

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

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

COMMENTS OF VERIZON

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Introduction and Summary

There are two key challenges facing the universal service program today. First is the unsustainable growth in universal service funding generally. The high cost fund is over four billion dollars – more than double the size from just six years ago. As the assessments on consumers grow with the fund, the burden of paying for the fund undermines the very goals the fund seeks to protect. The second challenge is the lack of a competitively neutral assessment mechanism to ensure that consumers of voice telephone service equitably share the burden of funding universal service, regardless of the provider or technology used. As intermodal competitors increasingly provide local service in place of traditional carriers, the failure of new providers to pay into the fund is undermining both the sustainability of the fund and the competitive goals of the Act.

¹ The Verizon telephone companies (“Verizon”) are the local exchange carriers affiliated with Verizon Communications Inc., listed in Attachment A, and those formerly associated with MCI, Inc. On Jan. 6, 2006, MCI, Inc. merged into MCI, LLC, a wholly owned subsidiary of Verizon Communications Inc. Those MCI business units and certain other Verizon business units that serve enterprise and government customers now call themselves Verizon Business; those MCI business units serving consumer residential and small business customers continue to operate using the name MCI.

This proceeding provides an opportunity to begin to address these key problems. The court’s remand order requires the Commission to explain how its rules address certain statutory principles – such as whether its federal high cost rules, in combination with mechanisms available to the states, are “sufficient” to contribute to the “preservation and advancement” of universal service, and to promote service at rates that are “reasonably comparable” between urban and rural areas.² However, the court emphasized that these principles cannot be considered in isolation. They must be evaluated as part of a holistic analysis that takes into account other and sometimes competing principles – including such key principles as affordability, sustainability, and a competitively neutral and equitable assessment mechanism. *See* 47 U.S.C. § 254(b).

Specifically, the Commission should overhaul its current high cost funding mechanism in several key respects. First, to “preserve and advance” universal service, protect the sustainability of the fund, and ensure the affordability of rates, the Commission must take meaningful steps to limit the size of the fund and to narrowly target universal service support to only those areas where it is truly necessary to achieve the goal of providing consumers access to quality services at affordable rates. When consumers have access to quality services that are being provided at just, reasonable, and affordable rates from a number of competing providers, the goals of universal service can be met without continuing to provide subsidies to certain select providers. Under these circumstances, actual market experience has shown that continued support is unnecessary to provide consumers with access to service at affordable rates. And in any narrowly targeted areas where support is necessary, the goals of universal service can be

² *Qwest Communications International v. FCC*, 398 F.3d 1222, 1236-37 (10th Cir. 2005) (“*Qwest IP*”).

met without expanding the subsidies to multiple providers. Accordingly, the Commission also should limit support to a single provider in the narrow circumstances where support is warranted to avoid a snowballing effect that jeopardizes the continuing viability of the fund.

Second, to ensure that the cost of supporting universal service is funded equitably by all consumers of voice telephone services without regard to the identity of their provider, the Commission must move to a new competitively neutral assessment mechanism. Verizon has proposed a contribution mechanism based primarily on telephone numbers. Under the current mechanism, traditional wireline and wireless carriers are faced with universal service obligations that are not imposed on providers of competing services, which puts them at a competitive disadvantage to other providers, and skews the marketplace decisions of consumers. Likewise, the current mechanism is fundamentally inequitable because it requires some consumers of voice telephone services to fund universal service, while others avoid their fair share of funding universal service simply because they obtain voice telephone services from a non-traditional provider.

Finally, the Commission must undertake the analysis required to address the court's question as to whether its universal service rules will promote reasonable comparability between urban and rural rates. In particular, the Commission should gather data to address the 10th Circuit's concerns about potential disparities between rural and urban rates. However, a review of sample rural and urban rate data that is currently available indicates that rates already tend to be "reasonably comparable" in rural and urban areas. Indeed, rates in many rural areas are *lower than* urban rates, which is again,

likely an opportunity to reduce universal service support and reinforces the need for a reassessment. In addition, as stated above, in areas where competitive alternatives to LEC services exist, and consumers have access to quality services at just, reasonable, and affordable rates that are provided by providers using competing technologies, high cost support is unnecessary.

By taking these key steps to both address the court's concerns and to address the more fundamental problems of the fund, the Commission can ensure that the goals of universal service are met in a competitively neutral and equitable manner that will provide a sustainable fund that does not overburden consumers and does not jeopardize the affordability of the services provided.

I. The Commission Should Undertake a Holistic Analysis that Appropriately Balances All of the Statutory Principles

The 10th Circuit generally faulted the Commission for looking at universal service statutory principles in isolation from one another. In addressing the statute on remand, the Commission must broaden its review, to not only address the specific terms identified by the court, but how the entire universal service statutory requirement fits together in light of changing market conditions.

The specific issues for remand involve how to define the terms "sufficient" and "reasonably comparable." See *Qwest II*, 398 F.3d at 1237; *Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking, CC Docket No. 96-45, WC Docket No. 05-337, ¶¶ 6-29 (rel. Dec. 9, 2005) ("Notice"). Specifically, the court found that the Commission erred in defining the term "sufficient" by "focusing solely on the issue of reasonable comparability in §254(b)(3)" and ignoring other Section 254(b) principles, and directed it to "articulate a definition of 'sufficient' that appropriately considers the

range of principles” under the statute. *Qwest II*, 398 F.3d at 1234. The court also held that the Commission’s definition of “reasonably comparable” was based on an impermissible statutory construction, because the FCC focused only on “preserv[ing]” universal service rather than, as the statute states, on “preservation and advancement.”³ The court remanded the mechanism, since it relied on the faulty definition of “reasonably comparable” that the court had invalidated. *Id.* at 1237.

While the court specifically addressed the terms defined in the Commission’s most recent order, the court’s overarching concern was the failure of the FCC to “consider fully the Act’s principles as a whole” and instead focus on isolated principles to the exclusion of others. *Qwest II*, 398 F.3d at 1234. As the court recognized, the Commission must examine “the evolving nature of the system of supports” and develop a “comprehensive picture” of how those supports should be structured in the current market. *Id.* at 1230. For present purposes, this means undertaking a thoroughgoing reassessment of the non-rural high cost fund to take into account the realities of today’s market environment, and narrowly target any support to those areas where it is truly necessary to meet universal service objectives. Ultimately, this means not only addressing the non-rural high cost fund, but also the much larger rural fund, which is subject to the same statutory definitions and goals.

The Act established explicit federal support for the “preservation and advancement of Universal service.” 47 U.S.C. § 254(b). In establishing a “specific and

³ Specifically, in interpreting the statutory command to “preserve and advance” universal service, the court cautioned that the term “universal service” cannot be described separately for each verb. That is, the Commission cannot reason that “preserve” applies to one thing (rate variances) but “advance” applies to another (evolving rules recognizing changes in markets and technology). *Id.* at 1236.

predictable mechanism,”⁴ Congress was trying to facilitate the transition away from markets characterized in many instances by exclusive franchises to competitive markets. But the universal service mechanism was just one tool to achieve the overarching goal of preservation and advancement of universal service during this transition. Moreover, Congress understood the core universal service goal of “access to” quality service at “just, reasonable and affordable rates” need not be dependent on a fund to the extent such a fund was unnecessary. *Id.* § 254(b)(1) (Multiple statutory universal service goals focus on “access” to services.) *Id.* §§ 254(b)(2), (3), (6). Where such access is or can be provided through the operation of market forces, universal service support is demonstrably not necessary.

Indeed, Congress recognized that the funding mechanism was only a limited tool to help achieve the statutory goals. When it described the mechanism, it included the goals that such mechanism be “specific, predictable and sufficient.” 47 U.S.C. § 254(b)(5). The requirement that support be specific and predictable suggests a limit on the fund to avoid open-ended growth that is neither specific nor predictable.

Sufficiency is more complex, and must include consideration of principles of affordability and sustainability. The Commission should define “sufficient” as “an affordable and sustainable amount of support that is adequate, but no greater than necessary, to achieve the goals of the high-cost program.”⁵ This incorporates the principle that whether funding is “sufficient” involves an inquiry not merely into whether

⁴ 47 U.S.C. § 254(b)(5).

⁵ “Sufficient” is not defined by the statute, but standard definitions of the term are “enough” or “adequate” or as much as is “necessary.” See WEBSTER’S II NEW COLLEGE DICTIONARY 1128 (3d ed. 2005); see also BLACK’S LAW DICTIONARY 1447 (7th ed. 1999) (“as is *necessary* for a given purpose”) (emphasis added).

there is *enough* support, but whether there is *too much*. In fact, the court specifically agreed that the Commission could limit the term “sufficient” by including in the definition the requirement that it be “only as large as necessary” to meet the statutory goal. *Qwest II*, 398 F.3d at 1234. A crucial component of ensuring that universal service levels are “sufficient” (and “predictable”) involves making sure that the fund size does not grow so large as to be unsustainable. On remand, therefore, the Commission should define “sufficient” in relation to other principles including affordability and sustainability.⁶

Indeed such growth could imperil both the affordability and sustainability of the Commission’s universal service mechanisms. While market forces have reduced telephone rates and made them more affordable over time, the growth of the fund has meant that the universal service assessment has become an ever larger proportion of consumer’s bills. The increasing cost of universal service obviously tends to offset the benefit to consumers of competitive entry, since it is consumers who must bear the cost of universal service. And failure to limit the fund by targeting it so that it will just be sufficient, ultimately will negatively impact affordability and the long term sustainability of the fund. The 10th Circuit has repeatedly recognized that “excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1).” *Qwest II*, 398 F.3d at 1234, citing *Qwest Corp. v. FCC*, 258

⁶ The court found that the FCC erred in defining the term “sufficient” by “focusing solely on the issue of reasonable comparability in §254(b)(3)” and ignoring other Section 254(b) principles. *Qwest II*, 398 F.3d at 1234. It directed the Commission to “articulate a definition of ‘sufficient’ that appropriately considers the range of principles identified in the text of the statute.” *Id.*

F.3d 1191, 1200 (10th Cir. 2001) (“*Qwest I*”).⁷ Thus, in evaluating the fund, the Commission should determine whether consumers have access to protected services without the need for explicit support, and narrowly target support for those services and areas where it is necessary for such access.

The Commission and the Joint Board have recognized that another goal of universal service policy is “competitive neutrality.” This complements the statutory goal that any assessment mechanism be “equitable.” 47 U.S.C. § 254(b)(4). In any reform of universal service policy, the Commission must establish assessments that do not favor one class of providers over another. And it must ensure that the costs of universal service are not inequitably borne by only some consumers of voice telephone service who choose to purchase service from traditional wireline and wireless providers, while other consumers who purchase their service from non-traditional providers avoid their fair share of that cost. Consistent with all the universal service goals, this requires the Commission to evaluate the impact that the current market has on its existing policies. In particular, the Commission must address the impact of intermodal competitors offering pervasive service today, most without the need for universal service support, and many without the burden of universal service assessment.

II. The Statutory Principles Require the Commission to Consider the Current Market Environment, Where There Now Exists Extensive and Vigorous Intermodal Competition For Local Telephone Services

As noted above, the overriding goal of universal service is to provide consumers with “access to” telephone service in all regions of the nation at “affordable” rates. In

⁷ See also *Alenco Communications v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000) (“[E]xcess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market.”).

order to fulfill this goal, the Commission's universal service policies must respond to the realities of the current telecommunications marketplace. In particular, the Commission's policies can not continue to assume that consumers' "access to telecommunications and information services," 47 U.S.C. § 254(b)(3), is only available from traditional wireline local exchange carriers. Today, nearly all consumers have access to telephone services from cable companies, wireless carriers, and VoIP providers.

Cable companies are providing consumers with access to telecommunications services over their own networks. By the end of 2007, cable companies are projected to be offering telephony services (VoIP or switched) to 94 percent of U.S. households.⁸ Some major cable operators, including Time Warner Cable and Cablevision, already offer telephony services in their entire footprint, while others, such as Cox, plan to reach that milestone by year-end 2006 at the latest.⁹ As one Wall Street analyst has noted: "By the end of 2006, [VoIP] will be offered almost ubiquitously by cable operators."¹⁰

As a result, there has been rapid growth in the number of cable telephony subscribers. According to FCC survey data, as of January 2004, approximately 13

⁸ Jeffrey Halpern, *et al.*, Bernstein Research Call, *Quarterly VoIP Monitor: VoIP Gathering Momentum, Expecting 20M Cable VoIP Subs by 2010*, at Exhibit 7 (Jan. 17, 2006) ("Jan. 2006 Quarterly VoIP Monitor").

⁹ See Craig Moffett, *et al.*, Bernstein Research Call, *Cable and Telecom: VoIP Deployment and Share Gains Accelerating; Will Re-Shape Competitive Landscape in 2005* (Dec. 7, 2004); see also, Thomson StreetEvents, TWX – Q4 2004 Time Warner Inc. Earnings Conference Call, Conference Call Transcript (Feb. 4, 2005) (statement of Time Warner Inc. CFO Wayne Pace); News Release, Cablevision, *Cablevision Systems Corporation Reports First Quarter 2005 Results* (May 5, 2005), available at http://www.findarticles.com/p/articles/mi_m0EIN/is_2005_May_5/ai_n13672660; see also Comcast, presentation at the Bear Stearns 18th Annual Media, Entertainment & Information Conference, at 10-11 (Mar. 2, 2005).

¹⁰ Craig Moffett, *et al.*, Bernstein Research Weekly Notes, *Cable and Telecom: VoIP Will Reshape Competitive Landscape in 2005* (Dec. 17, 2004).

percent of customers that were offered cable telephony were subscribing to the service.¹¹ Some cable operators report that, in some areas, their telephony services have been purchased by as much as 20-40 percent of their cable subscribers.¹² Collectively, cable companies are expected to serve more than 9 million lines by the end of 2006 and more than 13 million by year-end 2007.¹³ Analysts expect that cable companies will achieve an overall penetration rate of 15-20 percent within the next five years.¹⁴

Wireless companies are also providing consumers with access to telephone service in both rural and urban areas. According to a recent Commission report, 97 percent of the total U.S. population already has access to three or more different wireless

¹¹ See *Report on Cable Industry Prices, Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, Report on Cable Industry Prices, 20 FCC Rcd 2718, 2730, ¶ 37 & Table 10 (2005).

¹² See, e.g., Chris Bowick, SVP Engineering & CTO, Cox Communications, *Cox Communications: Distribution at Its Best*, presentation at the Bear Stearns 17th Annual Media, Entertainment & Information Conference 19 (Mar. 8, 2004); *Q1 2004 Cox Communications Inc. Earnings Conference Call – Final*, FD (Fair Disclosure) Wire, Transcript 042904as.714 (Apr. 29, 2004) (Pat Esser, Cox executive vice president & COO); News Release, Cox Communications, *Cox Brings Telephone to Five New Markets in '05* (Mar. 8, 2005), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=683077> (“In some communities, such as Omaha, Neb. and Orange County, Calif., 40 percent of consumers subscribe to Cox Digital Telephone.”).

¹³ See Jan. 2006 Quarterly VoIP Monitor, at Exhibit 8.

¹⁴ See, e.g., Douglas S. Shapiro, *et al.*, Banc of America Securities Research Brief, *Battle for the Bundle: Mapping the Battlefield, Our First Report from the Front* 3 (June 14, 2005) (“Cable should have 19.8 million telephony subs by 2010, or 18% penetration of homes passed.”); see also Raymond James & Assoc. Inc., *Reassessing the Impact of Access Lines on Wireline Carriers*, at 1 (July 11, 2005) (estimating that cable and standalone VoIP will reach over 20 percent of residential households by 2010); Jan. 2006 Quarterly VoIP Monitor, at Exhibit 8 (“we expect all the Bells to see roughly the same level of line losses, approximately 20-22% by 2010”); Frank Governali, *et al.*, Goldman Sachs, *Americas: Telecom Services* (Jan. 12, 2005).

providers in counties in which they live.¹⁵ In fact, wireless service has grown so spectacularly that of 362 million voice lines counted by the FCC at the end of 2004, 181.1 million – more than 50 percent – are wireless.¹⁶ And the number of wireless subscribers has grown from about 35 million at the time the 1996 Act was enacted to more than 190 million today.¹⁷

Consumers view access to wireless service as an alternative to wireline telephony. A Yankee Group survey found that approximately 10 percent of wireless users do not have a landline phone at all.¹⁸ Lehman Brothers estimates that 16 million wireline access lines have been lost to wireless since 1999, and that wireless substitution will continue to add more than 6 million new wireless subscribers each year.¹⁹ As a result, analysts

¹⁵ See *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Tenth Report, 20 FCC Rcd 15908, 15925, ¶ 41 (2005) (“*Tenth Report*”). According to the same report, 87 percent of the U.S. population lives in counties with five or more mobile telephone operators competing to offer service, and 41 percent of the population lives in counties with six or more mobile telephone operators competing to offer service. *Id.*

¹⁶ See FCC, Wireline Comp. Bur., Ind. Anal. & Tech. Div., *Data on Local Telephone Competition: Status as of December 31, 2004*, at 1 (rel. July 8, 2005), available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0705.pdf.

¹⁷ See CTIA-The Wireless Association, *Background on CTIA’s Semi-Annual Wireless Industry Survey* at 5 (2005), available at <http://files.ctia.org/pdf/CTIAMidYear2005Survey.pdf>.

¹⁸ Kate Griffin, Yankee Group, *Pervasive Substitution Precedes Displacement and Fixed-Mobile Convergence in Latest Wireless Trends*, at 5 (Dec. 2005). See also J. Armstrong, *et al.*, Goldman Sachs, *2006 Outlook – Stuck in Neutral* at 31 (Jan. 13, 2006) (wireless-only customers represent a 12.5 percent share of the residential market).

¹⁹ B. Bath, Lehman Brothers, *Telecom Services - Wireline* at Figure 11 (July 7, 2005). See also T. Horan, *et al.*, CIBC World Markets, *3Q05 Communications and Cable Services Review* Exh. 12 (Nov. 23, 2005) (estimating wireless substitution at 20 million lines as of year-end 2005, increasing by 5-6 million lines each year through 2007).

predict that the number of wireless-only users will grow to 20-25 percent of the market by 2010.²⁰ And even if they are not replacing their landline phone altogether, at least 14 percent of U.S. consumers now use their wireless phone as their primary phone.²¹

Independent VoIP providers also provide consumers with access to telephony service. Any consumer with broadband access – which is now available to more than 90 percent of U.S. households from a provider *other than* the incumbent LEC²² – can obtain voice service from multiple independent VoIP providers. Vonage, for example, provides service to more than 1.3 million customers in the U.S. and completes more than 35 million calls each week.²³ Skype, a service that allows customers to make *free* computer-to-computer calls, was recently acquired by eBay, and reports that 59 million people are registered to use Skype’s free service.²⁴

Because consumers increasingly view wireless, cable telephony, and VoIP as viable alternatives to wireline service, wireline access lines are now falling at

²⁰ D. Barden, J. Bender, & R. Dezego, Banc of America Securities, *Setting the Bar: Establishing a Baseline for Bell Consumer Market Share* 4 (June 14, 2005); Raymond James & Assoc. Inc., *Reassessing the Impact of Access Lines on Wireline Carriers*, at 1 (July 11, 2005) (predicting 25 percent wireless substitution by 2010).

²¹ See C. Wheelock, In-Stat/MDR, *Cutting the Cord: Consumer Profiles and Carrier Strategies for Wireless Substitution*, at 1 (Feb. 2004) (“14.4% of US consumers currently use a wireless phone as their primary phone.”).

²² See, e.g., NCTA, Industry Overview: Statistics & Resources, <http://www.ncta.com/Docs/PageContent.cfm?pageID=86> (112.5 million homes passed by cable modem service as of June 2005); see also NCTA, *2005 Mid-Year Industry Overview* at Chart 5 (cable modem service is available to approximately 93 percent of homes passed by cable) (citing Morgan Stanley).

²³ Vonage, SEC Filing (Form S-1), at 1 (Feb. 8, 2006); Vonage, Fast Facts, available at http://www.vonage.com/corporate/aboutus_fastfacts.php.

²⁴ Press Release, eBay, *eBay Completes Acquisition of Skype* (Oct. 14, 2005); Press Release, eBay, *eBay To Acquire Skype* (Sept. 12, 2005).

approximately 5 percent annually.²⁵ Industry experts forecast that cable and VoIP will have more than 9 million subscribers by year-end and that in five years 45 percent of U.S. households will either be wireless only or will use VoIP to make their calls.²⁶

These intermodal competitors have been providing services that compete with the quality and prices of LEC services, often without the help of *any* universal service support. Their success and rapid growth proves that where consumers have access to these affordable services, there is no need to continue high cost subsidies.

In fact, telephone services are also far *more affordable* than they were even ten years ago, when the 1996 Act was adopted. Wireless prices have declined by as much as 10 to 20 percent a year over the last decade.²⁷ Moreover, prices charged by wireless and other intermodal competitors have constrained the rates ILECs can charge, because the services are highly cross-elastic. An econometric analysis by the Competitive Enterprise

²⁵ See Viktor Shvets & Andrew Kieley, Deutsche Bank, *Consumer Wireline Erosion: The Strategic Response to "Water Torture"* 2 (May 19, 2005) ("[A]ccess line losses will escalate over the next 12 months towards 6%, and possibly as high as 8% per annum, driven by wireless cannibalization, rapid take-off of cable telephony, and proliferation of non-facilities-based VoIP services."); see also Viktor Shvets, *et al.*, Deutsche Bank, *2006 Preview: Out with the Old, In with the New* 9 (Dec. 19, 2005) ("In 2005, Verizon continued to suffer the highest rate of loss (ending the year at an estimated rate of around 6.7%). We continue to believe that this is primarily caused by its 'cutting edge' exposure to aggressive cable telephony deployments by CVC and Time Warner."); Jason Armstrong, *et al.*, Goldman Sachs, *Preview in Pictures (PiP) – 4Q2005, Americas Telecom Services 2* (2006) ("Access line continues to worsen, on average 40 bp worse than last quarter, we estimate. We expect 6.8% line loss from VZ, 130 bp worse than any other RBOC."); Courtney Munroe, IDC, *US Landline 2005-2009 Forecast and Analysis*, at Table 10 (Dec. 2005) (showing the total number of access lines falling 5%).

²⁶ See Jan. 2006 Quarterly VoIP Monitor, Exhibit 8; Frank G. Louthan, IV, Raymond James & Associates, Inc., *Reassessing the Impact of Access on Wireline Carriers*, at 2 (July 11, 2005).

²⁷ See *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, 19 FCC Rcd 20597, 20700, Table 9 (2004) (showing average revenue per minute declining every year since 1995).

Institute found that “a one percent increase in wireline prices would result in a nearly two percent increase in wireless demand. In other words, if wireline carriers were to increase their prices, wireless service providers would gain a substantial number of subscribers.”²⁸ Just as important, the wireless carriers would gain a substantial number of minutes. Consumer surveys reveal that wireless service has already displaced 64 percent of long distance and 42 percent of local calling from landlines in households with wireless phones.²⁹ By 2004, wireless minutes of use had risen to 1.1 trillion, an increase of 32.7 percent from 2003 and more than 300 percent since 2000.³⁰ During the same time, the Commission’s own data show that average residential wireline toll minutes have declined rapidly for the industry as a whole – from an average of 149 minutes per month in 1997, down to only 71 minutes per month in 2003 (and undoubtedly much less today, given the increase in wireless and decrease in wirelines).³¹

²⁸ Stephen B. Pociask, Competitive Enterprise Institute, *Wireless Substitution and Competition: Different Technology but Similar Service – Redefining the Role of Telecommunications Regulation*, at 15 (Dec. 15, 2004), available at <http://www.cei.org/pdf/4329.pdf>.

²⁹ Kate Griffin, Yankee Group, *Pervasive Substitution Precedes Displacement and Fixed-Mobile Convergence in Latest Wireless Trends*, at 5 & Exhibit 3 (Dec. 2005).

³⁰ See CTIA-The Wireless Association, Background on CTIA’s Semi-Annual Wireless Industry Survey, *Reported Wireless Minutes of Use Exceed One Trillion in 2004* at 8 (2005), available at <http://files.ctia.org/pdf/CTIAYearend2004Survey.pdf> (“CTIA Semi-Annual Survey”); see also *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, Ninth Report, 19 FCC Rcd 20597 (2004) available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-216A1.pdf.

³¹ See Ind. Anal. & Tech. Div., Wireline Competition Bureau, *Trends in Telephone Service* at Table 14.2 (June 2005) (includes: IntraLATA-Intrastate, InterLATA-Intrastate, IntraLATA-Interstate, InterLATA-Interstate, International, Others (toll-free minutes billed to residential customers, 900 minutes, and minutes for calls that could not be classified)) (“*Trends in Telephone Service*”).

According to the 2004/2005 edition of the FCC's Statistics of Communications Common Carriers, from 1996 to 2005, the change in the consumer price index for local residential services generally was in line with movement of the consumer price index for all consumer items.³² However, as a result of competition generally, and the increase in bundled offerings, customers' *overall* bill for telephone services, which were widely affordable to start with, has been getting even more affordable. The prices for total telephone service *decreased* 5.8 percent from 1998 to 2005; during the same time, the cost of all consumer items was *increasing* by 15.3 percent.³³ On average, in 1998, consumers spent 2 percent of their income on telephone services; today, that number is only 1.8 percent.³⁴ Thus, phone service has been getting more affordable, both in real terms, and compared to the costs of other services.

³² See FCC, Statistics of Communications Common Carriers, Table 5.10 (2004/2005 ed.) ("Statistics of Communications Common Carriers"). Much of the change in local residential services was not from the monthly rate, but from increases in the SLC, taxes, 911 and other charges. For example, while the average monthly charge increased 10.2% from 1994 to 2004 (\$13.19 to \$14.53), during the same time period the SLC increased 63.7% (\$3.55 to \$5.81) and the cost of taxes, 911, and other charges on average grew 71.9% (\$2.31 to \$3.97). See *id.*, Table 5.11 – Average Residential Rates for Local Service in Urban Areas, 1994-2004. The SLC increases were largely due to implementation of the CALLS plan and the Multi-Association Group Plan, which increased the end user charge, but decreased per-minute access charges. See *Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd 12962 (2000); *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 11244, ¶ 30 (2001).

³³ See Statistics of Communications Common Carriers, Table 5.10. The first year with available statistics for total telecommunications service expenditures was 1998.

³⁴ Compare U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Expenditure Survey* Table 3 (1998) (showing consumer unit income of \$41,622 (before taxes) and \$830 of expenditures for telephone services), available at <http://www.bls.gov/cex/1998/Standard/age.pdf>, with U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Expenditure Survey* Table 3 (2004) (listing consumer unit income (before taxes) as \$54,453 and \$990 worth telephone services expenditures), available at <http://www.bls.gov/cex/2004/Standard/age.pdf>.

Again, this trend appears to be consistent in both rural and urban areas. *See* Section V, below.³⁵ This is not surprising, as nationwide cable, wireless and VoIP providers increasingly are offering calling plans with unlimited minutes of use.³⁶ The wireless carriers' all-distance plans, beginning in 1999 and 2000, have already led to massive displacement away from landline long distance calls and reversed what had been a steady increase in wireline long distance minutes. "Thanks to unlimited night and weekend minutes . . . cell phone plans are the method of choice when it comes to long distance calling from home."³⁷

However, as the price for telephone service goes down and universal service program costs increase, consumers increasingly are finding larger percentages of their monthly telecommunications service bill consists of payments into the universal service fund. As explained in Section IV, the universal service fund in general, and the high-cost portion of the fund in particular, have continued to grow: total high-cost disbursements were \$1.718 billion in 1998, and are predicted to exceed \$4 billion this year. A combination of growing universal service fund costs and declining telecommunications revenues has driven up the contribution factor dramatically. In 1998, the contribution factor averaged 3.16 percent; however, the contribution factor is now at 10.9 percent –

³⁵ Declaration of Patrick Garzillo, ¶ 4-22 (attached hereto) (describing analysis that found various urban and rural ILEC rates to be reasonably comparable).

³⁶ *See, e.g.*, Verizon Wireless, <http://www.verizonwireless.com/b2c/store/controller?item=planFirst&action=viewPlanOverview> (offering nationwide wireless calling plans and unlimited minutes of use); Vonage, <http://www.vonage.com/> (a VoIP provider offering nationwide calling plans and unlimited minutes of use); Net2Phone, <http://web.net2phone.com/consumer/voiceline/> (a cable telephony provider offering nationwide calling plans and unlimited minutes of use).

³⁷ W. Mossberg, *The Mossberg Solution, Turning Your Home Phone into A Cellphone – Call-Forwarding Devices Let You Use Cellular Service on a Traditional Phone*, WALL ST. J., Dec. 3, 2003, at D6.

nearly 3.5 times greater than it was just eight years ago.³⁸ This both increases the burden imposed on consumers to support universal service, and offsets part of the benefit of competitive entry, which has disciplined prices in other respects.

It is critical that the Commission's policies respond to the new marketplace by narrowly targeting its high cost support to only those areas where no provider otherwise would provide quality services at just, reasonable, and affordable rates, and such support is unnecessary anywhere where the market – rather than explicit subsidies – can achieve these statutory goals.

It is equally important that the Commission discontinue the policy of providing support to more than one carrier per study area, as this creates a waste of universal service dollars, and exacerbates the problem of spiraling fund costs. Non-ILEC carriers have been applying for and receiving high-cost support in an increasing number of study areas, putting additional strains on the fund size.³⁹ Moreover, to the extent that subsidies are larger than necessary to meet the statutory goals, that problem is exacerbated when multiple carriers receive support.⁴⁰ Competitive neutrality does not require support of

³⁸ See *Trends in Telephone Service*, at Table 19.6 ; see also Public Notice, *Proposed Second Quarter 2006 Contribution Factor*, DA 06-571 (rel. Mar. 13, 2006).

³⁹ High-cost support to CETCs more than doubled between 2003 and 2004 alone. *Trends in Telephone Service*, at Table 19.5. And the percentage of high-cost support received by wireless providers also more than doubled over that same time period. Compare *id.* at Table 19.2, with FCC, Wireline Comp. Bur., Ind. Anal. & Tech. Div., *Trends in Telephone Service*, at Table 19.2 (rel. May 6, 2004) (showing that the percentage of high-cost support to wireless providers increased from 3.8% in 2003 to 9.3% in 2004).

⁴⁰ In less than five years, the share of high-cost funds spent to subsidize duplicative networks in high-cost areas skyrocketed from 0.1 percent to 9.5 percent. *Trends in Telephony Service*, at Table 19.5. See also Comments of OPASTCO, CC Docket No. 96-45 (Sept. 30, 2005) (writing that CETCs are the primary drivers of growth in the rural high-cost program).

multiple carriers. Instead, support to all carriers should be reduced or eliminated where not absolutely necessary, to achieve a more competitively neutral playing field.

Ironically, many of these new universal fund recipients were previously profitably providing service in that same area without federal support. One part of the solution is for the Commission to target support as narrowly as possible, and to limit support in the narrow set of circumstances where it truly is necessary to only one ETC in any one study area.

Likewise, narrow targeting means that the Commission should look at the whether areas that receive service could allow providers to adjust rates and still provide consumers access to quality service at affordable rates. In particular, there is clearly something wrong where, as with the non-rural portion of the fund, half of the support is directed to a single state, Mississippi.⁴¹ Indeed, a review of available revenue data indicates that BellSouth, which receives roughly a third of the total non-rural fund for its Mississippi services, could replace universal service support by adjusting its rates and still provide service at rates that are comparable with other providers across the country.⁴²

Moreover, an additional \$48.4 million of the support given to Mississippi is received by 13 competitive ETCs, whose support is simply a byproduct of the Commission's portability rules, which allow them to get the same levels of support as the ILEC.⁴³ Of course, if support to BellSouth in Mississippi is eliminated, "portable"

⁴¹ See *Federal-State Joint Board on Universal Service, 2005 Universal Service Monitoring Report*, CC Docket No. 98-202, Table 3.25 (Dec. 29, 2005) ("*Joint Board Monitoring Report*") (stating that in 2005, Mississippi received \$148.1 million of the total \$290.85 million high-cost model support that was disbursed).

⁴² See Garzillo Declaration, ¶¶ 41-42 & Exh. E.

⁴³ See *Joint Board Monitoring Report*, Table 3.25.

support to these carriers in Mississippi will be eliminated as well. However, this merely emphasizes the problem with supporting multiple carriers in high cost areas. Providing too much support to the ILEC produces a snowball effect, encouraging other carriers to seek ETC status in high cost study areas in order to get a share of universal service dollars. In fact, ten of the 13 non-ILEC carriers in Mississippi started receiving high-cost support within the last two years.⁴⁴ The Commission should immediately address those areas where it appears that carriers are receiving more support than is necessary, by reducing or eliminating high-cost funding. And it also should take steps to eliminate funding of duplicative networks in high cost areas by reducing the number of ETCs that can receive universal service support.⁴⁵

As the Commission recently recognized when reviewing evidence of competition in the marketplace for wireless services, “competitive pressure to attract new customers and retain existing customers has resulted in concerted efforts by carriers to improve service quality,” and “price competition” serves to control or reduce rates.⁴⁶ In an environment where competition is coming from all segments of the marketplace, and each is poised to take a significant portion of the historic wireline market, universal service policies should not continue to indefinitely fund support where actual market experience shows that subsidies are not necessary to achieve the core goal of universal service.

⁴⁴ *See id.*

⁴⁵ *See* Comments of Verizon, CC Docket No. 96-45, at 7-9 (Sep. 30, 2005).

⁴⁶ *Tenth Report*, 20 FCC Rcd at 15958, 15965 ¶¶ 132, 154.

III. The Principles of Competitive Neutrality and Equitable Distribution of the Cost of Universal Service Require the Commission to Overhaul Its Mechanisms for Assessing Contributions

The problems caused by an over-sized federal universal service fund are exacerbated by the lack of an equitable assessment mechanism. Not only do consumers have to pay for a fund that is too large; a subset of customers have to pay a disproportionate share of that fund while others pay nothing.

The Commission has added the principle of “competitive neutrality” as an additional federal universal service goal.⁴⁷ The Commission explained that the term meant that, “universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.”⁴⁸ But the current mechanism does just that. In particular, under the current mechanism, traditional wireline and wireless carriers are faced with universal service obligations that are not imposed on competing voice telephone services, such as VoIP services. By bearing a disproportionate universal service burden, traditional wireline and wireless carriers are placed at a competitive disadvantage relative to other providers of voice telephone services that are not faced with universal service obligations. This disproportionate burden inevitably skews the marketplace decisions of consumers.

Moreover, the current mechanism is fundamentally inequitable because it requires some consumers of voice telephone services to fund universal service, while others avoid their fair share simply because they obtain voice telephone service from a non-traditional

⁴⁷ See *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, ¶¶ 46-52 (1997).

⁴⁸ *Id.* ¶ 47.

provider. And as technology evolves and more customers move to voice telephone services that may not be paying their fair share – or any share – this inequity will become even greater as the burden on the remaining customers of traditional wireline and wireless services is commensurately increased.

Competitive neutrality and the statutory principle of equitable distribution of the cost of universal service therefore require a revision to the assessment mechanism for apportioning contributions to universal service. One alternative under discussion, which would ensure far greater competitive neutrality, would be a telephone numbers-based system. A properly structured assessment mechanism – based primarily on working telephone numbers – would capture all providers of voice services that connect with the public switched network, regardless of the technology used to provide these service obligations.⁴⁹ By capturing an entire class of services that compete with local service and yet often exempt themselves from universal service obligations, it would minimize arbitrage opportunities and broaden the base of contributors. Such a plan would also avoid the current problem of determining the interstate portion of revenues associated with services or packages that include both interstate and intrastate services that cannot be readily segregated into their component parts. Moreover, consistent with the Commission’s competitive neutrality goals, it would help ensure that contribution obligations do not guide or distort consumer choices or market decisions. Such a mechanism would be more equitable, avoiding unduly burdening certain customers or

⁴⁹ As Verizon has stated, the Commission should also assess functional equivalents to telephone numbers that provide customers with the ability to make or receive voice calls from the public switched telephone network. This will ensure that providers that switch from North American Numbering Plans to some other form of addressing will continue to contribute to the fund.

services. Towards that end, the Commission could continue to assess classes of service that do not generally have a telephone number associated with them, like special access and prepaid calling cards, on an interstate retail revenue basis. In adopting any new mechanism, however, the Commission should minimize rate shock to customers that would otherwise experience a dramatic increase in contribution obligations.⁵⁰

IV. In Order to Achieve the Goals of Affordability And Sustainability, the Commission Must Reduce the Size of the High-Cost Fund, And Universal Service Spending Generally, And Narrowly Target Support to Only Those Areas Where it is Truly Necessary

The Commission has recognized the need to limit the growth of the universal service fund, and high-cost support in particular.⁵¹ However, the universal service fund in general, and the high cost portion of the fund in particular, has continued to grow: total high-cost disbursements were \$1.718 billion in 1999, yet the Universal Service Administrative Company (“USAC”) predicts that by the second quarter of 2006, the

⁵⁰ Specifically, the Commission should assess only one-half a telephone number based assessment to numbers provided to wireless family share plans, allow carriers flexibility in how they recover contribution costs from Centrex and business customers, and ensure an adequate implementation period for the industry. *See* Letter from Kathleen Grillo, Verizon, to Marlene H. Dortch, FCC, CC Docket No. 96-45 (filed Mar. 3, 2006).

⁵¹ *See, e.g., Petition of Mid-Rivers Telephone Cooperative, Inc. for Order Declaring it to be an Incumbent Local Exchange Carrier in Terry, Montana Pursuant to Section 251(H)(2)*, Notice of Proposed Rulemaking, 19 FCC Rcd 23070, 23077, ¶ 11 (2004) (finding that the “Commission has recognized the vital importance of avoiding excessive growth in the universal service fund size”). *See also* Comments of CTIA, CC Docket No. 96-45, at 21 (Sept. 30, 2005) (noting that “the current inefficient high-cost universal service mechanism . . . does not target support” appropriately); Comments of Qwest, CC Docket No. 96-45, at 10 (Sept. 30, 2005) (“[T]he federal fund has become too large, and certainly cannot be permitted to grow larger.”); Comments of BellSouth, CC Docket No. 96-45, at 6 (Sept. 30, 2005) (recognizing that the overall size of the fund should be controlled).

high-cost fund requirements will be over a billion dollars *per quarter*.⁵² Since 1998, approximately \$35.7 billion has been expended to implement Section 254,⁵³ with more than \$18 billion of this support being spent for high-cost support.⁵⁴ Even if there were no additional growth in the high-cost fund, by the end of 2006 the total high-cost fund would be more than \$4.195 billion per year – more than double the size of high-cost mechanism from just six years ago.⁵⁵ A combination of growing universal service fund costs and declining telecommunications revenues has led to a contribution factor of nearly 11 percent⁵⁶ -- roughly three times the factor in effect just a few years ago.⁵⁷

The growth in universal service spending simply cannot continue to go unchecked. The overall size of the universal service fund is growing to levels that could threaten two of the primary goals of the universal service program: affordability, and the sustainability of the fund.

First, the size (and continued growth) of the fund is not sustainable. This undermines both the goal of sufficiency and the goal of a specific and predictable

⁵² *Trends in Telephone Service*, at Table 19.3; see USAC, *Federal Universal Support Mechanisms Fund Size Projections for the Second Quarter 2006*, Appendix HC02 (January 2006) (“*USAC 2d Quarter 2006 Projections*”) (projecting annualized high-cost support funding to be \$4.195 billion). See also USAC, *Distribution of High Cost Support Between CETCs & ILECs 1998 Through 4Q2005 (Unaudited)* (calculating total high-cost disbursements of \$3.824 billion for 2005).

⁵³ Comments of USAC, WC Docket No. 05-195, at 14 (Oct. 18, 2005).

⁵⁴ See USAC, Universal Service Fund Facts, <http://www.universalservice.org/about/universal-service/fund-facts.aspx>.

⁵⁵ See *USAC 2d Quarter 2006 Projections*, at Appendix HC02.

⁵⁶ See Public Notice, *Proposed Second Quarter 2006 Contribution Factor*, DA 06-571 (rel. Mar. 13, 2006).

⁵⁷ See *id.* The contribution factor for the first quarter of 2006 was 10.2%. See Public Notice, *Proposed First Quarter 2006 Contribution Factor*, DA 05-3203 (rel. Dec. 15, 2005).

mechanism. *See* Section I, at pp. 6-8. As market forces have reduced telephone rates and made them more affordable over time, the growth of the fund has meant that the universal service assessment has become an ever larger proportion of consumer bills for voice telephone service. The increasing cost of universal service obviously tends to offset the benefit to consumers of competitive entry, since it is consumers who must bear the cost of universal service. And failure to limit the fund by targeting it so that it will just be sufficient, ultimately will negatively impact affordability and the long term sustainability of the fund. Thus, in evaluating the fund, the Commission should determine whether consumers have access to defined universal services without the need for explicit support, and narrowly target support for those services and areas where it is necessary.

Second, the size of the fund, and the resulting assessment on consumers' bills can jeopardize the goal that all rates remain "affordable." 47 U.S.C. § 254(b)(1). As the 10th Circuit recognized "excessive subsidization may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1)." *Qwest II*, 398 F.3d at 1235. Indeed, this concern has been generally recognized. *See Alenco*, 201 F.3d at 620 ("[E]xcess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market."); *see also Qwest I*, 259 F.3d at 1200.

As a result, as competition grows, the amount of support should *decrease*. As discussed above in Section II, new technologies and competition from intermodal carriers serve to reduce rates, and make telephone services throughout the country "affordable," *without* the need for explicit subsidies. The Commission must undertake the analysis to

reduce or eliminate support in those areas where competition has made such support unnecessary.

V. Although the Commission Should Collect Rural and Urban Rate Data, Available Data Demonstrates that Rural And Urban Rates Already Are “Reasonably Comparable” in a Manner Consistent with the Requirements of the Act

On remand, the Commission should define “reasonably comparable” rates as those that are “similar” or “within a reasonable range of” nationwide urban rates.⁵⁸

Congress said rural rates should be “reasonably comparable” –not “identical to” or “no higher than” – urban rates, recognizing that there should be some flexibility in the Commission’s implementation of universal service goals.

In particular, the Commission should not attempt to craft a mechanism that eliminates all but the most minor deviations in rates. Otherwise, the Act’s goal of comparability would turn into a requirement of national rate uniformity – something that goes far beyond a reasonable reading of Section 254. Such a federalized uniformity requirement for local rates would also render Section 2(b) a nullity.⁵⁹ If Congress wanted local rate uniformity, it surely could have said so, as it did with long distance rates.⁶⁰ Indeed, a mechanism that fluctuated based entirely on actual increases in rates might

⁵⁸ Again, the statute does not define “reasonably comparable;” however, “comparable” means “[l]ike or equivalent,” WEBSTER’S II NEW COLLEGE DICTIONARY 234 (3d ed. 2005).

⁵⁹ See 47 U.S.C. § 152(b) (limiting the FCC’s jurisdiction over intrastate services).

⁶⁰ See *id.* § 254(g) (directing the Commission to adopt rules that require that the rates charged by interexchange providers “to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas”).

create incentives for carriers to raise rates temporarily in order to attempt to get additional high-cost funding.

Moreover, the Commission cannot design a mechanism that would ensure that every individual rate in every rural area is reasonably comparable to every individual rate in every urban area, nor should it try. The result would be a backdoor requirement of rate uniformity. The question of whether the Commission's universal service mechanism is "sufficient" to achieve "reasonably comparable" rates should be based on whether the Commission's policies are working to achieve reasonable comparability in the aggregate.

Any attempt to quantify a concept such as "reasonably comparable" is bound to involve subjective determinations, and benchmarks set to measure reasonable comparability will be inherently arbitrary. As the Commission has recognized, rates may vary for a number of reasons, and it is impossible to make a direct comparison of rate elements when factors such as calling areas, minutes of use and other concerns may make any apples-to-apples rate comparisons impossible.⁶¹ However, making use of what data is available, the Commission should continue to establish a benchmark proxy to measure whether rates can be deemed presumptively within the "reasonably comparable" realm. Specifically, it should retain the presumption that rates that are within two standard deviations of the national average urban rate are "reasonably comparable." As the Commission has found before, two standard deviations is a commonly used measure of

⁶¹ *Federal-State Joint Board on Universal Service*, 18 FCC Rcd 22559, 22572, 22609 (2003) ("Order on Remand").

dispersion in statistics, and is a useful tool in highlighting data points that are not like the central bulk of the data.⁶²

When viewed in the aggregate, currently available data suggests that rural and urban local telephone rates generally are reasonably comparable, and have been since at least 2001. Indeed, based on an analysis Verizon undertook of rates of rural ILECs in six states, it appears that the average rural rate is not only reasonably comparable to the urban rate, but it is actually, on average, *lower*. See Garzillo Declaration, ¶ 11 (attached hereto). Because it appears that some rural areas have extremely *low* rates – rates, in many cases that are far below those charged in urban areas – there is an opportunity in those situations to reduce support because rural carriers there are likely receiving *too much* high-cost support. Verizon also examined the comparability to urban areas of sample basic telephone rates from rural areas that were originally identified in the GAO Report, and for which 2005 rates could be found.⁶³ Although the rural areas identified by the GAO include some of the most rural areas of the country,⁶⁴ rates in those areas also are reasonably comparable to urban rates, both in 2001 and today. See Garzillo Declaration, ¶¶ 13-21; *see also id.* at p. 11, Chart 1.D.

⁶² See *id.* at 22591-92, ¶ 53; *see also* Reply Comments of Verizon on Joint Board Recommended Decision, Declaration of Eugene Goldrick, CC Docket No. 96-45 (filed Jan. 17, 2002).

⁶³ See *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding*, General Accounting Office Report to the Ranking Minority Member, Subcommittee on Telecommunications and the Internet, Committee on Energy and Commerce, House of Representatives (Feb. 2002) (“GAO Report”).

⁶⁴ The GAO Report contains rural rate information from some of the most rural areas in the country because the GAO only sampled rural carriers serving non-Metropolitan Statistical Areas. See GAO Report, at Table 3. And MSAs, in general, contain at least one urbanized area of 50,000 or more inhabitants. Thus, if there were any discrepancy between rural and urban ILEC rates it would likely show up when comparing the rates charged by carriers serving non-MSAs to rates charged in urban areas.

It is true that the *Qwest II* court was concerned that, “[b]y designating a comparability benchmark at the national urban average plus two standard deviations, the FCC has ensured that significant variance between rural and urban rates will *continue unabated*.” 398 F.3d at 1236 (emphasis added). In particular, the court noted that, under a two standard deviations benchmark, “rural rates falling just below the comparability benchmark may exceed the lowest urban rates by over 100%.” *Id.* at 1237. But this comparison falls into the trap of seeking individual comparability. Because the Commission failed to address rate comparability in the context of an overall statutory framework, the court looked at this concern in isolation and raised its concern in that context. Through a more holistic approach, as outlined above, the Commission can balance comparability against other universal service goals. By attempting to achieve overall rate comparability, it can then address outliers to see if they truly need support, or if there are other competitive alternatives that serve universal service goals by giving consumers access to service at reasonable costs. In particular, if consumers in rural areas have competitive alternatives that charge lower rates, the rate comparability of an ILEC is irrelevant.

In addition, rural rates generally appear to be dispersed in the roughly same proportion as urban rates. *See* Garzillo Declaration, ¶ 12; *see also id.* at pp. 6-7, Charts 1.B and 1.C.⁶⁵ Thus, even if the court was correct that the Commission’s rate benchmark would allow some individual rural rates to be 70-80 percent above the urban average rates, if roughly the same proportion of urban rates *also* are 70-80 percent above the

⁶⁵ Of the areas surveyed, only one rural rate (United Telephone of the West, in Wyoming, at an average rate of \$57.65 per month) fell outside the high-side of the range of urban rates. *See* Garzillo Declaration, ¶ 12.

urban average, then rural and urban rates are “reasonably comparable.” In other words, as the Commission has recognized, the statute cannot plausibly be read to require that rural rates be *more* comparable to urban rates than urban rates are to each other.⁶⁶

Although preliminary indications are that rates are reasonably comparable, the court indicated that on remand, the Commission should produce evidence of this fact. *Qwest II*, 398 F.3d at 1237. In order to produce this empirical evidence, the Commission should issue a data request to the states to gather detailed evidence on rates for all ILECs, both rural and non-rural. Verizon included, in Attachment F, a data request that the Commission uses to gather rates from sample cities to include in the FCC Reference Book, which could serve as an appropriate model for a broader data request to the states. See Attachment F; see also *FCC Reference Book of Rates, Prices Indices, and Household Expenditures for Telephone Service* (2005), available at <http://www.fcc.gov/wcb/iatd/lec.html>. The Commission should require rate gathering on an annual basis, as part of the states’ annual certification requirements. The Commission should also gather data on competitors rates through publicly available sources.

The Commission should work with the states and carriers to develop a draft data request that both meets the Commission’s needs but also minimizes unnecessary burdens to the data gatherers. In addition, by tailoring any request to the types of data that carriers and states readily track, or are publicly available, the Commission can obtain more reliable data that is more likely to be consistent across different states and carriers.

⁶⁶ *Order on Remand*, 18 FCC Rcd at 22585 (“[U]rban rates themselves varied widely at the time of the 1996 Act and vary more widely today. A benchmark of 25 percent above the average urban rate would require rural rates to be closer to the average urban rate than other urban rates.”).

In addition, the Commission should continue to require states to certify that rates in urban and rural areas throughout the state are reasonably comparable to nationwide benchmarks. *See* 47 C.F.R. § 54.316(a). However, the Commission should amend the certification requirements in two ways. First, it should require states to gather and produce data regarding the specific rates being charged by ILECs in rural and urban areas in the states, rather than simply stating that such rates are below the applicable benchmark. Again, this will allow the Commission to examine not just those states that are receiving not enough support, but also to investigate and address those areas that are receiving more than is necessary. If rates in one state are far below the benchmark, and the state is also receiving significant amounts of high-cost support, the Commission should consider eliminating or reducing support in those areas. Second, the Commission should change the consequences for failing to certify so that all states produce rate data. Currently, the only penalty for failure to file is a potential loss of non-rural high-cost support; however, because only ten states currently receive non-rural high-cost funding, another forty (plus the District of Columbia and Puerto Rico) have no incentives to comply with the certification requirement. The Commission should change the rules to provide that states will risk losing *all* high-cost funding (rural or non-rural), unless they annually certify to the rates in their states.

VI. The Commission Should Grant PRTC's Request to Create A Separate Mechanism For Insular Support

The Commission should adopt the Notice's tentative conclusion to create a non-rural insular mechanism for support. *See* Notice, ¶¶ 30-38. Section 254(b)(3) provides that consumers "in rural, *insular*, and high cost areas, should have access to telecommunications and information services . . . at rates that are reasonably comparable

to rates charged for similar services in urban areas.”⁶⁷ Puerto Rico undoubtedly is an “insular” area within the meaning of this provision.⁶⁸ Nonetheless, Puerto Rico Telephone Company (“PRTC”) is classified as a non-rural carrier for purposes of calculating high-cost support, even though, according to Census Bureau data, more than half of Puerto Rico is rural.⁶⁹ PRTC has demonstrated that the current non-rural high-cost mechanism does not properly target the needs of insular areas. *See PRTC Petition*, at 9, 12 n.43.⁷⁰ Granting PRTC’s petition would not implicate the remaining issues with non-rural high-cost support, and thus issuing an order on PRTC’s petition should not await resolution of those other, more complicated issues.

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

⁶⁸ *See, e.g., Federal-State Joint Board on Universal Service: Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas*, 14 FCC Rcd 21177, ¶¶ 135, 138 (1999) (tentatively concluding that Puerto Rico is an insular area, and expressing concern “about the low subscribership levels in insular areas, including Puerto Rico”).

⁶⁹ *See Petition for Clarification and/or Reconsideration of the Puerto Rico Telephone Company, Inc.*, CC Docket No. 96-45, at 5 (Jan. 14, 2004) (“PRTC Petition”).

⁷⁰ “The intrinsic difficulties of serving insular areas as described in detail above – issues with geography, demographics, and climate – effectively prevent a general proxy cost Model from accurately reflecting the cost structure of serving the island.” *Id.* at 15. Indeed, the Joint Board recognized that “while we believe that proxy Models may provide an appropriate determination of costs on which to base high cost support, we are less certain that they may do so for rural carriers in Alaska and insular areas.” *Federal-State Joint Board on Universal Service*, Recommended Decision, 12 FCC Rcd 87, 239-40, ¶ 298 (1997).

VII. Conclusion

For all the foregoing reasons, the Commission should overhaul the current high cost mechanism to remove support that is no longer necessary, and respond to the court's request to gather data on rates and define key statutory terms.

Respectfully submitted,

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