

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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

To: The Joint Board

**REPLY COMMENTS OF
QWEST COMMUNICATIONS INTERNATIONAL INC.**

Craig J. Brown
Suite 950
607 14th Street, N.W.
Washington, DC 20005
(303) 383-6649

Attorney for

QWEST COMMUNICATIONS
INTERNATIONAL INC.

October 31, 2005

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND SUMMARY	1
II. HIGH COST SUPPORT, PARTICULARLY FOR RURAL CARRIERS, NEEDS TO BE CONTAINED.....	4
A. The Fund Has Become Huge, With Little Indication That The Money Is Being Spent In A Way That Furthers The Goals Of Section 254.....	5
B. Universal Service Should Not Be Subsidizing Rural Carriers’ Broadband Deployments, Or Their Entry Into Adjacent Territories.....	7
C. The Joint Board Should Recommend Certain Immediate Steps To Constrain The Size Of The Federal Fund	10
III. THERE IS NO JUSTIFICATION FOR THE CURRENT DISPARITIES BETWEEN THE RURAL AND NON-RURAL HIGH COST PROGRAMS.....	14
A. The Distinctions In The Rural And Non-Rural Programs Are Inequitable	15
B. Competition Has Eliminated The Ability Of Non-Rural Carriers To Subsidize The High Cost Areas They Serve.....	17
C. The Costs Faced By Small And Large Telephone Companies In High Cost Areas Are Roughly The Same	17
D. The Holdings Of The Tenth Circuit In <i>Qwest I</i> And <i>Qwest II</i> Should Be Applied To Both Rural And Non-Rural Companies.....	18
IV. CONCERNS ABOUT THE BLOCK GRANT PROPOSALS CAN BE OVERCOME THROUGH CLEARLY DEFINED AND OBJECTIVE COMMISSION GUIDELINES AND OVERSIGHT	19
V. CONCLUSION.....	22

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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

To: The Joint Board

**REPLY COMMENTS OF
QWEST COMMUNICATIONS INTERNATIONAL INC.**

Qwest Communications International Inc. (“Qwest”) submits the following reply comments in response to the Federal-State Joint Board on Universal Service’s (“Joint Board”) proposals to modify the Federal Communications Commission’s (“Commission”) rules relating to high cost universal service support.¹

I. INTRODUCTION AND SUMMARY

As the lead petitioner in both appeals to the Tenth Circuit of the Commission’s high cost rules for the so-called non-rural carriers, Qwest has been an active participant in the Commission’s repeated efforts to adopt a universal service high cost mechanism for non-rural carriers that complies with the statute. Over time, Qwest’s views regarding the high cost programs have evolved, as the programs have grown larger and more fragmented, with only a loose connection to the principles of Section 254.

In the latest remand by the Tenth Circuit, the court faulted the Commission for failing to tie the high cost program for non-rural carriers to the fundamental principles of Section 254 --

¹ *Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission’s Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, FCC 05J-1 (rel. Aug. 17, 2005) (“*Proposals Public Notice*”). Public Notice extending comment cycle, FCC 05J-2 (rel. Sept. 13, 2005).

sufficient support to ensure affordable and reasonably comparable rural and urban rates. These criticisms of the non-rural program are even more applicable to the high cost programs targeted to the areas served by rural incumbent local exchange carriers (“ILECs”), as the Commission has made no effort to determine whether the amount of high cost support being provided in those areas is sufficient -- or necessary -- to ensure affordable and reasonably comparable rates.

The court’s remand, and the pendency of the intercarrier compensation proceeding, therefore offer the Joint Board and the Commission an ideal time to revisit the fundamental underpinnings of the existing subsidy systems -- both implicit and explicit -- for providing telecommunications in the rural areas of America. As the Commission has found, high cost funding should be provided at levels that are sufficient to meet the goals of Section 254, and no more. Too much funding imposes unnecessary burdens on contributors, including lower-income consumers, who are most at risk of falling off the network. The Joint Board therefore should carefully consider all proposals to constrain or reduce the size of the fund, while continuing to meet the objectives of the Act.

Aside from the rural ILECs, there is significant consensus in the initial comments in this proceeding on a number of fundamental issues. *First*, the federal fund has grown too large, with no indication that it is accomplishing the core goals of universal service and Section 254. Indeed, the very size of the fund threatens to make telephone service unaffordable, in contravention of Section 254(b)(1). *Second*, the Joint Board and the Commission need to address high cost reform in a holistic manner, moving away from the piecemeal approach that characterizes the current system. *Third*, federal high cost support should be targeted to high cost areas, not to particular types of carriers or networks. There is no justification for the vastly different amounts of federal support provided in rural areas, depending on whether the

incumbent telephone company is a “rural” or “non-rural” carrier. *Fourth*, the Commission’s high cost rules must encourage efficient entry and provision of services in rural markets, regardless of the technology used by the new entrant. Current Commission rules for rural carriers reward inefficiency by providing support to all eligible telecommunications carriers (“ETCs”) on the basis of the rural ILEC’s embedded costs.

Taken together, the four proposals in the *Proposals Public Notice* provide a rough outline of high cost reform that would begin to satisfy these principles. Each of the proposals seeks in one way or another to constrain the size of the fund. The proposals also would eventually shrink the current disparities in funding between rural areas served by small (*i.e.*, rural) telephone companies and those served by larger (*i.e.*, non-rural) telephone companies. And the proposals would attempt to address the growth in the fund in areas served by competitive ETCs (“CETCs”). Finally, each of the proposals would give the states a greater role in determining the distribution of federal high cost support in their states.

Qwest agrees with these common aspects of the Joint Board’s proposals, but believes that the proposals need to be fleshed out in a number of ways. In its initial comments, Qwest suggested a number of modifications and refinements of the proposals. In particular, Qwest outlined federal guidelines that the Commission could adopt to ensure that states distribute high cost support in a manner consistent with the requirements of Section 254.

Not surprisingly, rural ILECs generally continue to argue for the status quo, which provides them more than 70 percent of the \$3.5 billion in total federal high cost support. They claim that they are entitled to continue to receive that support without a showing that it is actually needed to ensure affordable and reasonably comparable rates in the rural areas they serve. The rural carriers also claim that CETCs are the sole cause of recent fund growth. They

thus ignore the fact that growth in support to CETCs generally is not offset by any decline in funding to rural carriers -- even if a rural carrier loses customers to a CETC. The rural carriers also try to prop up the meaningless justifications for maintaining completely different methodologies for determining high cost support for rural and non-rural carriers.

A number of parties note the integral relationship between the issues raised in this docket and the pending intercarrier compensation proceeding and upcoming *Qwest II* remand.² Qwest agrees that reform of the rural support mechanisms must be considered in tandem with intercarrier compensation reform and the *Qwest II* remand. Qwest has made extensive submissions in the pending intercarrier compensation docket, which outline a means of rationalizing intercarrier compensation without increasing the federal universal service fund. Qwest's positions in that docket are closely linked to the views expressed in Qwest's initial comments and in this filing.

II. HIGH COST SUPPORT, PARTICULARLY FOR RURAL CARRIERS, NEEDS TO BE CONTAINED

The initial comments reveal deep and widespread concern about the size and growth of the high cost fund. This concern is heightened by the results of the last Monitoring Report, which showed a smaller percentage of customers on the network in 2004 than in 2003. Despite these concerns, the rural ILECs resist any change in the Commission's high cost rules that would reduce their high cost support. Indeed, many rural ILECs suggest that they need more support. These carriers contend that more funding is necessary for them to deploy broadband services, even though the Commission has found that broadband is not eligible for high cost funding.

² See, e.g., General Communication, Inc. ("GCI") at 9-11; AT&T Corp. ("AT&T") at 3-5; Frontier Communications and Citizens Incumbent Local Exchange Carriers ("Frontier") at 12-13; United States Telecom Association ("USTA") at 11. And see *Qwest v. FCC*, 398 F.3d 1222 (10th Cir. 2005) ("*Qwest II*").

Such comments reveal the degree to which the Commission's current high cost rules have become unmoored from the purposes of Section 254.

A. The Fund Has Become Huge, With Little Indication That The Money Is Being Spent In A Way That Furthers The Goals Of Section 254

As discussed in the initial comments of Qwest and numerous other parties, the federal fund has grown to alarming heights over the past five years. This growth has been concentrated in those programs targeted to areas served by "rural" carriers, particularly in rural areas in which CETCs have entered. The fund growth cannot all be blamed on CETCs, however. To the extent CETCs are gaining customers, one would expect a corresponding reduction in the incumbent's support in that area. That does not occur under the Commission's rules, however, because rural ILECs' support is based on their embedded cost, and all lines are eligible for high cost support. The Joint Board and Commission must undertake universal service reform that addresses all aspects of fund growth in the federal high cost programs.

Despite this continuing growth, rural ILECs want more. They assert that the Commission should eliminate the cap on the high cost loop fund and the other controls on the amount of support in these areas.³ Rural carriers also generally ignore the impact of fund increases on contributors. OPASTCO and other rural commenters assert that the Joint Board's proposals place too much emphasis on controlling the size and growth of the federal fund.⁴ But it is this "USF support grows on trees" mindset that has led to the bloated federal fund that exists today. The size of the fund is not merely an academic concern -- increases in the fund directly affect customer bills. End users of interstate telecommunications services currently face a federal surcharge, widely viewed as a tax, of approximately 10%. The increases in funding sought by

³ See, e.g., ACS of Alaska, Inc., *et al.* ("ACS") at 19-20.

⁴ See Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO") at 3-7.

rural ILECs would only worsen the situation. In this way, the size of the federal fund directly affects the affordability of telecommunications services, as well as the sustainability of the fund altogether.⁵ As the Fifth Circuit found, “excess subsidization may . . . detract from universal service by causing rates to unnecessarily rise, thereby pricing some consumers out of the market.”⁶ Based on the same reasoning, the Tenth Circuit upheld the Commission’s intention of making the fund “only as large as necessary.” The court found that this approach was consistent with the principle in Section 254(b)(1) of keeping rates affordable.⁷

Recognizing that the current situation is unsustainable, many rural carriers urge the Commission to modify the methodology used to determine universal service contributions. But contribution reform should not be used to hide the size of the fund, as some rural carriers appear to be advocating. Changing the contribution methodology ultimately cannot eliminate the burden that the mammoth universal service fund imposes on telecommunications users.

There is also no indication that the tremendous growth in high cost support over the past five years has furthered the goals of universal service. Traditionally, the success of universal service is measured in terms of penetration -- the percentage of customers on the network. According to the latest Commission figures, the national average penetration rate has fallen for the first time. Until 2002, average national penetration gradually climbed to approximately 95%.⁸ Between 2003 and 2004, however, the penetration rate (including both wireline and

⁵ See Oregon Public Utility Commission (“Oregon Commission”) at 6; the Verizon telephone companies (“Verizon”) at 4.

⁶ *Alenco Communs., Inc. v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000).

⁷ *Qwest II*, 398 F.3d at 1234.

⁸ Universal Service Monitoring Report, CC Docket No. 98-202, at 6-4 (rel. Oct. 2004) (“2004 Monitoring Report”).

wireless customers) had a “statistically significant” drop of 1.3%.⁹ In some states, penetration rates is lower in 2003 than they were in 1997, or even 1983.¹⁰ Given that funding for universal service programs are at the highest levels ever, these statistics on penetration should be very alarming to federal and state regulators.¹¹ The data also warrant a fundamental rethinking of the goals of universal service and the extent to which the current structure of universal service is furthering those goals.

B. Universal Service Should Not Be Subsidizing Rural Carriers’
Broadband Deployments, Or Their Entry Into Adjacent Territories

A number of rural ILECs suggest that their federal high cost support should be increased, or at least maintained at current levels, in order to spur broadband deployment in rural areas.¹² For example, CenturyTel urges the Joint Board to recommend expansion of rural high cost support to cover inter-office transport for broadband services and costs for loops that are not used to provide POTS services.¹³ These commenters ignore the fact that broadband is not a supported service. High cost support is available only for the provision of services that satisfy the requirements of Section 254(c), as interpreted by the Commission. Just two years ago, the Commission rejected proposals to designate broadband as a supported service, because it did not meet the Act’s criteria for inclusion in the list of supported services.¹⁴ Among other things, the Commission suggested that expansion of universal service to include broadband would not be in

⁹ *Id.*

¹⁰ *Id.* at 6-20-6-21 (Table 6.5).

¹¹ *See* National Association of State Utility Consumer Advocates (“NASUCA”) at 2.

¹² CenturyTel, Inc. (“CenturyTel”) at 4; National Telecommunications Cooperative Association (“NTCA”) at 6-7, 11; TDS Telecommunications Corp. (“TDS”) at 10.

¹³ CenturyTel at 12-13.

¹⁴ *In the Matter of Federal-State Joint Board on Universal Service*, Order and Order on Reconsideration, 18 FCC Rcd 15090, 15093 ¶ 8 (2003).

the public interest, because it could drastically increase the financial burden placed on carriers and ultimately consumers, as contributors to universal service.¹⁵

Thus, to the extent rural carriers are using high cost support today to fund their broadband deployments, that support is being used in a manner inconsistent with the statutory requirement that carriers use high cost support “only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.”¹⁶ GCI alleges exactly that. It claims that a rural incumbent in Alaska used high cost support to install shorter loop lengths than is necessary for telephony, in order to be able to offer video services over those facilities.¹⁷ If this allegation is true, that rural incumbent, and other rural incumbents like it, are effectively subverting the statutorily-defined process for determining supported services, and the Commission’s finding that broadband is not a supported service. And that’s not all. As GCI notes, the rural incumbent in such cases receives an unfair competitive advantage over its competitors, in violation of Section 254 and the Commission’s rules. These same concerns arise to the extent a rural ILEC uses high cost support received for one geographic area to subsidize its entry into an adjacent geographic area. In that situation, the support is being used in a manner

¹⁵ *Id.* at 15095 ¶ 11. Qwest does not dispute that the deployment of broadband to rural areas is in the national interest. But it is not clear that this effort needs to be funded through the high cost fund. Over the past seven years, Qwest has steadily increased the availability of DSL services in its local service territory, without the use of federal or state universal service support. Despite the rural character of its service territory, DSL is now available over 70 percent of Qwest’s access lines. Moreover, many smaller incumbents have taken advantage of grants and loans from the Rural Utilities Service. In just one example, RC Communications in Corona, SD received \$544,000 through RUS’ Community Connect Broadband Grant Awards program to build fiber to each of the premises within Corona, a town of 112 people. *See* <http://www.usda.gov/rus/telecom/broadband/comm-connect-summaries.htm>.

¹⁶ 47 U.S.C. § 254(e).

¹⁷ GCI at 5. It is reasonable to assume that deployments that bring fiber closer than 12,000 feet to the end user are being designed solely to improve broadband or video performance. The costs of such deployment should not be recoverable from universal service.

not intended under the Act, and is gaining for the rural ILEC an unfair competitive advantage over other carriers competing in that area. Such improper funding also makes the federal fund larger than is necessary. There is simply no reason a low-income customer in Newark, New Jersey should subsidize a small telephone company's entry into video services in Alaska,¹⁸ absent a finding by the Commission that such services meet the definition of a supported service in Section 254(c).

These scenarios of potential misuse of high cost support also point to two other problems with the Commission's current high cost rules. *First*, tying high cost support to rural ILECs' embedded cost makes it much more likely that such subsidization will occur. For the same reason, the provision of high cost support to CETCs based on their own costs is not the answer to controlling the size of the fund. The Commission should move away from the use of embedded cost as a basis for high cost support for any carrier. Reliance on embedded cost provides no incentives for efficiency and tends to result in overfunding of high cost support. Consistent with *Qwest II*, the Commission should shift its focus to ensuring that rates are affordable and reasonably comparable and that the other principles of Section 251(b) are satisfied. As noted by the Oregon Commission, "[t]here is no basis for an assumption that rates are based on cost."¹⁹ *Second*, if a carrier is using federal high cost support to subsidize its entry into broadband services or another geographic area, there is a strong indication that the carrier is receiving more high cost funding than it needs to provide supported services in the geographic area for which the support was intended.

¹⁸ See New Jersey Ratepayer Advocate at 24.

¹⁹ Oregon Commission at 8.

C. The Joint Board Should Recommend Certain Immediate Steps To Constrain The Size Of The Federal Fund

Qwest continues to believe that wholesale reform of federal universal service is required.

In its initial comments, Qwest suggested a framework for undertaking such reform through cooperative efforts between the Commission and the states.²⁰ But the need for broad reform should not delay the Joint Board and Commission from taking action now to control fund growth. In particular, the Joint Board should recommend the following immediate actions:

(1) freeze the rural and non-rural high cost programs at 2004 levels; (2) limit support to at most one connection per ETC for each household; and (3) adopt most aspects of Stage One of the Three Stage Package.

Freeze at 2004 Levels. As discussed in its initial comments, the Joint Board should recommend a freeze of both the rural and non-rural high cost programs at 2004 levels. Such a freeze would reverse some of the recent increases in the fund due to the increased entry of CETCs in rural areas. With respect to the programs at issue in this proceeding, the freeze should apply to High Cost Loop Support, Local Switching Support, Safety Net Additive Support, and Non-Rural High Cost Support.

The universal service system simply cannot sustain any more growth in these programs. Moreover, there are strong indications that the high cost support received by some rural ILECs is more than “sufficient.” Consistent with the Commission’s previous definition of this term, high cost support levels should be set no higher than is necessary to ensure that the applicable statutory requirements, including reasonably comparable and affordable rates, are satisfied.²¹

²⁰ Initial Comments of Qwest Communications International Inc. at 2-5.

²¹ See *In the Matter of Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559, 22578 ¶ 30 (2003) (“*Remand Order*”).

When comparing current levels of total federal universal service support by study area to study area non traffic sensitive (“NTS”) revenue requirements, it appears that some carriers recover more than their NTS revenue requirement from federal universal service funds, even without considering the various types of revenues they receive from end users (*e.g.*, for local, long distance, vertical features, broadband services) and other carriers (*e.g.*, from intrastate and interstate access charges).²² Typically, it is the NTS costs, such as the loop, that are the significant cost drivers in sparsely populated areas. The remaining traffic sensitive costs, such as switching, should exhibit less variance in rural and urban areas. Indeed, an analysis of NECA’s 2004 Study Results, which were released in September 2005,²³ indicates that many rural companies have switching costs that are no higher than larger companies such as Qwest.²⁴ To date, the Commission has not even attempted to determine whether the rural high cost programs are generating “sufficient” support.

As just discussed, at least some rural ILECs appear to be using federal high cost support to subsidize their provision of non-supported services or entry into other geographic markets, suggesting that those carriers are receiving more support than is necessary to provide the services for which the support is intended. There is also evidence that customers in some areas served by rural ILECs receiving high cost support are paying local rates significantly below the national

²² For example, South Park Telephone Company in Colorado received \$780,000 in total federal high cost support in 2005 for serving 163 lines, which works out to nearly \$400 per month in federal support for each line. *See* USAC Report HC01 - High Cost Support by State by Study Area-4Q2005. This support is \$76 more per month than the carrier’s NTS revenue requirement for each loop. *See* 2004 Monitoring Report, Table 3.30. South Park is not alone in this regard. At least seven other rural ILECs in Colorado alone receive more federal high cost support than their NTS revenue requirement.

²³ <http://www.fcc.gov/wcb/iatd/neca.html>.

²⁴ These results are obtained by dividing DL230_ACCT_2210 in USF2005LC05.xls, Column by Column DL070_CAT_13_LOOPS. A comparison of the switching costs for companies of various sizes is shown in Attachment A.

average.²⁵ Again this suggests that rural ILECs serving those areas are receiving more federal high cost support than they need. There is no justification for further growth of these programs.

One Connection Per ETC. As Verizon describes, the Joint Board and the Commission need to find a way to address the current inefficient subsidization of duplicate networks in rural areas.²⁶ An immediate way to constrain the size of the federal fund is to limit the number of connections eligible for support. Consistent with Qwest's initial comments, ETCs should be limited to at most one connection for each household they serve.

Such a limitation will properly balance the Commission's objectives of ensuring connectivity to the network while minimizing the contribution burdens that result from a large fund. As the Oregon Commission notes, policymakers have an obligation to ensure that no more money is spent on universal service than is necessary to provide a given level of service.²⁷ Limiting support to one connection per ETC for each household will also avoid the administrative difficulties of determining which ETC's connection is the primary connection.

Stage One of the Three Stage Package. The reforms in the Three Stage Package would begin to rationalize federal high cost programs by combining study areas within a state owned by a single company, moving large rural carriers to the Synthesis Model, freezing per line support upon competitive entry, and extending rate comparability review to rural carriers. Qwest

²⁵ See Sprint Nextel Corporation ("Sprint") at 10-11. Frontier freely acknowledges that local rates in many rural areas are lower than such rates in urban areas. Frontier's justifications for these differences are off the mark. Frontier at 8-9. Regardless of the events that led to the current situation, the fact remains that urban customers often are enabling customers in high cost areas to pay below market rates in such situations through their universal service contributions.

²⁶ Verizon at 7-9.

²⁷ Oregon Commission at 5.

supports each of these proposals, at least to the extent they constrain the size of the fund.²⁸ These proposals should not be controversial. The combining of study areas within a state, for example, is a sensible short-term step. As CTIA – The Wireless Association (“CTIA”) states, “[t]he artificial balkanization of carrier operations in a single state into multiple study areas creates opportunities for carriers to present themselves as smaller, and their costs higher, than their total statewide operations would reveal.²⁹ Ultimately concerns about the impact of combining a carrier’s study area within a state will be mitigated if high cost support is properly targeted to high cost wire centers, rather than study areas.

In contrast, the proposal in the Three Stage Package to determine support based on each ETC’s own costs appears to be unworkable, particularly in the short-term. It is unlikely that CETCs generally maintain the cost information that would be necessary for a regulator to determine the carriers’ costs, whether on an embedded or forward looking basis. Review of these costs could also impose a significant burden on regulators, which may not be warranted if the Commission intends to adopt a system that does not require the submission of such data. Qwest advocates that the Commission move away from the current reliance on embedded cost and high cost models. The Commission should instead rely on a simplified predictor of cost, such as households per square mile, plus an expanded rate certification process to ensure that rates are reasonably comparable and affordable.³⁰ If the Commission does so, the cost data sought in the Three Stage Package will be unnecessary.

²⁸ Qwest supports AT&T’s proposal to include large rural carriers in the statewide average in order to avoid an increase in model-based support. *See* AT&T at 4.

²⁹ CTIA at 2.

³⁰ Qwest Initial Comments at 22-24, 25-27.

The rural companies' criticisms of the reforms in Stage One of the Three Stage Package are unfounded. Nothing in the statute precludes the Commission from consolidating study areas within a state that are owned by the same company. The statute also does not prevent the Commission from moving large rural carriers to the Commission's high cost model. In fact, the 100,000 line cut-off proposed in the Three-Stage Package is well grounded in the statutory definition of rural telephone company.³¹ Under that definition, a carrier is considered a rural telephone company if its study area has less than 100,000 lines. If the Commission adopts the proposal to consolidate a carrier's study areas within a state for purposes of federal universal service, a carrier would no longer meet this definition if it has a total of at least 100,000 access lines in a state. Moreover, nothing in the Act requires the Commission to use a different high cost mechanism for rural and non-rural carriers.³² Indeed, such a distinction is unsustainable, given that the same statutory requirements apply to all carriers.

A number of rural companies imply that any loss in rural high-cost support would cause their rates to no longer be reasonably comparable or affordable, as required by Section 254.³³ At this time, there is no evidence in the record that this is the case. If that situation arises in the future, the Commission can address it through the expanded certification process.

III. THERE IS NO JUSTIFICATION FOR THE CURRENT DISPARITIES BETWEEN THE RURAL AND NON-RURAL HIGH COST PROGRAMS

Aside from the rural carriers, commenters generally agree that the current distinctions in the Commission's high cost rules between rural and non-rural carriers are inequitable.

Historically, the disparate treatment of non-rural carriers has been based on those carriers'

³¹ 47 U.S.C. § 153(37)(C) (defining rural telephone company as an entity that provides telephone exchange service to a study area with fewer than 100,000 access lines).

³² 47 U.S.C. § 254.

³³ *See, e.g.*, ACS at 5-8.

perceived ability to use their lower cost areas to subsidize any high cost areas they serve. To the extent such subsidization were ever possible, that opportunity has now disappeared with the onset of vigorous competition in those lower cost areas. In the absence of such implicit subsidies, the costs faced by rural and non-rural carriers in rural areas are largely the same. Ultimately, the best means of rationalizing the support provided to these carriers is to apply the Tenth Circuit’s holdings in *USTA I* and *USTA II* to all ETCs, whether small or large.³⁴

A. The Distinctions In The Rural And Non-Rural Programs Are Inequitable

Currently, rural carriers receive many times more federal support for serving a given high cost area than would be available to a non-rural carrier serving that area. As noted by CTIA, this rural/non-rural distinction “disserves consumers by directing too much support to some areas and too little to others.”³⁵

Ultimately this inequity affects the end users served by rural and non-rural carriers. It is simply unfair that customers living in certain high cost areas enjoy the benefits of subsidized phone service (lower rates, more service offerings), while customers in other high cost areas do not, solely because they are served by a large telephone company. ACS aptly characterizes a system that varies high cost support based on the size of the recipient as one that “arbitrarily penalize[s] customers in high-cost areas that are served by carriers . . . that serve low cost areas of the state, or that happen to live in a state with large numbers of low-cost lines.”³⁶

³⁴ Certain commenters acknowledge the current inequity between the rural and non-rural support mechanism, but suggest the way to address the problem is by increasing non-rural support, while maintaining the size of the high cost program for rural carriers. *See, e.g.,* Fairpoint Communications (“Fairpoint”) at 12-15. Given the immense size of the federal fund, this is not a workable approach. *And see, United States Telecom Association v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) (“*USTA I*”); *United States Telecom Association v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) (“*USTA II*”).

³⁵ CTIA at 3.

³⁶ *See* ACS at 9-10.

The distinctions in the Commission's high cost rules between rural and non-rural carriers are a relic of the days of monopoly regulation, rather than the result of a well-thought-out policy. Indeed, if the Commission were designing a high cost program from scratch, it would undoubtedly focus on the characteristics of particular rural areas, rather than which carriers happened to serve those areas. The Joint Board and the Commission must begin to move in this direction, toward a universal service system that is grounded in sound public policy and treats all rural Americans equitably.³⁷

This approach may result in increases in the local rates paid by some rural customers. To the extent those customers are receiving subsidized phone service at rates below the national average, those increases are warranted.³⁸ There is no statutory or policy justification for urban and suburban customers to subsidize below-market rates for customers living in rural areas. Whenever possible, a carrier should recover its costs from its end users. High cost support should be available only to the extent a carrier cannot recover its costs from its end users without driving its rates above affordable and reasonably comparable levels. The best way of accomplishing this objective is through use of a rate benchmark that reflects such levels.³⁹

As noted by GCI, the Commission's current focus on costs, rather than rates, may result in more high cost funding than is necessary to meet the affordability and reasonable comparability requirements of the statute.⁴⁰ The Commission's rules allow rural incumbents to recover much of their embedded costs through universal service funding, even if those costs are higher than

³⁷ Oregon Commission at 5.

³⁸ Sprint at 11; CTIA at 6.

³⁹ See Qwest Initial Comments at 18-21.

⁴⁰ GCI at 10.

necessary to provide the supported services. In such cases, the incumbent is being overfunded.⁴¹ This focus on costs rather than rates could also lead to the underfunding of an ETC if its high cost support is not sufficient to permit affordable and reasonably comparable rates. Such outcomes, as well as the Tenth Circuit's decision in *Qwest II*, support a shift in focus to rates, rather than costs.⁴² Qwest recommends that this shift be implemented through the adoption of guidelines governing the states' distribution of federal high cost support.

B. Competition Has Eliminated The Ability Of Non-Rural Carriers To Subsidize The High Cost Areas They Serve

Rural ILECs continue to argue that non-rural carriers need less federal high cost support because they can subsidize high cost areas by charging above-cost rates in low cost areas.⁴³ This position ignores reality. As ACS recognizes, carriers facing competition in their lower cost markets have no ability to create implicit subsidies for higher cost markets.⁴⁴ Competition has steadily eroded Qwest's market share in the lower cost areas of its service territory. Qwest therefore must fight for every customer in those areas and certainly cannot use the revenues it receives in those areas to subsidize customers in other, higher cost areas.⁴⁵

C. The Costs Faced By Small And Large Telephone Companies In High Cost Areas Are Roughly The Same

Rural carriers also continue to claim that their costs of providing service in rural areas are substantially higher than those costs for non-rural carriers. In arguing against the consolidation

⁴¹ *Id.* at 11.

⁴² *Qwest II*, 398 F.3d at 1237.

⁴³ *See, e.g.*, NTCA at 5; OPASTCO at 13; Home Telephone Company, Inc. and PBT Telecom at 4.

⁴⁴ ACS at 5-6.

⁴⁵ *See also* SBC Communications Inc. ("SBC") at 5 ("revenues from lower cost areas, and the cross-subsidies they provide, are rapidly eroding in the face of growing competition for the most lucrative customers").

of rural study areas, however, a number of rural companies and their consultants point out the unreasonableness of basing high cost support on the size of the telephone company. For example, Balhoff & Rowe note that, “[r]egardless of ownership, high cost markets . . . remain costly to serve, regardless of the structure of the serving firm.”⁴⁶ CenturyTel further acknowledges that the size of a carrier serving a rural area in no way changes the characteristics of that area -- long loop lengths, sparsely populated serving areas, and long backhaul distances.⁴⁷ As Frontier points out, the size of affiliated telephone companies “does not make the Adirondacks any less rural, the geographic area any less costly to serve on an outside plant or switching basis, nor the customers of [those high cost areas] any less deserving of support.”⁴⁸ The same arguments apply to high cost areas served by non-rural companies. In high cost areas in particular, the largest cost drivers are the labor expenses associated with deploying and maintaining the long loops necessary to serve customers in those areas. Non-rural carriers’ labor costs typically are no lower than such costs for rural carriers.

With regard to calling scopes, the same issues apply to all customers in rural areas, whether served by small or large telephone companies. Moreover, the steady drop in long distance rates has reduced the impact of smaller calling scopes. In the long run, intercarrier compensation reform would further mitigate the effects of this issue.

D. The Holdings Of The Tenth Circuit In *Qwest I* And *Qwest II* Should Be Applied To Both Rural And Non-Rural Companies

Due to the fragmented nature of the Commission’s high cost programs, the Tenth Circuit’s decisions have not been applied to the programs applicable to rural carriers. There is

⁴⁶ Balhoff & Rowe, LLC at 43.

⁴⁷ CenturyTel at 14.

⁴⁸ Frontier at 4.

no reason they should not be. The requirements of Section 254, including reasonable comparability, affordability, and sufficiency, apply to all areas of the country, regardless of whether they are served by large or small telephone companies. Shifting the focus of both the rural and non-rural programs to these requirements will provide a cohesive framework for these programs.

Grounding the rural high cost programs in the requirements of Section 254, as interpreted by the Tenth Circuit, will also allow the Commission to simplify the methodologies used to determine high cost support while ensuring that the goals of the statute are fulfilled. As described above and in its initial comments, Qwest believes that the Commission should move away from complicated high cost models and embedded cost methodologies.⁴⁹ Simple predictors of cost, such as households per square mile, will provide an equitable means of allocating support among carriers within a state. Application of the Commission's rate certification process will then ensure that each ETC in the state receives sufficient support to satisfy the requirements of Section 254, including affordability and reasonable comparability.

IV. CONCERNS ABOUT THE BLOCK GRANT PROPOSALS CAN BE OVERCOME THROUGH CLEARLY DEFINED AND OBJECTIVE COMMISSION GUIDELINES AND OVERSIGHT

As discussed in its initial comments, Qwest supports the general approach in the Joint Board proposals of providing the states a more substantial role in determining the distribution of high cost support within their borders.⁵⁰ Contrary to the positions of the rural ILECs, this approach is not precluded by the statute or sound public policy.

⁴⁹ Qwest Initial Comments at 22-24.

⁵⁰ *See id.* at 14-16.

As the Tenth Circuit found in *Qwest I* and *Qwest II*, Section 254 contemplates a partnership between the Commission and the states,⁵¹ though the Commission holds final responsibility for ensuring that the requirements of the statute are satisfied.⁵² Thus, the key to adopting a lawful block grant approach is for the Commission to adopt strict and specific guidelines while retaining oversight over the states' distribution of federal support.⁵³ As required by Section 254(b) of the Act, the Commission should adopt detailed binding guidelines that fulfill the principles identified in that Section.⁵⁴ Furthermore, the Commission should retain final authority over the amount of federal high cost support that would be distributed to particular ETCs, thereby ensuring that rates in all markets are affordable and reasonably comparable, consistent with Section 254 and *USTA II*.⁵⁵

In response to *Qwest I*, the Commission adopted an expanded certification process to ensure that rates in rural areas comply with the reasonable comparability requirements of Section 254. The Tenth Circuit upheld this approach in *Qwest II*.⁵⁶ The Commission should further expand the certification process to cover areas served by rural carriers. Through this process, states would certify that the rates within their states are affordable and the rates in rural areas are reasonably comparable to rates in urban areas, based on a comparison to a national benchmark. If a state is unable to make these certifications, it could request further federal assistance to

⁵¹ *Qwest v. FCC*, 258 F.3d 1191, 1203 (10th Cir. 2001) (“*Qwest I*”); *Qwest II*, 398 F.3d at 1232.

⁵² *Qwest I*, 258 F.3d at 1204.

⁵³ *Verizon* at 10-11.

⁵⁴ *See* *Qwest Initial Comments* at 16-27.

⁵⁵ *See USTA II*, 359 F.3d at 568.

⁵⁶ *Qwest II*, 398 F.3d at 1238.

ensure that these statutory requirements are satisfied, similar to the approach adopted in the *Remand Order*.⁵⁷

By adopting this approach, the Commission will ensure that the requirements of the statute, including predictability, are satisfied, thus fulfilling the requirements of Section 254, as interpreted by the Tenth Circuit. This framework would also be consistent with the D.C. Circuit's decision in *USTA II*. In that decision, the court held unlawful the Commission's attempted delegation of unbundling determinations to state commissions. In contrast to the situation here, the Commission did not retain any oversight in the *Triennial Review Order* over the states' subsequent unbundling determinations. Furthermore, the court found in that case that the Commission's delegation was so broad and unconstrained that the Commission had no means of ensuring that the states would adhere to the requirements of Section 251.⁵⁸ Here, Qwest is advocating that the Commission apply detailed, objective guidelines to the states to ensure that they distribute high cost support in accord with the requirements of Section 254. If it does so, the resulting block grants to the states will be lawful. These guidelines will also ensure that federal high cost support remains predictable.⁵⁹

Giving the states a larger role in the distribution of federal high cost support is also consistent with sound public policy. State commissions are in the best position to determine the

⁵⁷ *Remand Order*, 18 FCC Rcd at 22614-15 ¶ 93.

⁵⁸ *USTA II*, 359 F.3d at 567.

⁵⁹ There is no merit to NTCA's argument that the Tenth Amendment somehow bars the Commission from giving the states a role in determining federal high cost support within their states. *See* NTCA at 8-9. The Tenth Amendment generally precludes the federal government from commandeering state resources. *Printz v. United States*, 521 U.S. 898, 923 (1997). To the extent any state declines to participate in the determination of high cost support, the Commission should step into the state's shoes as it has done in other similar circumstances. *See Procedures Established for Arbitration of Interconnection Agreements Between Verizon and AT&T, Cox, and WorldCom*, Public Notice, 16 FCC Rcd 3957 (2001).

special needs of their states. For example, one state commission might decide to target most of the federal high cost support in the state to the highest cost wire centers in the state, while another state might distribute support more evenly among high cost wire centers. Complaints about the bureaucratic complexity of having each state determine the distribution of federal high cost support are overblown.⁶⁰ As noted, it is possible to simplify the distribution of high cost support,⁶¹ and the elimination of the distinctions between rural and non-rural carriers would consolidate several federal programs into one. By expanding the current certification process, the Commission would also build on existing processes, thereby reducing the administrative impact of the new universal service structure.

V. CONCLUSION

Aside from the filings by the rural ILECs, the initial comments in this proceeding reflect an emerging consensus that the existing high cost programs have drifted from the fundamental purposes of Section 254. The size of the federal fund must be stabilized and, to the extent possible, reduced. The best way to accomplish this objective is to ground high cost support firmly in the requirements of the statute -- principally the availability of supported services across all markets at rates that are affordable and reasonably comparable. At least some rural ILECs are receiving more support than appears to be necessary, as reflected in end-user rates that are lower than those rates in urban areas and the carriers' apparent subsidization of their deployments of broadband services and entry into other geographic markets. In undertaking high cost reform, the Joint Board and Commission must also take steps to eliminate unreasonable disparities between the high cost support programs for rural and non-rural carriers. State

⁶⁰ See, e.g., OPASTCO at 10.

⁶¹ See Dobson Cellular Systems, Inc. at 7-8 (recommending consideration of population density as a competitively-neutral proxy for determining cost).

commissions should play a fundamental role in this reform. Nothing in the Act nor sound public policy precludes such a role for the states, assuming the Commission adopts detailed guidelines governing the distribution of high cost support and retains final authority over such distribution.

Respectfully submitted,

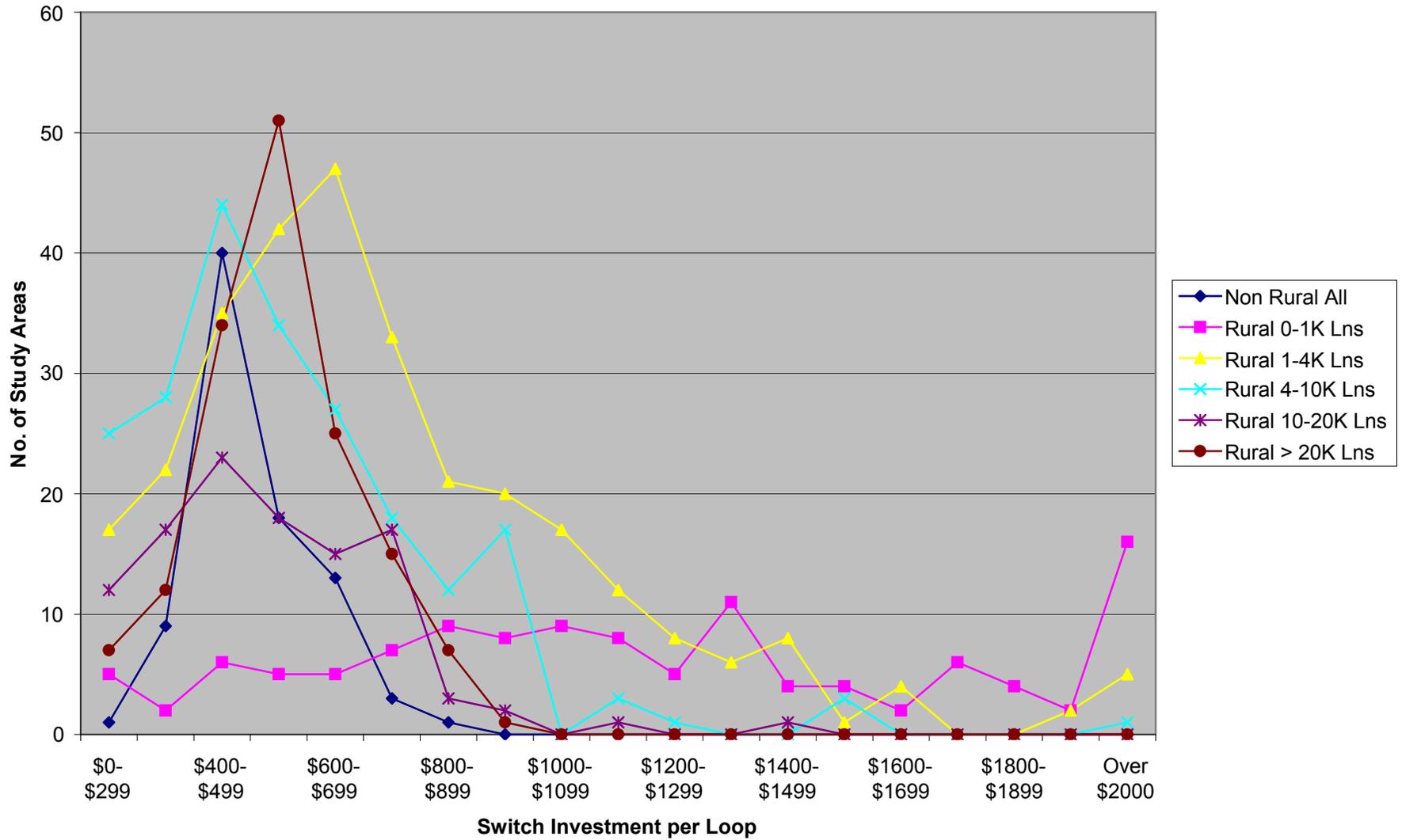
By: /s/ Craig J. Brown
Craig J. Brown
QWEST COMMUNICATIONS
INTERNATIONAL INC.
Suite 950
607 14th Street, N.W.
Washington, DC 20005
(303) 383-6649

Its Attorney

October 31, 2005

ATTACHMENT A

Distribution of Study Areas by Switch Investment per Loop



CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **REPLY**
COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC. to be: 1) filed
with the FCC via its Electronic Comment Filing System in CC Docket No. 96-45; 2) served via
e-mail on Ms. Sheryl Todd, of the Telecommunications Access Policy Division of the Wireline
Competition Bureau at (Sheryl.Todd@fcc.gov); 3) served via e-mail on the FCC's duplicating
contractor, Best Copy and Printing, Inc. at (fcc@bcpiweb.com); and 4) served via First Class
United States mail, postage prepaid, on the parties listed on the attached service list.

/s/Richard Grozier

October 31, 2005

G. Nanette Thompson
General Communication, Inc.
Suite 1000
2550 Denali Street
Anchorage, AK 99507

Michael F. Altschul
Christopher Guttman-McCabe
Paul W. Garnett
CTIA – The Wireless Association
1400 16th Street, N.W.
Washington, DC 20036

John F. Jones
Jeffrey S. Glover
CenturyTel, Inc.
100 CenturyTel Park Drive
Monroe, LA 71203

Karen Brinkmann.....CenturyTel
Jeffrey A. Marks.....ACS of Alaska
Richard R. Cameron
Latham & Watkins LLP
Suite 1000
555 Eleventh Street, N.W.
Washington, DC 20004-1304

Michael Strand
Montana Independent
Telecommunications Systems
POB 5237
Helena, MT 59604-5237

Michael E. Glover
Edward Shakin
Ann Rakestraw
Verizon
Suite 500
1515 North Courthouse Road
Arlington, VA 22201

Glenn H. Brown.....Fairpoint
McLean & Brown
Suite 32
55 Cathedral Rock Drive
Sedona, AZ 86351

Patrick L. Morse
FairPoint Communications, Inc.
POB 199
Dodge City, KS 67801-0199

Cammie Hughes
Texas Statewide Telephone
Cooperative, Inc.
Suite 200
3721 Executive Center Drive
Austin, TX 78731

Gerard J. Waldron.....TDS
Mary Newcomer Williams
John Blevins
Covington & Burling
1201 Pennsylvania Avenue, N.W.
Washington, DC 20004-2401

Gerard J. Duffy.....Western Telecomm
Blooston, Mordkofsky, Dickens,
Duffy & Prendergast
Suite 300
2120 L Street, N.W.
Washington, DC 20037

David W. Zesiger
Independent Telephone and
Telecommunications Alliance
Suite 800
888 16th Street, N.W.
Washington, DC 20006

Leonard A. Steinberg
Alaska Communications Systems
Group, Inc.
MS 65
600 Telephone Avenue
Anchorage, AK 99503

David L. Lawson.....AT&T
James P. Young
Sidley Austin Brown & Wood, LLP
1501 K Street, N.W.
Washington, DC 20005

Judy Sello
Leonard J. Cali
Lawrence J. Lafaro
AT&T Corp.
Room 3A299
One AT&T Way
Bedminster, NJ 09721

TCA, Inc. Telcom Consulting Associates
Suite 200
1465 Kelly Johnson Boulevard
Colorado Springs, CO 80920

Ron Comingdeer.....Rural OK Telecomm
Comingdeer, Lee & Gooch
6011 N. Robinson Avenue
Oklahoma City, OK 73118

Christopher M. Heimann
Gary L. Phillips
Paul K. Mancini
SBC Communications Inc.
1401 I Street, N.W.
Washington, DC 20005

Richard J. Johnson
4800 Wells Fargo Center
90 South 7th Street
Minneapolis, MN 55402

Richard A. Finnigan
Washington Independent Telephone Association
Montana Telecommunications Association
Monroe Telephone Company
2112 Black Lake Boulevard, S.W.
Olympia, WA 98512

David Cosson.....RICA
Kraskin, Moorman &
Cosson, LLC
2120 L Street, N.W.
Washington, DC 20037

Keith Oliver
Home Telephone Company, Inc.
POB 1194
Moncks Corner, SC 29461

Ben Spearman
PBT Telecom
1660 Juniper Spring Road
Gilbert, SC 29054

Paul M. Schudel.....Neb Rural
James A. Overcash
Woods & Aitken LLP
Suite 500
301 South 13th Street
Lincoln, NE 68508

Alex J. Harris
Frontier Communications
3 High Ridge Park
Stamford, CT 06905

Kenneth F. Mason
Gregg C. Sayre
Frontier Communications
180 South Clinton Avenue
Rochester, NY 14646-0700

Alan W. Pedersen
Jack H. Rhyner
Paula Eller
Sandwich Isles Communications, Inc.
Suite 2700
Pauahi Tower
1001 Bishop Street
Honolulu, HI 96813

Patrick Damon
Maine Public Utilities Commission
242 State Street
18 State House Station
Augusta, ME 04333-0018

Gregg Faber
Vermont Public Service Board
Drawer 20
112 State Street
Montpelier, VT 05620-2701

Angela N. Brown
BellSouth Corporation
Suite 4300
675 West Peachtree Street, N.E.
Atlanta, GA 30375-0001

Natelle Dietrich
Marc D. Poston
Missouri Public Service Commission
POB 360
Jefferson City, MO 65102

Seema M. Singh
Ratepayer Advocate
11th Floor
31 Clinton Street
Newark, NJ 07102

Shana Knutson
Nebraska Public Service Commission
300 The Atrium Building
1200 N Street
Lincoln, NE 68508

Richard A. Askoff
National Exchange Carrier
Association, Inc.
80 South Jefferson Road
Whippany, NJ 07981

David A. LaFuria.....Rural Cellular
David L. Nace
Steven M. Chernoff
Lukas Nace Gutierrez & Sachs
Suite 1500
1650 Tysons Boulevard
McLean, VA 22102

Robert S. Foosaner
Vonya B. McCann
Brian K. Staihr
Sprint Nextel Corporation
2001 Edmund Halley Drive
Reston, VA 20191

Daniel Mitchell
National Telecommunications
Cooperative Association
10th Floor
4121 Wilson Boulevard
Arlington, VA 22203

David C. Bergmann
National Association of State
Utility Consumer Advocates
Suite 1800
10 West Broad Street
Columbus, OH 43215-3485

Jan Reimers
ICORE, Inc.
326 South 2nd Street
Emmaus, PA 18049

James W. Olson
Indra S. Chalk
Jeffrey S. Lanning
Robin E. Tuttle
United States Telecom Association
Suite 400
607 14th Street, N.W.
Washington, DC 20005

Kate Giard
Regulatory Commission of Alaska
Suite 300
701 West 8th Avenue
Anchorage, AK 99501-3469

Christopher W. Savage.....Centennial Comm
Cole, Raywid & Braverman, LLP
Suite 200
1919 Pennsylvania Avenue, N.W.
Washington, DC 20006

Paul J. Feldman.....Surewest
Fletcher, Heald & Hildreth, PLC
11th Floor
1300 North 17th Street
Arlington, VA 22209

Lee Beyer
John Savage
Ray Baum
Oregon Public Utility Commission
6295 Aumsville Highway, S.E.
Salem, OR 97310

John Ridgway
Penny G. Baker
Iowa Utilities Board
350 Maple Street
Des Moines, IA 50319

Stuart Polikoff
Organization for the Promotion and Advancement
of Small Telecommunications Companies
Suite 700
21 Dupont Circle, N.W.
Washington, DC 20036