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

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

**REPLY COMMENTS OF T-MOBILE USA, INC.**


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**REPLY COMMENTS OF T-MOBILE USA, INC.**

T-Mobile USA, Inc. ("T-Mobile") supports the approach to rural high-cost universal service reform advocated by CTIA-The Wireless Association ("CTIA") and other wireless parties in their comments on the recommended support mechanisms to succeed the current five-year rural high-cost plan. In response to the Public Notice issued by the Federal-State Joint Board on Universal Service ("*Joint Board Notice*"),[1] CTIA and other commenters demonstrate that fundamental reform of the rural high-cost support programs is vital to achieving the pro-consumer and pro-competitive goals of universal service, while curbing the current, non-sustainable growth of the universal service funds. Notwithstanding the objections raised by rural local exchange carriers ("RLECs"), only replacement of the current rural embedded cost regime by a forward-looking, least-cost support mechanism can achieve the goals of universal service.

[1] FCC Public Notice, *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, 19 FCC Rcd 16083 (2004) ("*Joint Board Notice*").

## I. INTRODUCTION AND SUMMARY

T-Mobile is a commercial mobile radio service ("CMRS") provider and one of five nationwide wireless carriers. Through its subsidiaries and affiliates, T-Mobile constructs and operates broadband PCS systems throughout the United States. T-Mobile has not sought designation as an eligible telecommunications carrier ("ETC") in any market and thus receives no high-cost universal service fund ("USF") support.

The initial comments confirm that the current rural five-year plan adopted in the *Rural Task Force Order*[2] subordinates the goal of ensuring affordable telephone service to the protection of RLEC revenue streams. The RLECs' initial comments demonstrate that they will resist any reforms designed to advance the universal service goal of competitive neutrality and limit the growth of the funds. Instead, they advocate continued support based on their embedded costs, an approach that distorts investment incentives by failing to reflect current technological trends and improved efficiencies. Only dramatic changes in the high-cost USF mechanisms, with an appropriate transition period, can break this anti-consumer cycle.

As CTIA points out, the wireless industry is a large contributor to, but a limited recipient of, high-cost support. Moreover, an increasing number of customers are willing to use wireless service as their primary voice telecommunications connection, making wireless carriers uniquely situated to provide a useful critique of the current USF regime.[3] Because demand for wireless services is highly price elastic, the inflated USF contribution factor -- which is proposed to go to

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[2] *Federal-State Joint Board on Universal Service*, 16 FCC Rcd 11244 (2001) ("*Rural Task Force Order*").

[3] CTIA Comments at 2-6. All initial comments filed in response to the *Joint Board Notice* on October 15, 2004 will be cited in an abbreviated manner.

10.7 percent for the next quarter[4] -- artificially depresses demand for wireless services, thereby increasing inefficiencies, distorting both carrier and customer incentives, and retarding innovation and competition. USF reform, therefore, would benefit rural customers as much as, or more than, any market segment.

Accordingly, T-Mobile agrees with CTIA's and other wireless carriers' position that an effective, competitively neutral, pro-consumer USF program must be fashioned to replace the current rural high-cost plan. In order to ensure that future USF growth is no greater than strictly necessary, any reform must include a cost basis that reflects the use of the most efficient currently available technology. The Commission should have a transition plan in place when the current five-year plan expires on July 1, 2006. As of that date, mid-sized RLECs should be subject to the same forward-looking USF mechanism currently applied to non-rural LECs. The current rural embedded high-cost mechanism can continue to be applied to small RLECs during the transition, but with certain changes. Non-loop costs, such as risk-related profits and Corporate Operations Expenses, should be removed from the rural high-cost mechanism, and the authorized rate of return ("ROR") should be reduced from the excessive current level of 11.25 percent.

Following the transition, all RLECs should be moved from the rural high-cost loop support fund and the four related USF programs currently supporting them to a single, unified USF plan based on forward-looking costs. In order to target support to those areas most in need, eligibility criteria should be revised to reflect cost characteristics of the area to be served, such as population density measures.

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[4] *See* FCC Public Notice DA 04-3902, *Proposed First Quarter 2005 Universal Service Contribution Factor*, CC Docket No. 96-45 (Dec. 13, 2004).

In order to ensure that USF support is provided only where it is needed, RLECs seeking USF support should be required to charge local rates no lower than the nationwide average urban local rate. There is simply no statutory or policy justification for collecting subsidies from urban consumers, many of whom are low income, to support rural rates that are lower than those charged in urban areas. Finally, the Joint Board and the Commission also should consider other possible market-based mechanisms for long term reform of the high-cost USF programs, such as providing support through end users, instead of directly to carriers, and auctioning support to the carrier that offers to provide service for the lowest amount of subsidy.

## II. FUNDAMENTAL REFORM OF THE RURAL HIGH-COST FUNDS IS VITAL

CTIA and other commenters have made an overwhelming case for reform of the rural high-cost USF mechanisms. There is no longer any serious debate as to the inefficiencies generated by the current embedded cost support programs: rural high-cost loop support; local switching support ("LSS"); and interstate common line support ("ICLS").[5] Those programs create incentives for carriers to increase their costs to receive more support, thus "institutionalizing their inefficiencies."[6] CTIA points out that, between 2000 and 2003, the national average RLEC loop cost rose from approximately $337 to approximately $378 per month.[7] This was at a time when the rest of the telecommunications industry continued to experience major improvements in technology and innovation that brought rates down

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[5] *See* 47 C.F.R. §§ 36.601 *et seq.*; 54.301; 54.901 *et seq.* *See also* long-term support ("LTS") for rate-of-return LECs participating in NECA's common line pool. *Id.* § 54.303.

[6] Economics and Technology, Inc., *Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Consumers into Corporate Welfare for the RLECs*, at iii (Feb. 2004) ("*Lost in Translation*") (attached to Western Wireless Comments as Exhibit 3).

[7] CTIA Comments at 7.

significantly.[8] Many RLECs that file Form 492 data have an interstate ROR well above the already excessive authorized rate of 11.25 percent.[9]

The protected existence enjoyed by RLECs depends in large part on USF support, rather than the marketplace. USF support has become “an increasingly large - sometimes even predominant - share of the RLECs’ total revenues.”[10] The Economics and Technology, Inc. study, *Lost in Translation*, suggests that some measure of the excessive level of rural USF support can be gleaned from sales by large LECs of rural exchanges to small rural carriers at twice their book value.[11] Thus, although USF programs are intended “to benefit the *customer*, not the *carrier*,”[12] telecommunications “customers” are increasingly burdened by growing USF contributions supporting high RLEC earnings rather than affordable rates. USF contributions are themselves becoming more of an obstacle to affordable rates for all end users than the high costs that they were meant to subsidize.

Unnecessarily high rural USF support harms consumers in another way as well. Not only does the wireless industry contribute disproportionately to USF programs, but each dollar of contribution by wireless carriers is more burdensome than a dollar of contribution by the RLECs. Wireless services have a much higher demand elasticity than wireline local services.[13] Thus, the

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[8] *See* Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telephone Service* at Tables 12.3 and 13.4 (May 2004) (“*Trends*”) (showing declines in price indices and revenue per minute for toll services during the 2000-03 period).

[9] *Lost in Translation* at 13.

[10] *Id.* at 6.

[11] *Id.* at 23-25.

[12] *Alenco v. FCC*, 201 F.3d 608, 621 (5th Cir. 2000) (“*Alenco*”) (emphasis added).

[13] CTIA Comments at 5-6.

high USF contribution factor depresses demand for wireless services to a greater extent than it does for the RLECs' services, thereby retarding the innovation that wireless services potentially could provide and suppressing a source of competition to the RLECs.[14] Rural consumers therefore would be benefited as much as any market segment by USF reform.

It is time to return to first principles. USF reform must be guided by the original goals of universal service: USF support should advance the interests of consumers in high-cost areas, not any particular class of carriers; USF benefits must be competitively and technologically neutral; and the USF program must be made sustainable by curbing the growth of USF payments. As discussed below, the proposals advanced by CTIA and wireless carriers meet all of those goals.

## III. ELIGIBILITY CRITERIA FOR USF SUPPORT SHOULD REFLECT SERVICE COSTS, NOT CARRIER CHARACTERISTICS

As Verizon and other commenters point out, citing the Rural Task Force White Paper, *The Rural Difference*, mid-sized RLECs often exhibit many characteristics of the typical non-rural carrier.[15] The statutory definition of "rural telephone company" ("RTC") is so broadly framed that many large nationwide LECs meet the definition and thus receive rural USF support.[16] For example, CenturyTel, Inc. has 16 study areas in Wisconsin alone, thereby permitting it to meet per-study area maxima in the statutory definition and still qualify for rural USF support.[17] The Joint Board noted that about 40 carriers serving more than 100,000 lines in a

[14] *Id.*

[15] Verizon Comments at 4, 8-13, citing Rural Task Force, *The Rural Difference: Rural Task Force White Paper 2* at 25-26 (Jan. 2000) ("*The Rural Difference*").

[16] *See* 47 U.S.C. § 153(37).

[17] Verizon Comments at 6.

single study area now qualify as RTCs.[18] Citizens Communications Company, with 2.29 million total lines; ALLTEL Corporation, with 2.91 million total lines; Sprint Corporation, with 7.85 million total lines, and over 2 million in Florida alone; and CenturyTel, with 2.38 million total lines, all qualify as RTCs.[19]

Some of these LECs have acquired other LECs or exchanges for the publicly stated purpose of achieving operating efficiencies,[20] and all are larger than some non-rural carriers that receive funding based on forward-looking costs.[21] Citing *The Rural Difference*, Verizon points out that mid-sized RLECs with more than 100,000 lines in a study area account for only 1.5 percent of all rural study areas, but those study areas contain more than 27 percent of all rural lines.[22]

Verizon, CTIA and other commenters correctly note that these characteristics of mid-sized RLECs are perfectly suited for the application of the forward-looking non-rural high-cost mechanism.[23] Any errors in calculating costs on a forward-looking basis will wash out in the case of such large companies serving such diverse areas. Citing *The Rural Difference*, Verizon notes that mid-sized RLECs benefit from greater line density than small RLECs and are comparable to non-rural LECs in their percentage of high revenue business customers and capital

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[18] *Joint Board Notice* 19 FCC Rcd at 16086-87.

[19] Verizon Comments at 10-11, citing *Trends*, Table 7.3.

[20] *Id.* at 8 & n.13.

[21] *Id.* at 11.

[22] *Id.*, citing *The Rural Difference* at 26, Figure 6.

[23] *See, e.g.*, Verizon Comments at 10; Nextel Comments at 8.

investment per loop.[24] The Commission has noted that larger RLECs are more similar to non-rural LECs than they are to smaller RLECs.[25] Qualification as an RTC thus does not accurately identify those operational and cost characteristics needed to determine whether a carrier should receive rural high-cost support.

Accordingly, T-Mobile suggests that, as a short-term transitional measure effective upon expiration of the current five-year plan, the forward-looking high-cost model support fund now available to non-rural LECs be applied to: any RLEC study area with 50,000 or more access lines; to the statewide operations of any RLEC that has, together with any affiliates, 100,000 or more lines in a state; or to the nationwide operations of any RLEC that has, together with all of its affiliates, a total of one million or more lines. Those thresholds will more accurately distinguish cost characteristics among the variety of existing RLEC operations than the statutory definition of RTC.[26] As CTIA points out, with modest changes to the non-rural high-cost program, RLECs of this scale have no need to remain on an embedded cost USF mechanism.[27]

In the longer term, eligibility criteria should continue to be refined. If, as T-Mobile, CTIA and others advocate, the current USF mechanisms ultimately are replaced by a single, unified USF program for all eligible carriers, there will no longer be any need for a rural/non-rural distinction. Instead, the Commission should use eligibility criteria that accurately reflect cost characteristics, such as population density. Western Wireless proposes that eligibility be

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[24] Verizon Comments at 11-13.

[25] *Rural Task Force Order*, 16 FCC Rcd at 11311.

[26] *See also* Verizon Comments at 11-13 (recommending 100,000 lines per state threshold); Nextel Comments at 8 (also recommending 50,000/100,000 line thresholds).

[27] CTIA Comments at 22-23 (discussing appropriate changes to non-rural cost model for application to RLECs).

determined by the demographic characteristics of a geographic area unrelated to LEC study areas, such as the population density of each zip code or Census block group in a carrier's service area. Because this approach is based on cost factors of the area to be served, rather than carrier characteristics, the criteria could not be manipulated, and support could be more accurately targeted.[28] Dobson Cellular Systems, Inc. ("Dobson") points out that the recent *Rural Spectrum Order* established a presumption that "rural area" be defined as counties with a population density of 100 persons per square mile or less. The Commission noted that such a definition would not be difficult to administer because county boundaries do not change, and population data is widely available.[29] Some RLEC interests also endorsed a density-based eligibility criterion for USF support as preferable to an access line threshold.[30]

## IV. FORWARD-LOOKING COSTS ARE WORKABLE FOR RURAL OPERATIONS

A wealth of authority, supported by the economic literature, supports the wireless commenters' position that USF support should be based on forward-looking costs in order to ensure that the level of support is no greater than is necessary to ensure reasonable rates and to provide the efficiency incentives to carriers that facilitate the development of competition and that ultimately will reduce their costs and, thus, their need for support.[31]

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[28] Western Wireless Comments at 32-34.

[29] Dobson Comments at 5, citing *Facilitating the Provision of Spectrum-Based Services to Rural Areas and Promoting Opportunities for Rural Telephone Companies to Provide Spectrum-Based Services*, WT Docket No. 02-381, FCC 04-166, ¶ 11 (Sept. 27, 2004) ("*Rural Spectrum Order*").

[30] *See, e.g.,* Frontier and Citizens Comments at 5.

[31] *See, e.g., Joint Board Notice,* 19 FCC Rcd at 16090; *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8899-8900 (1997) (subsequent history omitted). *See also* Nextel Comments at 7; CTIA Comments at 19; Western Wireless Comments at 17-21.

Various parties have suggested ways to respond to RLEC objections to the use of forward-looking costs. RLECs claim that because that approach allegedly does not account for the variability of rural operations, its application to rural areas is administratively unworkable and cannot meet the requirements of sufficiency and predictability. As various parties have explained, however, the inputs to the forward-looking Synthesis Model used in calculating non-rural high-cost support can be adapted for rural areas and updated. Western Wireless points to the economic analysis that it submitted outlining the steps necessary to develop a workable rural forward-looking cost model.[32] CTIA points out that the *Rural Task Force Order* rejected the notion that forward-looking support was not suitable for RLECs and found that it could be adapted for RLECs by updating model inputs and using different benchmarks and averaging conventions.[33] In arguing that a forward-looking mechanism cannot provide sufficient support for rural carriers, RLECs ignore that excessive support can also violate the sufficiency requirement.[34]

Western Wireless suggests alternative ways of modifying the Synthesis Model, including, as an interim "reproduction cost" approach, starting with actual RLEC costs and adjusting them to reflect cost changes in order to develop the forward-looking costs of constructing a network reflecting the routing and topography of the RLEC's actual facilities.[35] Ultimately, Western Wireless and other parties propose for the long term a forward-looking cost model based on the most efficient technology in each service area -- whether it is wireline, wireless, cable, or

[32] Western Wireless Comments at 24.

[33] CTIA Comments at 20, citing *Rural Task Force Order*, 16 FCC Rcd at 11311-12.

[34] CTIA Comments at 20-21, citing *Alenco*, 201 F.3d at 620.

[35] Western Wireless Comments at 25-27.

otherwise. Once there is a forward-looking cost model based on the most efficient, least-cost, technology in a given area, whatever technology that may be, USF support for all eligible carriers serving that area, whether wireline, wireless or otherwise, should be limited to the difference between the amount derived from the least-cost technology forward-looking model, and the appropriate benchmark rate level.[36] If a carrier has higher costs in that area, the embedded excess should not be subsidized by USF support.[37]

CTIA suggests that funding rules under a unified forward-looking cost model could be framed to ensure that support is more widely available for all carriers than it is under the non-rural forward-looking model used today. Under the current non-rural high-cost mechanism, funding is available only where the statewide average forward-looking cost of non-rural service is above a certain nationwide average non-rural cost benchmark, irrespective of the high costs experienced by a particular non-rural LEC. Thus, non-rural high-cost support is available to LECs in only ten states. CTIA proposes that such statewide averaging be eliminated.[38] Support could then be provided for particular study areas or wire centers above a certain nationwide benchmark, irrespective of the statewide average.

[36] *Id.* at 27-28; Dobson Comments at 6-7; CTIA Comments at 26-27.

[37] General Communication, Inc.'s ("GCI's") expert, David Sappington, points out that the RLECs' carrier-of-last-resort obligations do not significantly add to their overall costs and thus do not justify a higher level of USF support. Moreover, wireless carriers take on similar obligations in securing ETC status. David E.M. Sappington, *Harnessing Competitive Forces to Foster Economical Universal Service* at 38-39 (Oct. 15, 2004) (attached to GCI's Comments as Exhibit B).

[38] CTIA Comments at 25.

## V. T-MOBILE RECOMMENDS A TRANSITION TO A SINGLE, UNIFIED FORWARD-LOOKING USF PLAN FOR ALL ELIGIBLE CARRIERS

For the reasons set forth above, T-Mobile agrees with CTIA and other wireless commenters that the dysfunctional rural embedded cost USF regime must be radically overhauled in order to return the USF focus to affordable rates for consumers in high-cost areas, while promoting economic efficiency and competition in rural areas. Because of the practical need to have a plan in place by the expiration of the current five-year plan in mid-2006, an interim plan should be implemented by that date while transitioning to a single, unified forward-looking USF program for all eligible carriers. Although this proceeding is limited to replacing the current five-year rural high-cost plan, it has become clear that any fully effective USF reform requires that all USF cost support programs be merged into a single program. It is illogical and unwieldy to allocate USF support according to whether the carrier providing service to a customer in a high-cost area is a price-cap or ROR carrier, or is rural or non-rural.[39] All that should matter is the cost characteristics of the service area in question.

In summary, T-Mobile recommends the following interim plan, to be effective July 1, 2006:

- The forward-looking high-cost model support fund now available to non-rural LECs should be applied to any RLEC study area with 50,000 or more access lines, to the statewide operations of any RLEC with 100,000 or more lines in a state, or to the nationwide operations of any RLEC with a total of one million or more lines. Smaller RLECs not meeting any of these thresholds may continue receiving rural embedded high-cost support during the transition.

- Smaller RLECs that continue to qualify for rural high-cost support should be required to calculate their embedded costs on a statewide basis in determining the amount of support they receive.[40]

[39] *See* Nextel Comments at 4-5, 12; CTIA Comments at 12-14, 17-19, 21, 25-26; Western Wireless Comments at 12-15.

[40] Western Wireless Comments at 36.

- Non-loop costs, such as risk-related profits and Corporate Operations Expenses ("COE"), should be removed from the rural high-cost mechanism, and the current 11.25 percent authorized ROR, established for the Bell companies in 1991, should be significantly reduced to reflect the true current cost of capital. As CTIA and other commenters point out, COE are not directly related to universal service loop costs, and *Lost in Translation* demonstrates that one-third of COE is attributable to inefficiencies.[41] The current cost of RLEC debt is 5.46 percent, far below the Bell company cost of debt of 8.8 percent when the 11.25 percent rate was prescribed.[42]

- The eligibility threshold for LSS should be reduced to make it available only to RLECs with fewer than 25,000 access lines in a study area, rather than 50,000 lines, in order to prevent mid-sized RLECs with just under 50,000 lines in a study area from exploiting regulatory arbitrage opportunities. As CTIA points out, improved economies of scale make it possible to purchase digital switches more cheaply than was previously possible.[43]

- As CTIA suggests, the Commission should freeze further growth in the current embedded cost support programs. LSS and ICLS should be frozen at current levels, and the rural high-cost fund should be capped at the 2005 level.[44]

- Rural high-cost support should be eliminated for rural exchanges or RLECs acquired by non-rural LECs.[45] The acquired exchanges or RLECs could receive USF support only if they qualified for non-rural support.

In the longer term, after an appropriate transition:

- All LECs should be moved from the inconsistent hodge-podge of funds they currently receive to a single, unified forward-looking, least-cost technology support fund.

- Eligibility for the new USF program should be based on population density or other cost characteristics of the area to be served, rather than carrier characteristics.

- To receive funding under the new USF program, a carrier should be required to charge local rates that are no lower than the average urban local rate.[46] Section 254 of the

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[41] CTIA Comments at 11; Nextel Comments at 9-10. *See also Lost in Translation* at 33-43.

[42] CTIA Comments at 10.

[43] *Id.* at 24. *See also* Nextel Comments at 11-12.

[44] CTIA Comments at 24.

[45] *See* Dobson Comments at 9.

[46] *See id.* at 8-9.

Communications Act provides no support for "over-subsidizing" rural telephone service to the point that it is less expensive than that provided in urban areas. Rather, it requires that rural consumers pay rates "that are reasonably comparable to rates charged for similar services in urban areas."[47] Thus, RLECs should be eligible to receive high-cost universal service funding only if they charge rates that are no less than the nationwide average urban rate. This restriction also would encourage rate rebalancing, a necessary step in any long-term USF reform.

- The Joint Board and Commission should consider other possible market-based reform mechanisms, as Nextel and other commenters suggest, such as providing USF support through end users, rather than directly to carriers, and auctioning support to the carrier that offers to provide service for the lowest amount of subsidy.[48] In that way, the Commission could be assured that the USF program meets the statutory goal of providing "sufficient funding of customers, not providers."[49]

## VI. CONCLUSION

The current rural embedded high-cost support fund requires fundamental reform along the lines proposed by CTIA and other wireless carriers in order to salvage the original goals of the USF program. Targeting the level and scope of funding so that it is directed only to those areas that require support is necessary to achieve the goal of ensuring affordable rates in rural areas without unduly burdening consumers in non-rural areas. That can only be accomplished by means of a forward-looking, least-cost support mechanism, which can provide efficiency incentives that will, in time, lessen the need for support. Once an interim rural USF transition

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[47] 47 U.S.C. § 254(b)(3).

[48] *See, e.g.,* Nextel Comments at 12; CTIA Comments at 27. Funneling USF support through end users would be consistent with the requirement in Section 254(e) that only ETCs receive USF support. In effect, the consumer would choose which ETC received the support.

[49] *See Alenco*, 201 F.3d at 620.

plan is implemented, the Commission should devote whatever resources are necessary to develop a forward-looking cost model that can be applied to rural service areas.

Respectfully submitted,

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