Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Federal-State Joint Board On Universal Service Seeks Comment On Proposals To Modify The Commission's Rules Relating To High-Cost Universal Service Support	)	
	)	

COMMENTS OF
FAIRPOINT COMMUNICATIONS

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I. INTRODUCTION AND SUMMARY

FairPoint Communications, Inc. (FairPoint) hereby submits these comments in response to the Federal-State Joint Board on Universal Service's (Joint Board) Public Notice, released August 17, 2005.

FairPoint provides telecommunications services to 246,000 rural access lines in 17 states across the country. FairPoint's operations consist of 28 rural study areas serving customers through a total of 84 rural wire centers. FairPoint's smallest study area consists of 329 access lines served by a single wire center, and its largest study area serves 35,217 access lines through four wire centers.

FairPoint is an active Member of the Organization for the Promotion and Advancement of Small Telephone Companies (OPASTCO) and the Western Telecommunications Alliance (WTA). To the extent that FairPoint's comments do not address certain issues raised in the Joint

Board Notice or that are otherwise covered in the OPASTCO or WTA comments, FairPoint supports the position advanced in the OPASTCO and WTA comments.

The Notice seeks comment on four specific proposals for universal service funding support submitted by state Joint Board members and staff that are attached as Appendices to the Notice. In general, all four plans propose that federal universal service support ultimately be shifted to block grants to the states, also called a State Allocation Mechanism (SAM), and that each state would distribute such support to Eligible Telecommunications Carriers (ETCs) within their state. The plans differ in the specifics on how this distribution would be accomplished, including how cost would be determined, what benchmarks would be used, how specific allocations would be determined, and other transitional issues. In addition, the proposal by Mr. Gregg proposes a number of short-term and mid-term changes to the existing federal universal service support mechanisms.

As will be more fully detailed in the remaining sections of these comments, FairPoint believes that, while certain parts of several of these proposals contain ideas or concepts that could serve the public interest[1], many of the proposals, particularly proposals to convert federal universal service programs to "Block Grants" administered at the discretion of the states, could seriously harm the universal service goals articulated in the Telecommunications Act of 1996.

The instant Notice represents the second time within the past year that the Joint Board has requested comments regarding fundamental reform of the universal service distribution

[1] Specific proposals that FairPoint believes could be helpful include Mr. Gregg's proposal to base support to competitive ETCs on their own costs, the Bluhm/Shiffman/Pursley proposal to establish a separate support program for wireless CETCs with appropriate technology-specific goals and metrics, and recommendation in Commissioner Nelson's proposal to expand the funding base for universal service support so that all carriers that utilize the PSTN be required to contribute to the USF as soon as possible.

mechanisms. On August 16, 2004, the Joint Board issued a Notice[2] seeking comment on issues relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the Federal Communication Commission's (FCC, Commission) Rural Task Force (RTF) Order.[3] The Notice sought comment in three general areas:

1. Whether a rural universal service support mechanism based on embedded cost or forward-looking economic costs best achieves the goals of the 1996 Act?

2. Whether the definition of rural telephone companies should be changed or modified for the determination of high-cost support, and if other changes in the calculation of rural high-cost support should be implemented.

3. Whether the Commission's rules regarding support for transferred exchanges should be retained or modified?

On October 15, 2004, FairPoint filed comments in response to this Notice which provided facts and data regarding the impact of specific universal service reform ideas on rural consumers served by companies such as FairPoint. Among the significant points made in these comments were:

- Nothing has changed since the original RTF recommendations were made that would make a forward-looking proxy model any more acceptable now for determining sufficient high-cost support levels for rural carriers.

- Rural carriers such as FairPoint are a small fraction of the size of the RBOCs, and thus have nowhere near their scale and scope economies. Thus forward-looking proxy models that may be appropriate for the RBOCs would be totally inappropriate for larger rural carriers and rural holding companies such as FairPoint.

- It would not serve, and indeed would harm, the public interest to subdivide the universe of rural telephone companies for purposes of developing different high-cost support mechanisms.

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[2] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, FCC 04J-2 (rel. Aug. 16, 2004) (Public Notice).

[3] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers,* CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (2001) (Rural Task Force Order).

- The dispersed nature of rural serving areas does not provide scale and scope efficiencies in the construction and maintenance of loop plant, and rural communities have smaller population clusters, resulting in fewer lines per switch. For this reason it would not be in the public interest to average support among multiple rural study areas in a state.

- Support to Competitive Eligible Telecommunications Carriers (CETCs) should be based on each ETCs cost of providing universal service.

- The Joint Board could help to improve and modernize services to many rural consumers by modifying the Safety Valve mechanism to provide incentives for carriers to invest in acquired rural exchanges.

FairPoint incorporates the facts and data articulated in its October, 2004 comments into the instant proceeding, and will rely on this information in responding to the four specific proposals.

II. THE CURRENT UNIVERSAL SERVICE SYSTEM HAS SERVED RURAL CONSUMERS WELL, AND CHANGES SHOULD ONLY BE MADE THAT WOULD ALLOW THESE PROGRAMS TO BETTER ACHIEVE DEFINED PUBLIC INTEREST GOALS

By any reasonable measure, the current universal service system has been a magnificent success, providing millions of rural consumers with access to affordable telecommunications and information services that they otherwise would not enjoy absent the incentives provided for facilities investment in high-cost rural and insular areas. Changes to the current regime should only be undertaken when they can be shown to have a clear and positive benefit to the rural consumer.

The ultimate touchstone against which any proposal for universal service reform must be measured is the universal service goals articulated in Section 254(b) of the Telecommunications Act of 1996. Those goals are:

1. Quality services should be available at just, reasonable and affordable rates.

2. Access to advanced telecommunications and information services should be provided in all regions of the Nation.

3. 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.

4. All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service

5. There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.

In addition to assuring the basic universal service goals of the Act, there are two specific concerns related to universal service funding that have developed recently, and against which any proposed USF revisions should also be measured:

- The rapid growth in support to competitive ETCs[4]; and
- The need to incent investment in rural infrastructure that will bring greater access to broadband services to rural consumers.

III. MEASURED AGAINST THE CRITERIA IDENTIFIED IN SECTION II, ABOVE, THERE ARE SEVERAL ASPECTS OF THE PROPOSED PLANS THAT ARE POSITIVE AND WOULD EFFECTIVELY SERVE THE PUBLIC INTEREST

Measured against the universal service goals of the 1996 Act, the need for a more rational competitive ETC funding program, and the need for a more sustainable universal service contribution mechanism, several elements of the proposed plans could bring positive change:

A. Determine Support Based on Each ETC's Own Costs

In his *Three Stage Package for Universal Service Reform*, Mr. Gregg proposes that "For those rural study areas remaining on embedded cost support, base per line support on each ETC's

[4] In its Order directing the Joint Board to examine criteria for designating competitive ETC's the Commission noted its intention to closely monitor growth in the fund "consistent with its obligation under section 254 to maintain a specific, predictable and sufficient universal service fund." *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Order, FCC 02-307, released November 8, 2002, at paragraph 5.

own costs, capped at the per line support of the incumbent."[5] In describing the rationale for this proposal, Mr. Gregg states "Basing embedded cost support on each carrier's own costs would prevent potential windfalls to competitive ETCs with lower cost structures than incumbents. Capping support would prevent competitive ETCs from reaping unreasonable per line support on an embedded basis simply because they serve few lines."[6]

The following chart shows the dramatic growth in annualized support to competitive ETCs (CETCs) through the third quarter of 2005:

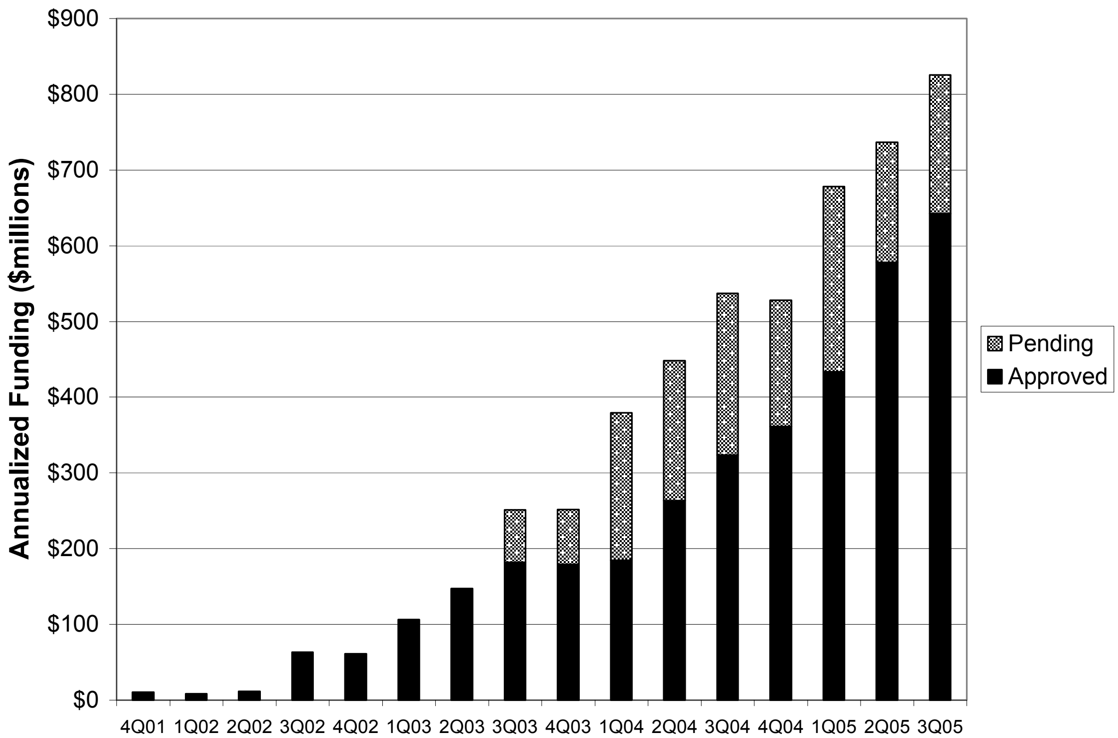

Chart I

In January of 2003, OPASTCO issued a white paper in which it predicted that if ETC status were granted to all wireless carriers nationwide, that this could add approximately $2

[5] Notice Appendix B at page 9
[6] *Id* at page 10.

billion annually to the USF, a result which it notes would be clearly unsustainable.[7] Current trends as illustrated on Chart I clearly show that such support is moving towards the levels projected by OPASTCO.

While Mr. Gregg notes that wireless carriers may have a "lower cost structure" than the incumbent, the reasons for this difference are likely due more to the area served by the wireless carrier than any inherent cost advantages of wireless technology. Both wireless and wireline networks are relatively low cost in cities and towns where population concentrations are high.[8] Similarly, both technologies become very costly on a per customer basis in remote and sparsely populated rural areas. In the recent ETC Designation Order[9], the FCC has attempted to ensure that wireless ETCs commit to serve throughout the designated service are through the requirement to submit a five-year build-out plan. Mr. Gregg's proposal to base support on the actual cost of the CETC would appear to be a more efficient means to accomplish this objective, and would provide additional investment incentives, as high-cost support would only be provided as high-cost areas were actually served.

B. Restructure Support to Competitive ETCs

The *Universal Service Endpoint Reform Plan* (USERP) proposed by Joint Board staff members Peter Bluhm (VT), Jeff Pursley (NE) and Joel Shifman (ME) proposes a totally different approach to providing universal service support to wireless carriers. FairPoint believes that the CETC funding proposals made in this plan would be far superior to the current regime which provides equivalent per-line funding at the wireline incumbent's level. Their plan would

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[7] *Universal Service in Rural America – A Congressional Mandate at Risk*. Organization for the Promotion and Advancement of Small Telephone Companies, January, 2003 at pages viii and 21. It is worth noting that if the calculations used by OPASTCO were updated using current data, the impact would be closer to $3 billion.

[8] Wireless networks, due to the mobile nature of their service, also are less costly on a per customer basis in areas frequented by large numbers of mobile users, such as along major highways.

[9] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, FCC 05-46, released March 17, 2005.

establish a separate fund for wireless carriers that would focus on the unique aspects of mobile wireless service, and provide specific incentives to "substantially improve wireless coverage in unserved areas, with a particular emphasis on unserved areas with major roads."[10] Unlike the present system, such a plan would provide specific investment incentives for wireless carriers to serve remote rural areas, and would provide specific and tangible consumer benefits.

C. Restructure USF Collection Mechanism

The current USF collection mechanism is based on an assessment against interstate and international end-user revenues. With the continuing evolution of the telecommunications and information service markets, the current collection mechanism is becoming unsustainable. The collection mechanism must be restructured, and the funding collection base must be broadened. The *Holistically Integrated Package* proposed by Commissioner Nelson addresses the reform of the collection mechanism.[11] FairPoint believes that a collection mechanism that assesses all telecommunications and information service providers that benefit from the availability of ubiquitous and affordable network connections will best serve the public interest and the important goals of universal service.

IV. MANY OF THE MODIFICATIONS PROPOSED IN THE FOUR PLANS WOULD FAIL TO ACCOMPLISH THE PUBLIC INTEREST GOALS DESCRIBED IN SECTION II, ABOVE, AND WOULD HARM THE PUBLIC INTEREST

Many of the proposals contained in the Notice would have serious negative consequences for rural infrastructure investment and for rural consumers.

A. Short Term Proposals

Mr. Gregg proposes a number of short term proposals that would have a serious and negative impact on rural infrastructure investment:

[10] Notice Appendix D, at page 27.
[11] Notice Appendix C, at page 18.

1. Freeze Per-Line Support Upon Competitive Entry

As described by Mr. Gregg, this proposal would "freeze per-line support for the incumbent upon entry of a competitive ETC."[12] This proposal would have very significant impact on the services that rural consumers receive, as it would effectively break the link between universal service support and investment. Private capital is invested only when there is a reasonable expectation of a positive return on that investment. The current universal service system has been successful because providers have been assured that if they make investment in high-cost areas, the fund will provide adequate compensation for what otherwise would be an uneconomic investment. If universal service funding is capped at current levels, there would no longer be any incentive to invest in such areas. This would be a particularly disastrous policy choice in light of the national policy objective of President Bush to provide broadband service to all rural consumers by 2007.[13]

Implementing a "freeze on competitive entry" provision would also be unwise because it seeks to address a problem that does not, for the most part, exist. In its original conception, this proposal sought to eliminate the upward spiral of funding that would exist if:

- Incumbents lost lines to competitors,
- Incumbent's per-line support went up as line count went down but costs remained largely unchanged due to the fixed-cost nature of many telecommunications investments;
- CETCs also received the higher per-line support levels.[14]

The problem with this scenario is that this is not how local rural "competition" is playing out. With few exceptions, CETCs are wireless carriers and represent complementary rather than

[12] Notice Appendix B at page 8
[13] Reuters UPDATE – *Bush pushes broadband rollout by 2007*, March 26, 2004.
[14] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, released September 29, 2000, at page 26.

replacement products. Even with the significant growth of CETC funding shown on Chart I, funding to incumbent LECs has not increased materially over this time period.[15] Thus, while freezing per-line support on competitive entry will have an immediate and chilling effect on rural investment, it will do little or nothing to control fund growth. A more effective way to control fund growth and also serve the public interest would be to base each CETC's support on their own costs, and through programs that incent technology-specific investment in unserved rural areas.

2. Combine Study Areas

Under this proposal "all study areas within a state owned by a single company would be combined into one study area for universal service purposes."[16] As documented more fully in FairPoint's October 2004 comments, arbitrarily combining study areas in a given state would not be in the interest of rural consumers. While FairPoint is a holding company serving 246,000 access lines nationwide, it is in reality a collection of 28 rural study areas, with cost and operating characteristics similar to the overall body of small rural telephone companies. To the extent that a holding company structure provides scale economies, those will be reflected in the actual cost structure of its study areas.

Section 254(e) requires that universal service support be "explicit". Whenever costs are averaged over larger service areas this has the effect of having consumers in the lower cost areas subsidize customers in the higher cost areas. Combining existing study areas within a given state for support determination purposes implicitly assumes that scale economies in the provision of service will result from such a combination. This is usually not the case, as the rural service areas are often separated by long distances. More importantly, the higher costs of installing and

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[15] ILEC high-cost funding (excluding ICLS and IAS but including LTS) for the past four years is 2002 - $2.139B, 2003 - $2.121B, 2004 - $2.176B and 2005 $2.169B.
[16] Notice Appendix B at page 8.

maintaining loop plant in one sparsely populated area is not materially affected by the provision of loop plant in a different sparsely populated service area located a hundred miles or more away. Similarly, the higher costs of operating a switch with a small number of lines in one rural community is totally unaffected by the fact that the same company may operate another switch serving a small number of access lines in a distant community. FairPoint's October, 2004 comments provide specific facts, data and illustrations of study areas in the states of Colorado and Illinois that illustrate why combining study areas would not serve the needs of rural consumers receiving service in these areas.

3. Move Large Carriers to the Model

Mr. Gregg proposes that "All rural carriers serving 100,000 lines or more within a state would have support determined pursuant to the Commission's high-cost model, just as it is for non-rural carriers."[17] While this specific proposal would not impact FairPoint, we feel compelled to reiterate our concerns with forcing a model developed for RBOCs on rural carriers a tiny fraction of their size, and on rural consumers, who depend on universal service support for affordable basic and broadband network connections. As more fully documented in FairPoint's October, 2004 comments, nothing has fundamentally changed since the Rural Task Force issued its recommendations in September of 2000[18] and concluded that the proxy model was inappropriate for use with rural telephone companies. Furthermore, the Commission itself has expressed concerns regarding whether forward-looking cost models, in general, have produced the intended results.[19] Universal service support based on actual embedded cost provides rural

[17] *Id.*
[18] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, released September 29, 2000, at pages 17-18.
[19] Notice of Proposed Rulemaking, WC Docket No. 03-173, FCC 03-224, Released September 15, 2003.

consumers with affordable network connections, and provides the appropriate incentives for investment in networks capable of providing access to broadband services in more rural areas.

B. Moving Federal universal service support mechanisms to "Block Grants" to the states would not serve the public interest

The most obvious problem with taking the current universal service mechanisms and providing monetary block grants to the states to spend at their discretion is that it would de-link rural infrastructure investment and universal service support. Furthermore, it would eliminate a valuable federal tool to incent the delivery of broadband services to rural consumers. Congress specifically gave the Commission authority over federal universal service programs, while at the same time encouraging state commissions to establish state-specific mechanisms to preserve and advance universal service.[20]

In addition to the important legal and policy reasons why the current federal universal service system should not be scrapped in favor of state Block Grants, there is another practical consideration that should not be ignored. The Commission has recently opened an inquiry into the management and administration of the universal service fund. It is important to note that the current fund operates on a single national set of rules and principles. If each state were to establish its own unique rules and procedures for the distribution of federal funds it would create a level of complexity, both in terms of policy implementation and administrative cost, which cannot be ignored.

C. Eliminating the Distinction Between Rural and Non-Rural Carriers Without Providing Specific Supplemental Funding Would Harm Rural Consumers

[20] Sections 254(b)(5) and 254(f).

In October of 1999, the FCC issued its Ninth Report and Order in CC Docket 96-45[21] in which it outlined the new high-cost universal service support mechanism for non-rural carriers. The non-rural mechanism is based upon a forward-looking proxy model developed by the Commission and described in the Tenth Report and Order in CC Docket No. 96-45,[22] and provides high-cost support to a state when the weighted average forward-looking cost for all non-rural wire centers within a state exceeds 135 percent of the weighted average cost for all non-rural wire centers nationwide. The rationale for this using statewide average cost is that the non-rural mechanism provides funding "sufficient to enable reasonably comparable rates among states, while leaving states with sufficient resources to set rates for intrastate services that are reasonably comparable to rates charged for similar services within their borders."[23]

One of the consequences of the Ninth Report and Order is that in many states significant implicit support remains within the universe of non-rural carriers, with low-cost non-rural wire centers subsidizing high-cost non-rural wire centers.[24] In essence, this implicit support represents an unfunded liability if policy makers seek to provide additional explicit support to high-cost non-rural wire centers. Another unintended consequence of the non-rural support mechanism is that in many non-rural areas investment in rural wire center infrastructure has lagged behind the more urban areas of these companies, and rural customers of non-rural carriers have less access to broadband services than consumers in similar areas served by rural carriers.

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[21] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, FCC 99-306, released November 2, 1999.
[22] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Tenth Report and Order, FCC 99-304, released November 2, 1999.
[23] Ninth Report and Order at paragraph 7.
[24] The term "non-rural" carrier is an unfortunate historical accident, as it refers primarily to the size of the carrier, and not to the nature of the territory served. Indeed, many non-rural carriers serve significant amounts of rural territory. Generally such carriers also serve large numbers of low-cost customers in urban areas. In contrast, most rural carriers lack large concentrations of low-cost urban customers, and rely on the separate rural high-cost mechanism to provide comparable services at reasonably comparable rates.

Several of the proposals seek to eliminate the distinction between the non-rural and rural high-cost mechanisms by converting existing federal support mechanisms into Block Grants to the states that would be allocated by the state to high-cost wire centers whether they are served by non-rural carriers or rural carriers. While the status of rural customers of non-rural carriers is a valid policy issue, FairPoint is concerned that if such a change is made without also recognizing the significant unfunded liability that exists for the high-cost non-rural wire centers, that rural consumers of the rural carriers would be significantly harmed.

A rough estimate of the unfunded liability for high-cost non-rural wire centers can be determined by using the data from the Commission's high-cost model and, instead of computing the amount of statewide average cost that exceeds 135 percent of the nationwide average cost, computing the amount by which the cost of each individual wire center exceeds 135 percent of the nationwide average.[25] Using this formula, total high cost support needs for high-cost non-rural exchanges is approximately $2.6 billion annually. If the calculation is performed using the 115 percent of nationwide average costs benchmark that is currently used in the rural high-cost mechanism, the total high-cost support need for high-cost non-rural wire centers would be approximately $3.5 billion. Data from USAC report HC01 for the fourth quarter of 2005 shows that total federal high cost support for all incumbent local exchange carriers, rural and non-rural, to be approximately $3.2 billion, of which $2.5 billion is received by rural carriers, and $700 million by non-rural carriers. The unfunded liability for non-rural high cost wire centers can thus be estimated to be between $1.9 billion ($2.6 B - $0.7B = $1.9B) using a 135% benchmark, and $2.8 billion ($3.5B - $$0.7B = $2.8B) using a 115% benchmark.

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[25] The data necessary to perform this calculation can be found in an Excel spreadsheet at http://www.fcc.gov/wcb/tapd/hcpm/wcsupport.xls. As stated earlier in these comments, FairPoint believes that proxy models are inappropriate for determining "sufficient" support levels for rural carriers. The Commission's proxy model is being used to rough-size the unfunded liability for non-rural carriers because it is the only publicly available data for this purpose, and it is being applied to non-rural company wire centers.

While providing additional explicit universal service support to high-cost non-rural wire centers may be a valid concern, this should not be done at the expense of rural consumers served by rural carriers. Unless specific supplemental funding in the $1.9 to $2.8 billion per year range is provided, attempting to fund high-cost rural wire centers of both rural and non-rural carriers from the current $3.2 billion of federal high-cost support will result in a significant shortfall of "sufficient" high-cost funding to rural carriers, with catastrophic consequences to the rural consumers served by their carriers.

V. CONCLUSION

For all of the reasons described above, FairPoint recommends that the Joint Board:

- Continue to base its rural high-cost support mechanism on embedded cost;
- Apply the rural high cost support mechanism to "rural telephone companies" as defined in Section 3(37) of the 1996 Act;
- Reject proposals to convert existing federal high-cost support programs into Block Grants to the states;
- Determine support for competitive ETCs based upon their own cost; and
- Expand the funding base for universal service support so that all telecommunications and information service providers that benefit from the ubiquitous and affordable telecommunications network contribute to its maintenance and enhancement.

Respectfully submitted,

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(via electronic filing) .

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