevent the market from discovering the smallest necessary subsidy (or whether, in some cases, service can be provided without subsidy at all).³⁶ It would instead merely institute protectionist policies to insulate a single class of carriers – ILECs – from the ordinary consequences of marketplace competition that face every other American business.

To demonstrate the inherent inefficiencies and competitive biases created by a system that pays differential support to ETCs in the same market, it is useful to consider how that market would function in the absence of support payments.³⁷ As an example, ACS today receives lump-sum monthly high cost support roughly equivalent to \$12.17 per line per month for serving residential customers in Zone 2 of ACS' Fairbanks study area. GCI also receives \$12.17 per line per month in support for serving lines in the same area.³⁸ In the absence of this subsidy, ACS' retail rates would need to be approximately \$12.17 per line per month higher in order for ACS to

³⁵ See *Sappington* at 25-26.

³⁶ See *id.* at 30.

³⁷ See *id.* at 20-22.

³⁸ See 47 C.F.R. § 54.307(a).

receive the same revenue it now receives with the subsidy. GCI, as the newer entrant, would have the opportunity to compete for that entire \$12.17 for every customer. In the absence of this subsidy, GCI would have the incentive to enter whenever it could do so profitably, based on the unsubsidized amount of revenue it would receive in competition with ACS' unsubsidized prices. If GCI were 10 percent more efficient than ACS, it would have the option of cutting its rates by up to 10 percent in order to attract more customers, or charging the same rates as ACS, and earning a greater margin, or something in between. The market would dictate GCI's pricing in response to ACS' pricing, and would dictate ACS' response to any price reductions implemented by GCI. Over time, as Dr. Sappington documents, competition creates a virtuous cycle, moving prices toward the long run incremental costs of the most efficient provider, and forcing all competitors to invest and innovate continually to drive costs lower and performance higher.³⁹ Providing a \$12.17 subsidy to both ETCs for residential lines simply reduces customers' price by \$12.17, while maintaining the same revenue opportunity for each ETC, and transmitting the same pricing signals and efficiency incentives to both carriers.

By contrast, competitive incentives and market discipline would be greatly skewed if a subsidy were provided to only one ETC but not another, or in a greater amount to one ETC than to another.⁴⁰ If, for example, ACS were to receive a subsidy of \$12.17 per line, and GCI were to receive no subsidy for providing the same service to the same subscriber, GCI would have no incentive to enter unless it could provide lines at an average of \$12.17 *less* than ACS. Put another way, ACS could be as much as \$12.17 per line per month less efficient (and more costly)

³⁹ See *Sappington* at 22.

⁴⁰ See *id.* at 28-29.

than GCI before GCI could begin to impose competitive discipline on ACS by attracting some of its customers. Under such a system, the competitive market's incentives for efficient service would be blunted dramatically, and the ratepayer, through universal service fees, would fund inefficient service. Such a system of disparate support would wholly disengage the competitive market's self-propagating mechanism, which ensures that competitive ETCs and ILECs both have incentives to deliver the highest value to customers at the lowest price.

The Joint Board asks whether a competitive ETC has a competitive advantage over a rural ILEC when support is based on the ILEC's costs and the competitive ETC has lower costs.⁴¹ While the lower cost carrier (whether ILEC or CLEC) has a competitive advantage – as is true in any market absent any subsidy – the Joint Board must take care not to confuse the concepts of competitive neutrality with profit equalization.⁴² Competitively neutral policies, such as the Commission's current rules for high cost support, if fully implemented and as applied to carriers offering substitute services, do not change the relative abilities of firms to compete in the marketplace. For example, if a competitive ETC's costs are \$1 per unit lower than the rural ILEC's costs before a competitively neutral policy is implemented, then the competitive ETC's effective costs remain \$1 per unit lower than the rural ILEC's after the policy is implemented. By contrast, profit equalization policies offset differences between the relative abilities of firms that would otherwise arise in the marketplace. For example, if a profit equalization policy were implemented in setting described above, both the competitive ETC and the rural ILEC would have the same profit – and the same net costs after subtracting the subsidy – because the rural

⁴¹ See *Public Notice* at ¶ 36.

⁴² See *Sappington* at 22-24.

ILEC will be provided \$1 per unit more in subsidy than the competitive ETC to offset the ETC's cost advantage. Of course, providing that additional \$1 of subsidy to the rural ILEC completely stymies the ability of the "invisible hand" of the market to direct consumers to take service from the most efficient provider. As a result, consumers will pay more – both directly in their service rates and indirectly through higher USF contribution fees – to pay for inflated universal service support.⁴³

The Commission has previously recognized the competitive inequities and market distortions created by paying ILEC support that is unavailable to new entrants providing a substitute service. Indeed, it declared that Section 253 preempts as unlawful barriers to entry intrastate universal service mechanisms that deliver disparate or no support to competitive ETCs providing a substitute service in competition with the ILEC. As the Commission concluded:

A new entrant faces a substantial barrier to entry if its main competitor is receiving substantial support from the state government that is not available to the new entrant. A mechanism that makes only ILECs eligible for explicit support would effectively lower the price of ILEC-provided service relative to competitor-provided service by an amount equivalent to the amount of the support provided to ILECs that was not available to their competitors. Thus, non-ILECs would be left with two choices – match the ILEC's price charged to the customer, even if it means serving the customer at a loss, or offer the service to the customer at a less attractive price based on the unsubsidized cost of providing such service. A mechanism that provides support to ILECs while denying funds to eligible prospective competitors thus may give customers a strong incentive to choose service from ILECs rather than competitors.⁴⁴

⁴³ See *id.* at 30.

⁴⁴ *Western Wireless Corporation Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, Memorandum Opinion and Order, 15 FCC Rcd 16227, 16231 (¶ 8) (2000).

The Commission hit the nail on the head. Providing an ILEC with more support per line than competitors offering substitute services cannot be competitively neutral and will skew the market in favor of one competitor – the ILEC.

Providing differential support to each carrier based on each carrier's own costs of providing substitute services would also eliminate incentives for cost cutting by either carrier.⁴⁵ ILECs and competitive ETCs offering substitute services would essentially be under parallel, but non-interacting, systems of rate-of-return regulation. As each carrier increased its costs, its support and therefore total revenue per unit (but not the price on which it competes to win customers in the marketplace) would increase. The more each carrier increases its costs, the more support it would receive. To prevent an unchecked upward climb in support, the Commission would have to institute full rate-of-return regulation of competitive ETC rates.

Recognizing this flaw, some parties in earlier comments in this docket have proposed capping universal service support for competitive ETCs so that a CETC's support would be no greater – but could be less – than the competing ILEC's. However, this proposal suffers from essentially the same deficiency that results from placing competitive ETCs under rate-of-return regulation: a competitive ETC would still have no incentive to reduce its costs below the level at which its high cost support would begin to phase-out. If it were to do so, it would simply lose high cost support without gaining any competitive advantage in the marketplace.⁴⁶ Because ILECs would continue to receive support based on their higher costs, and competitive ETC support would fall as they became more efficient, universal service support would shield ILECs

⁴⁵ See *Sappington* at 28-29.

⁴⁶ See *id.* at 29.

from the consequences of their inefficiency and failure to innovate. Under these circumstances, competitive ETCs would not be able to capitalize on their efficiencies, because the benefit of efficiencies would actually flow *to the USF* in the form of support reduction.

High cost support for all ETCs providing services that are substantial substitutes for one another should be measured by the same ruler. This is the only means to replicate the price signals that would occur in a competitive market. The Commission adopted such an approach more than seven years ago when it determined that high cost support for competitive ETCs should be based on ILEC support.⁴⁷ The wisdom of the Commission's policy choice is proven by the fact that, in Alaska, GCI's competitive entry is delivering price reductions and other benefits to consumers – just as would occur in the absence of any subsidies and as the Commission and the Joint Board anticipated.

B. Distributing Equal Support to all ETCs Providing Substitute Service Is Consistent with Section 254(e)'s Sufficiency Requirement.

Rural ILECs and their representatives are likely to argue that the Joint Board will violate the requirements of Section 254(e) if it pays competitive ETCs that provide a substitute for the ILEC's landline telephone exchange service for a substantial portion of the communications within the study area per line high cost support based on the rural ILEC's high cost support (which, in turn, is based on the total embedded costs of the ILEC's network). Rural ILECs argue that this over-subsidizes competitive ETC services when the competitive ETC is a lower cost provider. As a corollary, they might argue that excessive support, defined as per line support that is greater than the competitive ETC's own costs, necessarily must be diverted away from the provision, maintenance, and upgrading of facilities used to provide universal service, in violation

⁴⁷ See *First Universal Service Report and Order*, 12 FCC Rcd at 8932-8934 (¶¶ 286-290).

of the same statutory provision, because the amount of support exceeds that which is necessary to achieve these goals.

In the first instance, it is important to recognize that support provided to CETCs that provide a full *substitute* for the ILEC's service has contributed little to the growth of the High Cost Fund. According to USAC statistics, total wireline CETC High Cost Fund support in the first two quarters of 2004 (not just the growth) was running at an annualized rate of less than \$10 million per year – or approximately 0.3 percent of all High Cost Fund expenditures.⁴⁸ By contrast, since 2001, rural ILEC High Cost Fund support has grown by approximately \$600 million – from \$2.5 billion in 2001 to an annualized rate of \$3.1 billion in 2004. During that same period, High Cost Fund support to wireless CETCs, which largely offer services that are *complements* to traditional ILEC service, has mushroomed by almost \$220 million – from \$20 million in 2001 to an annualized rate of \$240 million in the first two quarters of 2004. Furthermore, because a wireline CETC's customer usually drops ILEC service, the extremely modest amount of growth in the High Cost Fund due to wireline CETC support could be almost entirely offset if the FCC and USAC were actually to implement the provisions of rule 54.307 that require ILEC support to be reduced when a CETC captures a line from the ILEC.⁴⁹ There is

⁴⁸ See Exhibit C, attached, showing the share of High Cost Fund support for wireline CETCs, as compared with wireless CETCs and ILECs, *from*:
<http://www.universalservice.org/hc/whatsnew/072004.asp#072704>.

⁴⁹ As discussed in n.34, *supra*, the FCC and USAC have never implemented those provisions of rule 54.307 that require an ILEC to lose support when a CETC serves lines within the ILEC service area. Implementing this rule would eliminate the duplicate support the ILEC currently receives even though it does not serve the CETC's customers.

In theory, there could still be a small amount of growth from an “upward spiral” in per line support as the ILEC lost lines and its support in subsequent years was recalculated over a smaller base of lines. That growth could be addressed by adopting the Joint Board's proposal

simply no basis on which to conclude that support provided to wireline CETCs is causing any significant growth in the High Cost Fund.

Furthermore, arguments that sufficiency – and therefore excessiveness of support – must be judged on a carrier-by-carrier basis ignore the Fifth Circuit’s decision in *Alenco Communications v. FCC*.⁵⁰ The Fifth Circuit in *Alenco* expressly rejected ILEC arguments that sufficiency must be judged from the perspective of the *carrier*, holding that Section 254(e) instead requires only that there be sufficient support for “*customers* to receive basic telecommunications services.”⁵¹ When sufficiency is judged from the perspective of the customer, and not the perspective of “every local telephone provider as well,”⁵² sufficiency has no logical relationship to an individual ILEC’s or competitive ETC’s costs of service, but can only be judged with respect to the market rates of *competing* providers in the absence of high cost support. With equal support, a lower cost carrier can undercut its higher cost rival, just as it would in an unsubsidized market.⁵³ However, when a higher cost carrier can receive greater support than a lower cost carrier, *neither* carrier is incented to maximize efficiency because any efficiency gains serve only to reduce that carrier’s universal service support and cannot translate into a marketplace advantage.⁵⁴ It would be ironic and counterproductive, at a time when the Joint Board and the Commission are concerned with the growth of the high cost fund, for the

to freeze per line support for all carriers when a CETC is certified. *See Federal-State Joint Board on Universal Service*, Recommended Decision, 19 FCC Rcd 4257 (¶ 77) (2004).

⁵⁰ 201 F.3d 608 (5th Cir. 2000) (“*Alenco*”).

⁵¹ *Id.* at 620 (emphasis added).

⁵² *Id.*

⁵³ *See Sappington* at 22-24.

⁵⁴ *Id.*

Joint Board to recommend a basis of support that encourages both ILECs and competitive ETCs to inflate their costs of service.

Indeed, under *Alenco*'s customer-focused sufficiency requirement, if providing the same support to both carriers reveals that the marketplace will deliver universal service at rates well below the upper limits of affordability and reasonable comparability, the proper remedy is to reduce the support to all ETCs in that market, not just to the ETC that is the most efficient in providing universal service. Nothing in Section 254 requires the Commission to pay higher levels of support to inefficient carriers to subsidize their market presence. Indeed, paying differential support to ETCs serving the same customer in the same market not only violates competitive neutrality, but would do exactly what the Fifth Circuit rejected in *Alenco* – confuse the Act's command for universal service to provide “sufficient funding of *customers*” with “sufficient funding of every local telephone provider.”⁵⁵

⁵⁵ *Alenco*, 201 F.3d at 620 (emphasis in original). Moreover, if sufficiency were really to be determined on a *carrier*, rather than a *customer* basis, such an interpretation would truly subsidize competitive entry. In the early stages of competition, a competitive ETC's per line costs are likely to be much greater than those of the ILEC, not lower. A start-up competitive ETC will not yet have achieved even its baseline operating scale, let alone be able to approach the ILEC's economies of scale and scope. Under the rural ILECs' proposal to pay competitive ETCs based on competitive ETC costs, USF might actually grow due to the increased per line high cost support amounts provided to competitive ETCs. Such a policy would also dull the incentives of competitive ETCs to minimize their operating costs over time.

VI. CONCLUSION

For the foregoing reasons, GCI respectfully asks the Commission to adopt the recommendations outlined herein.

Respectfully submitted,

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