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

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337

COMMENTS OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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I. INTRODUCTION.

The New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") welcomes the opportunity to submit comments in response to the Notice of Proposed Rulemaking released by the Federal Communications Commission ("FCC" or "Commission") on December 9, 2005,[1] seeking comments on issues raised by the United States Court of Appeals for the Tenth Circuit's (Tenth Circuit) decision in *Qwest Corp. vs. FCC* ("Qwest II") regarding the Commission's non-rural high cost fund ("HCF").[2] The Ratepayer Advocate urges the Commission to heed the fact that ultimately customers pay for the non-rural high cost fund. As the FCC has stated previously: "the principle of sufficiency encompasses the idea that the amount of support should be only as large as necessary to

[1] / *In the Matter of Federal-State Joint Board on Universal Service*, FCC CC Docket No. 96-45; *High-Cost Universal Service Support*, FCC WC Docket No. 05-337, *Notice of Proposed Rulemaking*, Rel. December 9, 2005 ("NPRM"). Reply comments are due May 26, 2006. *In the Matter of Federal-State Joint Board on Universal Service*, FCC CC Docket No. 96-45; *High-Cost Universal Service Support*, FCC WC Docket No. 05-337, *Order*, Rel. January 26, 2006.

[2] / *Qwest Corp. v. FCC*, 398 F 3d 1222 (10th Cir. 2005) ("Qwest II").

achieve the relevant statutory goal."[3] Also still relevant is the FCC's prior finding that "[b]ecause support ultimately is recovered from customers, collecting more support than is necessary to benefit certain customers would needlessly burden all customers."[4] The Ratepayer Advocate urges the Commission, as it considers approaches for responding to the Court's directives, to establish accountability by carriers to their consumers: As a result of the Telecommunications Act of 1996[5] ("Act" or "1996 Act"), and in the name of replacing purportedly eroded implicit support for high cost areas, non-rural carriers are receiving millions of dollars that they would not otherwise have received. Meanwhile, the local competition (which Congress believed would jeopardize incumbents' implicit support) has not materialized, and now, consumers are harmed in multiple ways. Competitive choice is diminishing in the wake of major mergers, and yet consumers must simultaneously pay for high cost support.

A. INTEREST OF THE RATEPAYER ADVOCATE IN THE INSTANT PROCEEDING

The Ratepayer Advocate is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities. The Ratepayer Advocate participates actively in relevant Federal and state administrative and judicial proceedings. The above captioned proceeding is germane to the Ratepayer Advocate's continued participation and interest in implementation of the 1996 Act. New

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[3] / *Federal-State Joint Board on Universal Service*, FCC CC Docket No. 96-45, *Order on Remand*, 18 FCC Rcd 22559 (2003), *remanded, Qwest II, 398 F. 3d 1222* ("Order on Remand"), at para. 37, note omitted.

[4] / *Id.*

[5] / Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the 1996 Act," or "the Act," and all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.

Jersey consumers' interests, among others, include the following:

- As net contributors to the high cost fund, New Jersey consumers have an interest in ensuring that the high cost fund is sufficient but not excessive. Ultimately, consumers foot the bill for universal service charges.
- As users of the public switched network, seeking to communicate with consumers throughout the nation, including consumers located in high cost areas, New Jersey consumers have an interest in ensuring that high cost funds are sufficient to enable rural consumers to pay charges that are reasonably comparable to those in urban areas: as has been long-recognized, the value of the network increases as the number of subscribers increases. To the extent that high rates discourage subscribership, consumers throughout the country lose on the positive externality associated with interconnectedness.
- As consumers of virtually monopoly basic local exchange service, who must ultimately pay for universal service fund ("USF") charges, New Jersey consumers have an interest in a high cost fund mechanism that encourages economically efficient investment in the local network, and that covers only those costs that are properly associated with the provision of basic local exchange service.

B. SCOPE OF THE PROCEEDING

The directives set forth in the 1996 Act regarding universal service, although seemingly straightforward in their objective, have proven complex and controversial to implement. In its *NPRM,* issued on December 9, 2005, the FCC responds to the Tenth Circuit's directive that the FCC

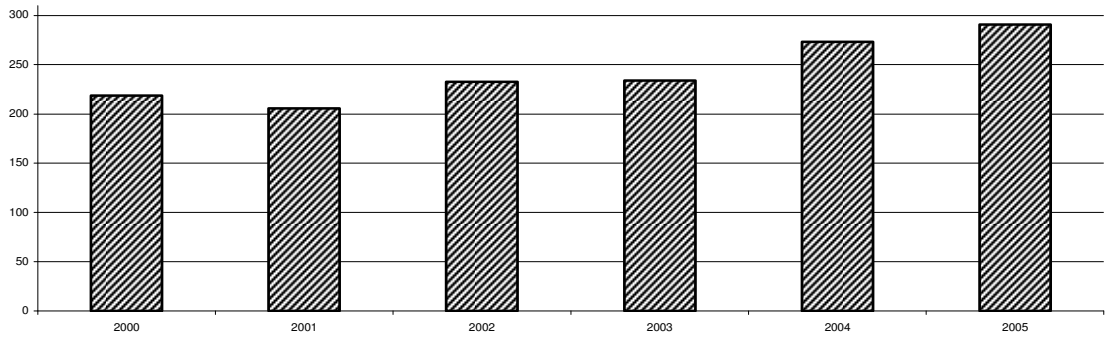
more properly define the terms "sufficient" and "reasonably comparable."[6] The FCC seeks comments on "how reasonably to define the statutory terms 'sufficient' and 'reasonably comparable' in light of the Court's holding in *Qwest II*."[7] The FCC further seeks comments on the high cost support mechanism for non-rural carriers in light of the Tenth Circuit's remand.

C. BACKGROUND

Neither the rural nor the non-rural high cost fund should become an entitlement program for incumbent local exchange carriers.

Figure 1 shows the growth in non-rural high cost funds disbursed to eligible telecommunications carriers ("ETC") since 2000. In the face of purported local competition, and with the deployment of more efficient technology, one would expect local exchange carriers' ("LEC") costs to decline, and, in turn, cause a decline in the need for high cost funds. The increasing trend in non-rural high cost funds, therefore, is troubling for the consumers who shoulder the burden of the high cost fund.

Figure 1
Total Non-Rural High-Cost Support Payments
(in millions of dollars)



Source: Federal-State Joint Board Monitoring Reports, December 2005 Monitoring Report, released December 2005, Table 3.25, High-Cost Model Support Payments By Non-Rural Study Area, based on Universal Service Administrative Company filings to the FCC.

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[6]/ *NPRM*, at para. 1, citing *Qwest II*.

[7]/ *Id.*

The Ratepayer Advocate urges the Commission to ensure that any high cost fund mechanism, whether for rural carriers or for non-rural carriers, not become an entitlement for carriers. Table 1 shows non-rural HCF disbursements on a state level between 2000 and 2005.

Table 1

High-Cost Model Support for Non-Rural Carriers by State

	2000	2001	2002	2003	2004	2005	2005 Supported Lines	2005 Support per Line
Alabama	$51,743,652	$46,445,571	$42,927,069	$42,116,427	$42,621,753	$46,094,139	1,126,111	$40.93
Kentucky	$1,165,656	$0	$3,262,920	$3,189,189	$16,315,065	$17,170,329	667,187	$25.74
Maine	$10,775,778	$8,873,436	$5,480,907	$5,653,734	$2,137,286	$2,017,408	284,444	$7.09
Mississippi	$103,707,456	$103,996,830	$120,595,569	$120,967,993	$136,773,388	$148,098,462	1,183,206	$125.17
Montana	$1,541,526	$4,383,033	$10,887,342	$10,757,091	$17,806,404	$17,193,713	134,247	$128.08
Nebraska	$0	$0	$0	$0	$4,189,576	$7,064,549	194,313	$36.36
South Dakota	$0	$0	$0	$0	$1,536,621	$2,462,014	82,890	$29.70
Vermont	$15,103,584	$10,007,652	$9,117,498	$9,646,596	$10,792,938	$10,305,479	162,448	$63.44
West Virginia	$31,234,866	$25,875,165	$30,651,192	$31,654,752	$25,846,873	$26,056,549	437,164	$59.60
Wyoming	$3,399,585	$6,150,825	$9,879,543	$10,044,726	$15,405,661	$14,388,869	78,097	$184.24
Total	$218,672,103	$205,732,512	$232,802,040	$234,030,508	$273,425,565	$290,851,511	4,350,107	$66.86

Source: Federal-State Joint Board Monitoring Reports, December 2005 Monitoring Report, released December 2005, Section 3, Table 3.25, High-Cost Model Support Payments By Non-Rural Study Area, based on Universal Service Administrative Company filings to the FCC.

Note: The amounts shown in this table include only funds distributed through the High-Cost Model Support mechanism. The table excludes Interstate Access Support and Interstate Common Line Support. The table includes funds distributed to both ILECs and CETCs. States not listed above received no non-rural high cost support from 2000 to 2005.

Procedural background.

In its *Ninth Report and Order* (1999), the Commission established a forward-looking federal high-cost support mechanism for non-rural carriers[8] and a nationwide cost benchmark to determine support that was set at 135% of the national average cost per line.[9] The *Ninth Report and Order* was remanded by the Tenth Circuit in 2001, after the Court determined that the Commission had failed to define "sufficient" and "reasonably comparable" adequately[10] and failed to provide sufficient support

[8] / Non-rural carriers are defined as ILECs that do not meet the definition of a rural telephone company. *Order on Remand*, at note 1, citing 47 U.S.C.§ 153(37). As explained by the Commission, "rural telephone companies are incumbent carriers that either serve study areas with fewer than 100,000 access lines or meet one of the three alternative criteria." *Id.* Rural carriers serve fewer than twelve percent of lines. *Id.*

[9] / *NPRM*, at para. 3.

[10] / *Qwest II*, at 1228, citing Qwest *Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001)("Qwest I").

for its 135% benchmark.[11] In addition to requiring the Commission to define the statutory terms and to provide adequate justification for the level of support selected on remand, *Qwest I* also required the FCC to develop mechanisms to induce state action with regard to the development of their own universal service programs and to explain its plan for all universal service mechanisms, as a whole, more fully.[12]

The Commission issued its *Order on Remand*, in response to *Qwest I,* in October 2003. In its *Order on Remand*, the Commission adopted a rate review and expanded certification process "to induce states to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers."[13] The Commission defined "sufficient" as "enough federal support to enable states to achieve reasonable comparability for rural and urban rates in high-cost areas served by non-rural carriers," and "reasonably comparable" by setting a national urban residential rate benchmark.[14] The Commission set a national urban *rate* benchmark at two standard deviations above the average urban residential rate and a *cost* benchmark based on two standard deviations above the national average cost.[15]

In February 2005, the Tenth Circuit remanded the Commission's *Order on Remand*. *Qwest II* held that the Commission had still failed to define "sufficient" and "reasonably comparable" stating that the Commission's definition of sufficient:

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[11]/ *NPRM,* at para. 4.

[12] / *Qwest II*, at 1228.

[13] / *NPRM*, at para. 5.

[14] / *Id.*

[15] / *Id.*

> . . . ignores the vast majority of § 254(b) principles by focusing solely on the issue of reasonable comparability in § 254(b)(3). The Commission has not demonstrated in the Order on Remand or the limited record available to this court why reasonable comparability conflicts with or outweighs the principles of affordability, or any other principles for that matter, in this context.[16]

The Court directed the Commission to define "sufficient" in a manner which "considers the range of principles" contained in the statute.[17] The Court further found that:

> . . . the Commission's selection of a comparability benchmark based on two standard deviations appears no less arbitrary than its prior selection of a 135% cost-support benchmark. On remand, the FCC must define the term "reasonably comparable" in a manner that comports with its concurrent duties to preserve and advance universal service.[18]

Thus, the non-rural high-cost support mechanism was deemed invalid.[19] The Court did, however, uphold the Commission's determination that states are not required to replace implicit subsidies with explicit subsidies and the Commission's requirements with respect to state certification of reasonably comparable rates.[20]

The Commission, in its *NPRM*, seeks comment regarding:

- A definition of "sufficient" that takes into account all of the principles in section 254(b);
- A definition of "reasonably comparable" that is consistent with the Commission's "duties to preserve and advance universal service";[21]

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[16] / *Qwest II*, at 1234.

[17] / *Id*.

[18] / *Id.*, at 1237.

[19] / *NPRM*, at para. 6.

[20] / *Id.*

[21] / *Id*., at para. 7.

- The modification of the high-cost funding mechanism for non-rural carriers to address the Court's and Commission's interpretation of these statutory terms; and
- The adoption of a non-rural insular mechanism.[22]

The Court directed the Commission to take into account the range of principles set forth in Section 254(b) of the Act. These principles include:

> (1) *Quality and Rates* – Quality services should be available at just, reasonable, and affordable rates.
> (2) *Access to Advanced Services* – Access to advanced telecommunications and information services should be provided in all regions of the Nation.
> (3) *Access in rural and high cost areas* – 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) *Equitable and Nondiscriminatory contributions* – All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.
> (5) *Specific and predictable support mechanisms* – There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.
> (6) *Access to Advanced Telecommunications Service for Schools, Healthcare, and Libraries*- Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h).
> (7) *Additional principles* – Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.

In the legislation enacted more than ten years ago, Congress directed the Commission and state regulators to "promote universal service by ensuring that consumers in all regions of the nation have access to affordable, quality telecommunications services."[23] Ten years later, as the

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[22] / *Id.* The Ratepayer Advocate does not address the adoption of a non-rural insular mechanism in these initial comments.

[23] / *NPRM*, at para. 2. *See, also,* Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act).

Commission continues to grapple with how to achieve this objective while balancing the Congressionally-established principles, the major difference in the local telecommunications market is that consumers are increasingly availing themselves of broadband access, in an apparent mirroring of the trend when consumers increasingly adopted basic local exchange service between the 1920s and 2000.[24]

II. DEFINITION OF SUFFICIENT

The Court's admonitions with respect to the Commission's definition of "sufficient" underscore the need for a more consolidated approach to universal service and clear statements with respect to the purposes of each individual universal service mechanism.

As discussed in Section I above, Section 254 of the Act requires the Commission to consider several principles in crafting universal service programs and policies. The Commission seeks comment regarding how to balance the seven principles in section 254(b) and, if the principles conflict with one another, how the Commission should resolve the conflict.[25] The Court found that the Commission had failed to properly define sufficient because it essentially disregarded all of the principles in Section 254(b) except reasonable comparability:

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[24] / See Figure 2. Figure 2 shows the historical trend of increasing penetration for basic telephone service between 1920 and 2000. For example, the penetration rates were 35 percent in 1920; 62 percent in 1950, 90 percent in 1970, and 98 percent in 2000. The estimate of 98 percent, shown in Figure 2, is based on data from the FCC's *Trends in Telephone Service*. This FCC estimate is based on the decennial census. In contrast the data reported in the FCC's *Subscribership in the United States*, data through July 2005, released November 2005 differs (see footnote 44) because the data are based on the census' monthly current population survey. The FCC explains: "Unfortunately, the results of the CPS cannot be directly compared with the penetration figures contained in the 1980, 1990, and 2000 decennial censuses. This is due to differences in sampling techniques and survey methodologies and because of differences in the context in which the questions were asked. For example, the 2000 decennial census reported 97.6% of all occupied housing units in the United States had telephone service available, whereas the CPS data showed a penetration rate of 94.6% of households for March 2000. This difference is statistically significant and appears to indicate that the CPS value may be on the low side and the decennial census value may be on the high side, with the most probable value lying somewhere in between." *Id.,* at 2.

[25] / *NPRM*, at para. 8.

> The FCC's definition of "sufficient" ignores the vast majority of §254(b) principles by focusing solely on the issue of reasonable comparability in §2543(b)(3). The Commission has not demonstrated in the Order on Remand or the limited record available to this court why reasonable comparability conflicts with or outweighs the principle of affordability, or any other principle for that matter, in this context.[26]

However, a reading of *Qwest II* suggests that the Commission has failed to present an accurate and comprehensive explanation of its universal service programs to the Court. As noted by the Court, the "complexity of current mechanisms employed to support universal service" cannot be overstated. Yet, the Court appears to refer solely to federal high-cost support in its analysis.[27] A judgment as to whether the Commission has followed Congressional intent with respect to universal service goals cannot be made about the high-cost fund in a vacuum. Any such judgment must include an analysis of each mechanism in the universal service fund. Although the high-cost fund is certainly the largest universal service mechanism in terms of monetary value, the schools and libraries; low income; and rural health care mechanisms also address the principles in Section 254(b). The high cost fund should be limited to supporting the high cost of subscribers' access to the public switched network. The purpose of the high-cost fund is to address differences in carriers' costs in order to ensure that carriers are investing in all regions of the country and thus service is available to all Americans. This issue points to the need for the Commission to consider all of its universal service programs together instead of reforming each mechanism on a piecemeal basis.

Reasonable comparability advances but does not guarantee affordability.

Section 254(b)(1) states that "[q]uality services should be available at just, reasonable, and affordable rates." The Commission seeks comment on whether if rural rates were reasonably

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[26] / *Qwest II*, at 1234.

[27] / *Id.,* at 1230. The Court notes the ongoing reforms with respect to the rural and non-rural high-cost programs but does not address other mechanisms.

comparable to urban rates that comparability would imply that those rates were also affordable.[28] The Commission states in its *NPRM* that the *Order on Remand* fails to address how the non-rural mechanism keeps rates affordable.[29] The Commission stated in its *Remand Notice* in response to *Qwest I* that a "major objective of universal service is to help ensure affordable access to telecommunications services to consumers living in areas where the cost of providing such services would otherwise be prohibitively high."[30]

The Commission asks whether it should define what is meant by "affordable rates."[31] The high cost universal service fund is meant to subsidize telecommunications services in areas where the costs of providing such services are particularly high, and, therefore, the HCF promotes affordability. However, the specific goal of affordability should be addressed primarily in federal and state Lifeline and Link up programs.

The Commission previously rejected proposals that it create eligibility requirements for non-rural high-cost support based on household income and did so again in the *Order on Remand*.[32] The Commission's reasoning continues to be sound. In its *Order on Remand*, the Commission stated:

> While the Joint Board and the Commission generally have considered affordability in implementing section 254, the Commission has not specifically identified an affordable rate, and we decline to do so now. Because various factors, many of which are local in nature, affect rate affordability, the Commission agreed with the Joint Board that it would not be appropriate to establish a nationwide affordable rate. The Commission also agreed with the Joint Board that states should exercise primary responsibility for determining the affordability of rates. The Commission previously rejected a proposal similar to the one SBC suggests now, concluding that

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[28] / *NPRM*, at para. 9.

[29] / *Id*.

[30] / *Id.*, citing *Remand Notice*, 17 FCC Rcd at 3001, at para. 3.

[31] / *NPRM*, at para. 10.

[32] / *Id*.

> it "would over-emphasize income levels in relation to other non-rate factors that may affect affordability and fail to reflect the effect of local circumstances on the affordability of a particular rate." Given the unique characteristics of each jurisdiction, we continue to find that states are better suited than the Commission to make determinations regarding affordability. Moreover, the Commission has previously rejected a proposal to link non-rural high-cost support to income and stated that "section 254(b)(3) reflects a legislative judgment that all Americans, regardless of income, should have access to the network at reasonably comparable rates."[33]

The Commission should not reconsider SBC's proposal to adopt an affordability benchmark based on the household income of a particular geographic area.[34] Such a benchmark would not necessarily target those most in need. For example, low-income consumers residing in high-income rate centers or counties would not receive any assistance. While ensuring that rates in rural areas are reasonably comparable to rates in urban areas may not address these subscribers either, the states should ultimately retain authority over affordability issues. The Commission should affirm its previous determination that it is "better to address affordability issues unique to low-income consumers through the federal low-income programs specifically designed for this purpose rather than through the high-cost support programs."[35] This conclusion remains appropriate and is compatible with the Court's decision in *Qwest II*.[36]

The Commission asks whether it should consider the effect of universal service contributions on contributors and whether the "burden" of contributions affect affordability.[37] There is indeed a risk that universal service fees contribute to the high cost of telecommunications services faced by

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[33] / *Order on Remand*, at para. 45, cites omitted.

[34] / *NPRM*, at para. 10.

[35] / *Id*.

[36] / *Id*.

[37] / *Id*., at para. 11.

consumers. In New Jersey, a state where carriers receive no non-rural high cost model support funds,[38] increases are particularly burdensome. The Court noted in *Qwest II*, "excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1)."[39]

Although the Commission could seek to narrow the gap between urban and rural rates, "reasonably comparable" rates need not result in an elimination of the gap.

The Court found fault with the Commission's *Order on Remand* because, among other things, the Commission did not address sufficiently the need to advance universal service. The Court stated:

> The use of the conjunctive "and" in the phrase "preserve and advance universal service," or "preservation and advancement of universal service," clearly indicates that the Commission cannot satisfy the statutory mandate by simply doing one or the other. The Commission is charged under the Act with concurrent duties.[40]

With reference to the variance among rural and urban rates, the Court suggested that the Commission's advancement of universal service "certainly could include a narrowing of the existing gap between urban and rural rates." The Court stated:

> "Universal service" is defined in the Act as "an evolving level of telecommunications services," taking into account those services that are essential to basic needs, subscribed to by a majority of consumers, deployed in networks, and consistent with defined policy goals. 47 U.S.C. § 254(c)(1). Implicit in this definition and the Act is access to these telecommunications services by consumers throughout the nation. Rates cannot be divorced from a consideration of universal service, nor can the variance between rates paid in rural and urban areas. If rates are too high, the essential telecommunications services encompassed by universal service may indeed prove unavailable. Thus, the Commission erred in premising its consideration of the

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[38] / Federal Communications Commission, *2005 Universal Service Monitoring Report*, CC Docket No. 98-202, Prepared by Federal and State Staff for the Federal-State Joint Board on Universal Service in CC Docket No. 96-45, data received through May 2005 ("2005 Monitoring Report"), at Table 3.25.

[39] / *Qwest II*, at 1234, citing *Qwest I*, 259 F.3d, at 1200.

[40] / *Id.*, at 1236.

> term "preserve" on the disparity of rates existing in 1996 while ignoring its concurrent obligation to advance universal service, a concept that certainly could include a narrowing of the existing gap between urban and rural rates.[41]

The Ratepayer Advocate recognizes the need for the Commission to demonstrate that it is committed to advancing (as well as preserving) universal service. As a fundamental matter, however, in response to the Court's concern that "[i]f rates are too high, the essential telecommunications services encompassed by universal service may indeed prove unavailable," there is simply no evidence that essential services are unavailable in rural areas. Furthermore, the Commission, in any order issued in this proceeding, should explain that the entire universe of the multiple universal service programs collectively *advance* universal service, and, therefore, the non-rural high cost fund should not be held up in isolation to fulfill entirely the congressional mandate to advance universal service.

On the particular matter of rate disparity, the Court does not provide guidance about the *degree* to which it suggests that the Commission narrow the gap between rural and urban rates. The country has a long history of rate variances, and yet, as Figure 2 shows, the nation has adopted basic telephone technology throughout the country.[42]

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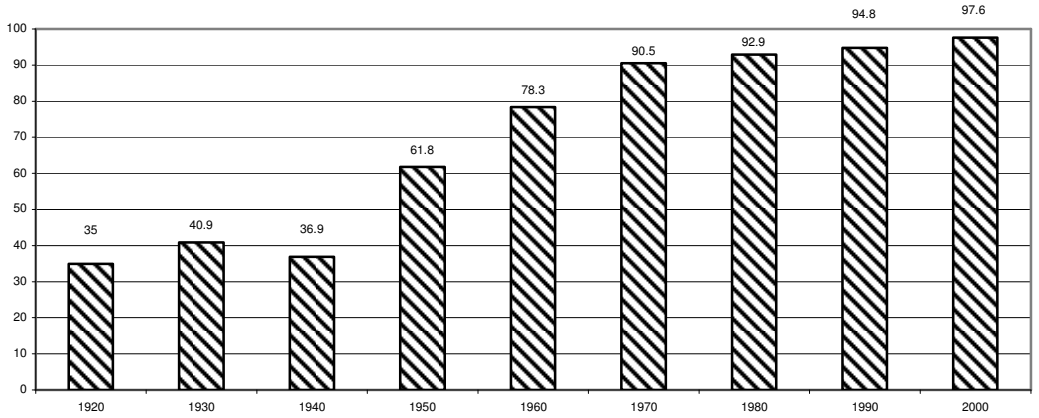
[41]/ *Id.*

[42] / As the next section discusses, however, the Ratepayer Advocate urges the Commission to investigate the reason for the apparent and recent decline in telephone subscribership.

Figure 2
Historical Telephone Penetration Estimates



Source: Federal Communication Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telephone Service, Tables Compiled as of April 2005*, Table 16.4.
Note: Estimates are based on data from the U.S. Census Bureau.

"Reasonable comparability" need not eliminate all variances. Variances in rates within states and among states are inevitable: the wide array of state decisions about rate design necessarily will yield rate variations within state boundaries and across state boundaries. Where, for reasons beyond their control (mountains, sparsely populated areas, rocky terrain, etc.), states experience above-average costs, the non-rural high cost fund can contribute to the goal of reasonably comparable rates. However, as long as intrastate rates are set by state public utility commissions, and not by the FCC, it would be unfair to the net contributors to any high cost fund to support (or second-guess) the specific rate-making decisions of other states.

The Ratepayer Advocate urges the Commission, in its decision in this proceeding, to describe the multitude of factors that influence rates and the inherent impossibility of eliminating all variation (unless the Commission were to infringe upon state's rate-making authority, which would violate section 2(b) of the Communications Act). Meanwhile, the Ratepayer Advocate does not oppose narrowing the variation between the universe of rural rates and the universe of rural rates, provided that the high cost funds that are disbursed to ETCs for that purpose translate directly into rate

reductions for consumers. Otherwise, consumers are simply subsidizing ETCs' profits in the name of advancing universal service. ETCs should be required to demonstrate specifically how they are using the high cost funds to narrow the urban/rural gap. Throwing money at the problem might satisfy the Court's mandate but would seriously disserve consumers, who ultimately must foot the bill. By way of analogy, in a state rate-making proceeding, LECs provide billing determinant data (quantities of services purchased) and pricing information, which enable a revenue calculation. If an ETC receives a high cost fund disbursement, it should be able to translate that disbursement into quantifiable rate reductions. Absent such a showing, the funds should not be awarded.

The Commission should investigate the apparent decline in subscribership in order to preserve universal service.

In August 2005, the National Association of State Utility Consumer Advocates ("NASUCA") sent a letter to FCC Chairman, Kevin J. Martin, seeking the commencement of an inquiry "into the source (methodological and/or actual) of the decline in reported telephone subscribership."[43] The most recently available statistics, released November 2005, indicate that nationwide telephone subscribership has declined over the past two and one half years from a high of 95.5% in March of 2003 to 94% in July of 2005.[44] This decline cannot be attributed to consumers "cutting the cord" and

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[43]/ National Association of State Utility Consumer Advocates, letter to Honorable Kevin J. Martin, Chairman, Federal Communications Commission, August 11, 2005 ("NASUCA Subscribership Letter"), at 2.

[44]/ Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Telephone Subscribership in the United States*, data through July 2005, released November 2005 ("FCC Subscribership Report"), at Table 1. The FCC report indicated that the percentage of households with a telephone in New Jersey fell from a high of 96.6% in July of 2003 to 94.7% in July of 2005. *Id.*, at Table 2.

opting to use wireless phones and/or alternative technologies for telephone service as opposed to wireline connections; the FCC study counts such households as telephone subscribers.[45] NASUCA observed that this decline comes at a time when the federal universal service fund "has reached its highest levels ever."[46] The Ratepayer Advocate concurs with NASUCA that the "apparent lack of access of an increasing number of Americans to basic telephone services cannot be overlooked as the nation moves to a broadband-based telecommunication system."[47]

Income undeniably affects affordability, but the Commission must consider carefully the feasibility of incorporating income as a factor in a high cost program.

A consumer's disposable income *and* a product's price affect whether a given item is affordable. The consumer's elasticity of demand affects a consumer's willingness to continue to subscribe to a service in the face of a price increase. Table 1 in Appendix A shows the median income of households in each state. Based on these data, assuming identical product prices (and identical products)[48] telephone service is less affordable, on average, in Maine than it is in California, and therefore one might posit that the former state should receive, all else being equal, more high cost support per eligible loop than the latter state. However, this approach would be unwise. The funds are distributed to the carrier, and not the consumer, and there is no guarantee that the rate in

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[45]/ *Id.*, at footnote 2. The question asked in the Current Population Survey, from which the FCC data are derived, is: "Does this house, apartment, or mobile home have telephone service from which you can both make and receive calls? Please include cell phones, regular phones, and any other type of telephone." *Id.*

[46]/ NASUCA Subscribership Letter, at 2.

[47]/ *Id.*

[48]/ As the FCC acknowledges (at para. 19), and is discussed in more detail below, differing local calling areas yield different local "products."

the more highly subsidized, lower income state would be less than in the less subsidized, higher income state.

In order to ensure that customers, not carriers, benefit from support, one could overlay income data on cost data at a geographically granular level. However, this approach, although perhaps theoretically attractive, would be administratively unwieldy unless an existing government income verification program were used. A theoretically compelling approach might be to provide any household in a high cost area with income below an established threshold with a HCF voucher (or, similar to food stamps, phone stamps) that could be used with any certified carrier. In this theoretical world, only those who could not otherwise afford service would be provided assistance, and, also, this linking of cost-based support to rates would respond to the Court's instructions to the FCC. Furthermore, consumers could select their provider.

This approach also assumes the existence of an income-verification method. The income cut-off for Lifeline is too low, and, therefore one might piggyback onto another existing government bureaucracy that examines income – the Internal Revenue Service. In this theoretical world, households with net incomes below a certain level, living in zip codes designated on a high cost list, would receive a tax credit for high cost telephone service. Providers could be permitted to deaverage rates (presumably based on states' simultaneous assessment of ILECs' revenue requirement, and taking into consideration providers' receipt of high cost subsidies from consumers); competitive suppliers could enter the market based on more accurate pricing signals; and those consumers residing in designated high cost areas, and with below-specified incomes would receive the high-cost credit. The income cut-off could be very generous, yet still eliminate subsidies for the wealthy. The HCF mechanism could also include tiered assistance – with several cost benchmarks, again mapped

to zip codes – with the most assistance to the most costly areas. In this ideal world, millionaires living on a Wyoming ranch would not be directly or indirectly subsidized by others for their decision to live at the end of a long dirt road in a sparsely populated area, but would instead pay cost-based rates. The portability of vouchers would also help to avoid further entrenching the incumbent carrier – because the consumer would choose the provider.

Clearly, however, this approach is not feasible because it assumes that states deaverage rates and that a well-functioning mechanism exists for distributing phone support to consumers (all but the wealthy) in high cost areas. Absent such an approach (that is, one that targets high cost support to the consumer), however, any high cost funding mechanism will have pitfalls, which, at best, the Commission can only seek to minimize, but not avoid all together. However, with the existing high cost fund mechanism, where the subsidy is disbursed to the carrier, there is no accountability to ensure that consumers benefit. Carriers are not required to demonstrate that, absent the subsidy, they will be unable to recover a reasonable return on their investment,[49] nor are they required to demonstrate that the subsidy is not being used to support carriers' pursuit of competitive and unregulated services. As a result of the Act, non-rural carriers are receiving more money, in the name of competition, but have not demonstrated a consumer benefit of either lower rates or higher service quality.

[49] / Holding Company interstate rates of return reported to the FCC indicate that the RBOCs continue to achieve high rates of return. BellSouth, Qwest, AT&T (then SBC), and Verizon report rates of return for 2004 of 20.3%, 28.18%, 21.55%, and 15.89%, respectively. FCC, ARMIS Report 43-01, Table I, Column h, Row 1915/Row 1910.

The digital divide between those who subscribe to advanced services and those who do not is thwarting the nation's vision of universal service.

As set forth by Section 254(b)(2) of the Act, "[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation." The non-rural high-cost fund does not presently support advanced telecommunications and information services. However, as, the Commission appropriately observes, "the public switched telephone network is not a single-use network, and modern network infrastructure can provide access not only to voice services, but also to data, graphics, video and other services."[50] The use of LECs' common platform for diverse services, many of which are unregulated or interstate services, raises several public policy concerns, which bear on the Commission's deliberations in this proceeding:

- LECs' increasing use of the common public switched network for services that have been classified as interstate means that the existing separations factor grossly over-allocates costs to the intrastate jurisdiction.[51] The excessive allocation of network costs to the intrastate jurisdiction inhibits states' ability to set just, reasonable, and affordable rates.
- Customers who do not subscribe to broadband services are subsidizing those customers who do subscribe to these advanced services. Unless and until federal and state regulators ensure that advanced services bear a fair share of the costs of the network,

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[50] / *NPRM*, at para. 12.

[51] / Based on the recommendation of the Federal-State Separations Joint Board, the Commission adopted an interim freeze on jurisdictional separations rules effective July 1, 2001, which expires in June 2006. *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Recommended Decision,* 15 FCC Rcd 13,160; *Jurisdictional Separations and Referral to the Federal-State Joint Board,* CC Docket No. 80-286, *Report and Order*, 16 FCC Rcd 11,382 (2001) ("Separations Freeze Order"). On December 12, 2005, the United States Telecom Association submitted a white paper entitled, "Paving the Way for Jurisdictional Separations Reform," which argues for an extension of the separations freeze that the Commission adopted five years ago until such time as the Commission adopts a permanent rule. The Ratepayer Advocate discusses its opposition to such an extension in comments submitted in other ongoing proceedings.

those customers who subscribe only to plain old telephone service ("POTS") will be subsidizing advanced services. Unless and until demand for broadband services approximates that for POTS, or LECs offer broadband services at POTS prices, this is an unfair consequence of the misallocation of network costs.[52]

- If, as a nation, we seek to ensure that all segments of society have comparable access to advanced services, the Commission should broaden its investigation beyond the framework of this proceeding, which simply compares rural and urban areas. In this more broadly defined investigation, the Commission should consider not only whether rural areas have broadband access comparable to that of urban areas, but also whether all socioeconomic groups have comparable access. Furthermore, access needs to be examined not only from the perspective of whether consumers have the *option* to subscribe to broadband service (*i.e.,* is the infrastructure deployed to the consumer's neighborhood?), but also whether consumers actually *subscribe to* advanced services. The Commission presently tracks penetration rates for basic telephone service.[53] The Commission similarly should measure and track penetration rates for broadband service.[54]

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[52] / Figure 2 shows the historical trend of increasing penetration for basic telephone service between 1920 and 2000. For example, the penetration rates were 35 percent in 1920; 62 percent in 1950, 90 percent in 1970, and 98 percent in 2000.

[53] / *See,* Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Telephone Subscribership in the United States*, data through March 2005, released May 2005; Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Trends in Telephone Service*, Tables compiled as of April 2005.

[54] / "Universal service policy is built on the principle that all of us benefit when more of us are connected. This principle resides at the core of the Telecommunications Act. And Congress made clear that the Commission must be working to ensure that all Americans—rural, urban and everything in between—have access to reasonably comparable services at reasonably comparable rates." *Order on Remand*, Separate Statement of Commissioner Michael J. Copps.

The nation's access to and use of advanced services raises several important questions. In its *NPRM*, the Commission states that it "has found that the use of high-cost support to invest in infrastructure capable of providing access to advanced services is not inconsistent with the requirement in Section 254(e) that support be used 'only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.'"[55] The Commission asks to "what extent should the Commission consider whether non-rural high-cost support is sufficient to enable carriers to upgrade networks in their high-cost areas so that the networks are capable of providing access to advanced services."[56]

The FCC has previously stated that "the goal of advancing universal service is consistent with our understanding that our universal service rules should evolve as markets and technology change."[57] As Figure 3 shows, non-rural carriers are enormously successful in selling broadband access to their customers, which belies the purported need to subsidize LECs' forays into advanced services.[58]

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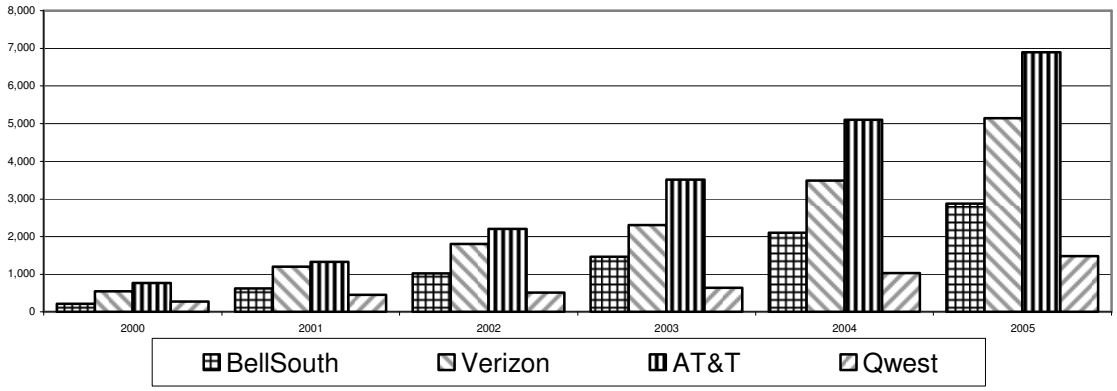
[55] / *NPRM*, at para. 12.

[56] / *Id*.

[57] / *Order on Remand*, at para. 39. *See, also, Order on Remand*, note 138 which states, "Section 254 explicitly defines universal service as an 'evolving level of telecommunications services' to take into account advances in telecommunications and information technology. 47 U.S.C. § 254 (c); see also S. Conf. Rep. No. 230, 104th Cong., 2nd Sess. 131."

[58] / The Ratepayer Advocate urges the Commission to require ILECs to submit broadband demand data separately for rural and urban areas.

Figure 3
Growth in DSL Customer Base
(in thousands)



Sources: BellSouth, Qwest, SBC (now AT&T), and Verizon quarterly and annual reports from 2000 through 2005

The burden should be on non-rural ETCs to demonstrate any need for support to provide advanced services. Furthermore, the Commission should focus not only on the *supply* of advanced services but also the *demand* for advanced services. A logical first step would be to expand the Lifeline and Linkup programs to encompass a steep discount for broadband access, which a consumer could use for any supplier.[59] Any attempts by the Commission to narrow the digital divide should address not only high cost areas, but also low-income communities. As Table 2 in Appendix A shows, the LECs favor affluent communities as they roll out fiber in neighborhoods. Appendix B summarizes general statistics about broadband demand. The Ratepayer Advocate welcomes the opportunity to contribute to any future Commission investigation of this issue, whether in this proceeding or a future

[59] / The Lifeline income eligibility is low and so would not address income constraints of the working poor, those on minimum wage, and others with little or no disposable income. For this reason, the Commission may need to explore other ways to target broadband support to a larger segment of the population. To promote technology neutrality (*i.e.,* not favoring one provider over another), the support should be fully portable. To promote administrative efficiency, an existing income verification program would be desirable.

proceeding.[60] However, the Ratepayer Advocate opposes the expansion of the non-rural high cost mechanism as a way to achieve broadband ubiquity; instead, the Lifeline program should be expanded to encompass broadband services. By using the Lifeline program, the Commission could ensure that subsidies flow to consumers rather than to carriers, thereby linking USF support to rates, as *Qwest II* requires.

Incumbent local exchange carriers should offer broadband at POTS prices.

To promote the affordable availability of advanced services, incumbent local exchange carriers ("ILEC") should offer broadband and fiber to the home at POTS prices.[61] If there are areas of the country that are either underserved or entirely neglected, the boundaries of those areas should be defined clearly. If the reason for the lack of advanced services is that the anticipated revenues from the advanced services would not cover the anticipated cost of deployment, the areas should be opened to high-cost bidding by competitors to serve the area. Competitors should then be required to commit to specified minimum service quality requirements, maximum pricing constraints, and minimum years of commitment to service. The competitor requiring the least amount of high cost support should be awarded the unique opportunity to serve the area for a specified period of time, until it can be demonstrated that the geographic area can support multiple suppliers. Alternatively, consumers should be awarded high cost/advanced services funds directly to be used as an offset against broadband charges.

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[60] / The Ratepayer Advocate also submitted initial and reply comments discussing these issues in the FCC's *Consumer Protection in a Broadband Era* proceeding. *See*, *In the Matter of Consumer Protection in a Broadband Era*, WC Docket No. 05-271, Comments of the New Jersey Division of the Ratepayer Advocate, January 17, 2006, at 15-23; Reply Comments of the New Jersey Division of the Ratepayer Advocate, March 1, 2006, at 13.

[61] / Presently, Verizon is offering DSL, a relatively slow version of broadband, for $14.95 per month. http://www22.verizon.com visited March 23, 2006.

An important component of determining whether high cost funds might be needed to promote advanced services is assessing the present demand for and deployment of broadband services. Appendix B provides a general overview of demand for broadband service. The Commission's report on high-speed access[62] provides information about broadband demand and also summarizes some data about deployment, *i.e.*, the availability of high-speed access. For example, one table summarizes the quantity of high-speed providers by state,[63] and a map entitled "High Speed Providers by Zip Code" illustrates the geographic distribution of high speed providers. The FCC's report includes some information about the relationship of deployment and household income.[64] The Ratepayer Advocate urges the Commission to continue to collect and report these data, and to expand its analysis of the relationship of income both to deployment and to consumer demand. In order to fulfill the nation's objective of universal service, advanced services must be available to and affordable by all consumers, regardless of geography or income.

Absent compelling information to the contrary, the Commission should assume that the existing level of high cost support is sufficient to enable carriers to deploy equipment that is necessary for advanced services in high cost areas.

Section 254(b)(3) states that "[c]onsumers 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

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[62] / Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, "High-Speed Services for Internet Access: Status as of December 31, 2004," July 2005, Providers of High-Speed Lines by Technology as of December 31, 2004 ("FCC High-Speed Report").

[63] / FCC High-Speed Report, Table 6. *See also,* Table 12, entitled, "Percentage of Zip Codes with High-Speed Lines in Service" which provides information about the status of broadband deployment throughout the nation.

[64] / FCC High-Speed Report, Table 15.

that are available at rates that are reasonably comparable to rates charged for similar services in urban areas." In addition to defining "reasonably comparable rates," the Commission seeks comment on whether it should consider other aspects of this principle (of reasonably comparable rates) in determining whether high-cost support is sufficient. The Commission questions if it should consider whether the telecommunications and information services provided in rural areas are reasonably comparable to those in provided in urban areas.[65]

The Ratepayer Advocate is not persuaded that such an exercise is necessary *for the purposes of modifying the non-rural high cost fund mechanism* at this time. However, for the larger and important purpose of ensuring that we do not become a nation of information haves and have-nots, the Ratepayer Advocate fully supports the Commission's efforts, in partnership with states, to assess the status of telecommunications and information infrastructures throughout the nation. Such an assessment, however, should not be limited to a comparison of rural and urban areas, but rather should encompass also a comparison of infrastructures in communities of diverse incomes.[66] Connecting homes in disenfranchised inner-city neighborhoods to advanced infrastructure is equally as important as connecting rural communities to the nation's evolving network.

All providers should contribute equitably to the preservation and advancement of universal service.

Section 254(b)(4) of the Act requires all telecommunications services providers to "make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." In this proceeding, the Commission seeks comment on whether it should assess "whether

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[65] / *NPRM*, at para. 13.

[66] / Table 1 in Appendix A provides the average income by state. More geographically granular analysis is necessary to ensure that all neighborhoods are being served equally.

all providers' contributions are 'equitable and nondiscriminatory' in considering whether non-rural high-cost support is sufficient."[67] Section 254(d) requires providers of "*interstate* telecommunications services … to contribute, on an equitable and nondiscriminatory basis. …"[68] The Commission observes that section 254(f) recognizes the authority of states to require intrastate telecommunications service providers to contribute to state universal service funding mechanisms.[69] The Commission further observes that, with respect to section 254(f) of the Act, the *Qwest II* decision rejects petitioners' arguments that implicit state subsidies may require some carriers to shoulder a "disproportionate and inequitable share of the burden in supporting their own high-cost consumers."[70] The Commission asks whether the Court's statement regarding section 254(f) of the Act "shed[s] any light on how these terms should be interpreted in section 254(b)(4).[71]

In the Ratepayer Advocate's view, the Court's statement regarding section 254(f) of the Act, which concerns states' authority to establish intrastate USF mechanisms, could reasonably be applied to the interpretation of section 254(b)(4). In other words, although all providers should contribute to the interstate high cost fund, the goal of the funding mechanism should not be to eliminate all disproportionate costs, but rather to mitigate the burden.

A rational non-rural high cost mechanism should be inherently specific and predictable.

Section 254(b)(5) states that there "should be specific, predictable, and sufficient Federal and state mechanisms to preserve and advance universal service." The Commission asks: "[i]n

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[67] / *NPRM*, at para. 14.

[68] / *Id*., citing 47 U.S.C. § 254(d), emphasis added.

[69] / *NPRM*, at para. 14.

[70] / *Id*., citing *Qwest II* ,at 1233.

[71] / *Id*., at para. 14.

determining whether non-rural high-cost support is sufficient, to what extent should the Commission also determine whether such support is specific and predictable?"[72] The Commission also seeks comment on how to define "specific" and "predictable." Disbursements should be based on a predetermined rule and/or formula that all service providers would know in advance. In this sense, the mechanisms would satisfy the statutory requirement that the mechanism is specific and predictable. However, because most, if not all, proposed mechanisms will likely rely on comparisons among states, the high cost fund mechanism necessarily will entail a level of unpredictability. The way in which the Commission determines first whether a particular area requires support and then determines the level of support necessarily depends on a comparison *among* states. If either costs or rates change in any particular state, the relationship among states necessarily will change, which, in turn, will affect the outcome of any high cost formula or mechanism.[73] In that regard, any high cost fund mechanism (other than one that freezes the level of support, which would contradict the other goals) contains an inevitable level of unpredictability.

The non-rural high cost fund should not be a barometer for assessing the Commission's compliance with the requirement set forth in Section 254(b)(6) concerning access by schools, health care providers and libraries to advanced telecommunications services.

According to Section 254(b)(6), "[e]lementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h)." The *NPRM* seeks comment as to "what extent should the Commission

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[72] / *Id*., at para. 15.

[73] / Because a common forward-looking cost model is used to compute costs, significant changes in a carrier's cost should be uncommon, and largely outside the control of the state and carrier. An example of a possible reason for a cost change in the cost model output would be a change in line density (resulting from population changes) in a carrier's territory. By contrast, rates are inherently less predictable because they can change as a result of a state's investigation of rate design and/or revenue requirement.

consider whether non-rural high-cost support helps enable schools, libraries, and health care providers to have access to advanced telecommunications services?"[74] The Ratepayer Advocate recommends that the Commission continue to limit the non-rural high cost fund to supporting the high cost of households' access to the public switched network. Because household members include students, health care patients, and library users, this access to the network implicitly furthers the goal of section 254(b)(6). The Ratepayer Advocate recommends that any high cost disbursements to schools, libraries and health care providers occur solely through the existing Schools and Libraries and Rural Healthcare programs.

III. REASONABLE COMPARABILITY

State rate designs are inherently complex and difficult to compare, which means that the Commission should establish broad ranges for assessing "reasonable comparability."

State rate designs result from unique regulatory proceedings which entail, among other things, decisions about cost recovery among customer classes, decisions about local calling areas, and decisions about revenue requirement.[75] One state's decision to adopt accelerated depreciation lives for an ILEC's plant, and another state's decision to set a relatively higher productivity offset in a price cap plan than does its neighboring state affect rate levels in each state. The myriad and countless ways that state regulators uniquely determine rate structures and rate levels within their jurisdictions contribute to variability among rates. The variability, therefore, is not necessarily related to the underlying cost of providing service, but rather to reasonable differences of view among state regulators about revenue requirement components, rate design, and price cap plan

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[74] / *NPRM*, at para. 16.

[75] / Revenue requirements, in turn, depend on individual state decisions about such matters as depreciation, cost of capital, treatment of yellow pages, etc.

mechanics. Because of these countless factors, which state regulators address, the Ratepayer Advocate is wary of any federal mechanism that places undue emphasis on precision in rate comparisons.

By way of example, Table 3 in Appendix A shows the enormous variation in toll revenues by states. The data are ranked by toll revenue and show annual toll revenues per line ranging between $90.53 in Arkansas and $2.59 in Nevada (and $0.11 in the District of Columbia). Toll revenues, in turn, depend on variables which affect demand (*e.g.,* a consumer's disposable income, elasticity of demand, and size of calling area) and the price for toll usage. All else being equal, assuming identical rate structures and demand characteristics, states with small local calling areas will necessarily have higher toll revenues.

Ultimately, the Commission must apply its administrative expertise to identify and define reasonable proxies for meaningful rate comparisons, but, in so doing, the Commission should explain to the Court the inherent limitations of comparing rates among states. Furthermore, a high-cost fund mechanism that relies on a wide variance among state rates is appropriate on grounds of fairness. By way of example, if the reason that rates in State A are higher than they are in State B is because, in revenue requirement determinations (which determine rate levels), State A does not impute directory revenues and State B does impute directory revenues, State B should not then be required to contribute high cost funds to support State A's rates. The significant quantity and complexity of variables that affect rate structures and rate levels within states are compelling reasons to establish broad ranges as the basis for ensuring that urban and rural rates are comparable.

The Commission seeks comment on how to define "reasonably comparable" in order to preserve and advance universal service in light of the Court's rejection of the Commission's analysis

in the *Order on Remand.*[76] As stated by the Commission, the *Qwest II* decision expresses concern that the variance between rural and urban rates is significant.[77] The Court found that the Commission erred in focusing more on "preserving" variability in rates than in "advancing" universal service. The benchmark constructed by the Commission (the national urban average plus two standard deviations), preserves the variability of rates, and, according to the Court, does little to advance universal service. For example, the Commission's data reports 2002 urban rates ranging from $15.65 to $35.19, with an average of $23.38. This average, plus two standard deviations, yields a benchmark amount of $32.28. The Court was concerned that this benchmark potentially allows a rural carrier to have rates twice those of the lowest urban rates. The Court seemed to implicitly approve of the highest urban rate being twice that of the lowest urban rate (*i.e.,* to tolerate significant variability among urban rates) and yet surprisingly found the variability between a theoretical rural rate and the lowest urban rate (*i.e.*, a variance of similar magnitude) unacceptable.[78]

Numerous state-controlled factors also contribute to variability, and, therefore, the Commission appropriately established a benchmark that permits a wide range of rates, which nonetheless can be reconciled with the directive of Section 254(b)(3) that consumers in rural, high-cost, and insular areas should have access to services provided in urban areas "at rates that are reasonably comparable to rates charged for similar services in urban areas."[79]

The Commission seeks comment regarding the data that it can use to assess the existing variance between rural and urban rates, and how the Commission should obtain the data. The

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[76] / *NPRM*, at para. 18.

[77] / *Id*.

[78] / *Qwest II*, at 1237.

[79] / Section 254(b)(3).

Commission also seeks the submission of rate data, suggested sources of data, and proposed methods for collecting and analyzing data.[80] The Ratepayer Advocate recommends that the Commission direct carriers to submit data in a uniform electronic format in a Commission-established template. However, because there are important and inevitable differences in rate design, such as variations in the size of local calling areas, any comparisons should not seek precision, but rather approximations of comparability. The Court has directed "reasonable comparability," and, in the Ratepayer Advocate's view, it would be unreasonable to expect the wide array of differing rate structures to allow an exact comparison.

Carriers should also be directed to submit penetration and pricing data for their bundled services, separately for urban and rural areas, by state, to enable the Commission to gauge if and when it should rely on prices for bundles as a way to assess comparability of rates. The bundle components, however, should be similar across states and carriers so that the "basket of goods" is comparable. Because states ultimately set rates, any efforts by the Commission to introduce or to induce excessive uniformity in rate structure would jeopardize states' ratemaking authority. Any mechanism must incorporate sufficient latitude to allow for state-by-state variations in rate structure, and state-by-state decisions about factors that affect rate levels (such as a carrier's return on equity, price cap rules, etc.).

The Commission seeks comment on the merits and mechanics of state-specific rate comparability benchmarks.[81] Certainly, states are in a better position than is the Commission to assess whether urban and rural rates within a state are reasonably comparable. In the *Order on*

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[80] / *NPRM*, at para. 18.

[81] / *Id.,* at para. 19.

Remand, the Commission adopted an "expanded certification process" to provide the Commission information regarding rate comparability (specifically, comparability of rates for rural areas served by non-rural carriers within the state compared to nation-wide urban rates).[82] The program adopted in the *Ninth Report and Order* required states to certify that ETCs receiving non-rural high cost model funding used the funds to "achieve the goals of the Act."[83] The newer certification rules, set forth in the *Order on Remand,* include additional requirements, which in addition to the certification that rates are comparable, include an explanation for "the basis for its conclusion as well as its proposed remedies, if necessary."[84] The expanded certification process requires rate comparability to be reported in one of several ways.

Generally, if states do not find reasonably comparable rates, they must propose a means for achieving comparability and submit supporting data with respect to residential rates in rural areas served by non-rural carriers. A "state's consideration of other relevant factors, however, may overcome the presumption [based on falling outside the safe harbor] that its rural rates are not reasonably comparable to urban rates nationwide. In this case, the state should explain its rate analysis and submit relevant rate data."[85] The Commission conditions the receipt of federal funds on the states filing the certifications once a year.[86] The Commission allows states to request additional

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[82] / *Order on Remand*, at para. 89.

[83] / *Id*.

[84] / *Id*.

[85] / *Id*., at para. 90.

[86] / *Id*., at para. 92.

federal support if they can show that the current level of federal and state support and programs are not sufficient to achieve "reasonable comparability of basic service . . . "[87]

Rates should be compared to a benchmark that is above the average.

The Commission seeks comment on whether it should continue to use a national rate benchmark and whether rates should be compared to an average, or some benchmark above the average.[88] Among other issues, the Commission also seeks comment on how it would justify any particular benchmark above the average. The Ratepayer Advocate recommends that the Commission adopt a benchmark above the average, although the Ratepayer Advocate recognizes the challenge that the Commission confronts in justifying any particular benchmark. However, just as courts afford state regulators deference in their application of administrative expertise to such matters as allowable returns on equity, so too should the court afford the Commission ample latitude to apply its administrative expertise to the challenge of determining a meaningful rate benchmark. In any event, any rate benchmark should recognize and accommodate some reasonable degree of divergence among rates throughout the country.

Increasing demand for bundles suggests that the Commission compare packages of services.

The Commission asks whether it should define reasonable comparability in terms of local rates only or whether it should consider a broader range of rates, such as for packages of services, to address differences such as ranges in calling scopes.[89] The Commission also asks the similar

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[87] / *Id.*, at para. 93.

[88] / *NPRM*, at para. 20.

[89] / *Id.*, at para. 21.

question of whether, in light of the increasing popularity of bundled services, "reasonably comparable" should refer to the total phone bill rather than just to local rates.[90]

As Appendix C shows, demand for bundled services is growing, which provides evidence that the Commission could explore further the merits of comparing prices of similar "baskets" of goods. Some limitations to comparing bundled prices that the Commission would need to address include: ensuring that the packages include the same services and retaining a way to compare a "barebones" package for those customers who do not subscribe to bundled services. The Ratepayer Advocate recommends that the Commission require ILECs to provide pricing information for their packages in rural and urban areas for each state they serve.

IV. FUNDING MECHANISMS

The Commission should continue to rely on a cost-based mechanism, and should reject proposals that rely on a rate-based universal service support mechanism.

The Commission indicates that the *Qwest II* Court invalidated the current non-rural high-cost support mechanism because it "rested on the application of a definition of 'reasonably comparable' rates that the Court also invalidated."[91] The Commission seeks comment on how the non-rural support mechanism achieves the Act's goals and principles, specifically responding to the Court's concerns. The Commission further questions whether, based on the Court's mandate that it provide "stronger evidence" that the non-rural high cost mechanism fulfills the Act's "rate-related goals," it should adopt a rate-based universal service mechanism.[92]

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[90] / *Id*., at para. 22.

[91] / *Id*., at para. 23, citing *Qwest II,* 398 F.3d at 1237.

[92] / *Id.*, at para. 23.

The Ratepayer Advocate opposes the use of a rate-based support mechanism. There is no evidence that state rates for local service correspond with the associated costs of providing local service. Using rates as a way to assess the need for high cost funds would be administratively impractical, economically inefficient, and create perverse incentives for states to raise rates.

The Commission's decision in this proceeding should continue to protect states' rate-setting authority.

The Commission should reject rate-based support mechanisms because such a mechanism could inhibit states' rate-setting authority. As the Commission has previously recognized, section 254 "did not affect the proscription in section 2(b) of the Communications Act against Commission regulation of intrastate rates."[93] As the Commission has also previously acknowledged, states have primary responsibility for ensuring reasonably comparable rural and urban rates. The Commission's primary role is to identify the states that lack the resources to support their high cost lines.[94] Furthermore, states are in the best position to assess the impact of competition on the erosion of implicit support.[95] The Court upheld the Commission's finding that Congress did not require states to transition from implicit high cost support to explicit high cost support:

> In keeping with the dual regulatory scheme embraced by the Act, Congress intended that the states retain significant oversight and authority and did not dictate an arbitrary time line for transition from one system of support to another. Compare Nat'l Ass'n of State Util. Consumer Advocates v. FCC, 372 F.3d 454, 459 (D.C. Cir. 2004) (holding that the Act did not require an immediate transition in federal support from implicit to explicit subsidies). Nor did Congress expressly foreclose the possibility of the continued existence of state implicit support mechanisms that function effectively to preserve and advance universal service. Under these

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[93] / *Order on Remand*, at para. 13, citing *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 421, 424, 446-48 (5th Cir. 1999).

[94] / *Id*., at para. 21.

[95] / *Id*., at para. 22

circumstances, we will not disturb the Commission's statutory interpretation.[96]

The Commission should continue to recognize states' unique authority to establish intrastate rates. The use of a rate-based support mechanism would constrain that authority.

The Commission seeks comment on numerous questions pertaining to the relationship between a cost-based support mechanism and the Act's rate-related goals. Among other questions, the Commission asks whether the "current cost-based support [can] be shown empirically to reduce rates, as directed by the court in *Qwest II*."[97] The Ratepayer Advocate supports efforts by the Commission to ascertain whether the disbursement of high cost funds to ETCs leads to rate reductions. Absent such a showing, consumers are simply subsidizing ETCs, without any offsetting benefit. Theoretically, as a direct result of receiving federal high cost support, an ETC should be able to lower urban rates to meet competition.

The Commission also questions whether another support mechanism, such as one based on embedded costs, study area, or wire center average costs, or a different distributive mechanism would better achieve the Act's goals.[98] The Ratepayer Advocate urges the Commission to reject the use of embedded costs as the basis for a support mechanism. The Commission's earlier findings continue to be relevant in today's market:

> As the Joint Board recognized, to the extent that it differs from forward-looking economic cost, embedded cost provide the wrong signals to potential entrants and existing carriers. The use of embedded cost would discourage prudent investment planning because carriers could receive support for inefficient as well as efficient investments. The Joint Board explained that when "embedded costs are above forward-looking costs, support of embedded costs would direct carriers to make

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[96] / *Qwest II*, at 1233.

[97] / *NPRM*, at para. 27.

[98] / *Id.*

> inefficient investments that may not be financially viable when there is competitive entry." The Joint Board also explained that if embedded cost is below forward-looking economic cost, support based on embedded costs would erect an entry barrier to new competitors, because revenue per customer and support, together, would be less than the forward-looking economic cost of providing the supported services. Consequently, we agree with the Joint Board's conclusion that support based on embedded cost could jeopardize the provision of universal service. We also agree with CPI that the use of embedded cost to calculate universal service support would lead to subsidization of inefficient carriers at the expense of efficient carriers and could create disincentives for carriers to operate efficiently.[99]

The Ratepayer Advocate acknowledges the Commission's need to respond to the concerns expressed by the Court in *Qwest II,* that is, to demonstrate that cost-based support is linked in some manner to rates. The most direct link would be to distribute the cost-based support directly to the consumers residing in high-cost areas who could then use the support to achieve rates that are comparable to their urban counterparts. As long as the funds are distributed to carriers, without any accountability by carriers for the use of the funds, the Court's directive will be virtually impossible to meet. It is not evident that the state certification process provides adequate assurance that the funds are benefiting consumers.

Carriers have failed to demonstrate that consumers are benefiting from the carriers' high cost support windfall.

The theory that carriers cannot lower urban rates to meet competition without eroding implicit support for rural areas, although superficially appealing, has not been proven. Indeed, the

[99] / *In the Matter of Federal-State Joint Board on Universal Service*, FCC CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776 (1997)("1997 Universal Service Report and Order"), at para. 228, notes omitted.

competition that the Act envisioned has not materialized,[100] and now, ILECs are benefiting from a high cost windfall, which was created to replace implicit support purportedly eroded by competition. If such competition truly threatened ILECs, one would expect ILECs to voluntarily *lower* rates in urban areas to meet the competition. The Ratepayer Advocate is not aware of ILECs lowering local exchange rates as a result of receiving high cost support. Since 2000, non-rural high cost funds have increased from $218,672,103 to $290,851,511, an approximate 25 percent increase, without any clear commensurate benefit to the consumer.[101]

Furthermore, the Commission should acknowledge and explain to the Court the inherent tension and contradictions within the language of the Act. High cost support is intended to render implicit support explicit, which would imply rate reductions in lower cost areas, while maintaining existing rural rates as a result of the high cost subsidy. Yet were a carrier to lower urban rates, the disparity between urban and rural rates would simply increase, thwarting the goal of reasonable comparability.

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[100] / For example, between 2004 and 2005, demand for Verizon's wholesale voice lines declined by 16 percent. "Verizon Communications Reports Strong 4Q 2005 Results, Driven by Continued Growth in Wireless and Broadband," January 26, 2006, http://investor.verizon.com/news/view.aspx?NewsID=718. Based on 2004 data, ILECs typically serve approximately 80 percent of local lines directly and about 15 percent of local lines indirectly by leasing wholesale facilities to competitors. Furthermore, in the wake of Verizon's acquisition of MCI and SBC's acquisition of AT&T in 2005, ILECs' market share is higher than that shown in the most recently available FCC data for 2004.

[101] / 2005 Monitoring Report, Table 3.25, High-Cost Model Support Payments by Non-Rural Study Area, based on Universal Service Administrative Company filings to the FCC.

V. CONCLUSION

The Ratepayer Advocate urges the Commission to consider carefully the implications for consumers throughout the nation of any decisions that it renders in this proceeding. Furthermore, any non-rural carrier that receives high cost support should be accountable to consumers and required to demonstrate how the high cost subsidy benefits consumers. For the reasons described above, a certain amount of variation among state rates is inevitable, in part because states render different decisions about overall revenue requirement and price cap mechanisms, which, in turn, contributes to variances. Therefore, the Commission should not seek to eliminate all variation in its pursuit of "reasonable comparability." Finally, the Ratepayer Advocate urges the Commission to ensure that broadband is affordable for all consumers regardless of their geographic location and income.

Respectfully submitted,

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