Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support	)	WC Docket No. 05-337 FCC 06J-1 CC Docket No. 96-45

COMMENTS OF GVNW CONSULTING, INC.

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Executive Summary

We respectfully request the Joint Board and Commission consider the reverse auction issue in the context of continuing to achieve the statutory mandates of TA 96. Without the reasonable prospect of an opportunity to recover infrastructure costs, investment will not continue to be deployed in many sparsely populated and high-cost to serve areas. We recommend that the Joint Board issue a report to the Commission with respect to the reverse auction proposal that would not include rural wireline carriers in an initial implementation period.

Under the proposed reverse auction scenario, universal service support would not be predictable over the long term. This type of uncertainty would certainly not provide sufficient incentive for efficient, long-term investment strategies that are prerequisite to infrastructure deployment in low density, high cost to serve areas of the country.

Competitive carriers are the recent root cause of universal service fund growth. From 1999 through 2005, CETCs enjoyed a growth rate of 235% in high cost funding. This compares to a very flat growth rate for RLEC funding – the annual growth rate for RLEC high cost funding was only 0.6% in 2005.

An initial review of the data indicates that county boundary lines differ from the current COLR areas, which could create a disincentive for the "county winner" to serve outlying customers of rural carriers.

It seems ironic that the states that most need support for universal service as part of a national public policy directive would be the ones most severely impacted by the growth in a national fund that has been caused in part by the Commission not proscribing a more rigid discipline for granting eligible carrier status.

INTRODUCTION AND BACKGROUND

GVNW Consulting, Inc. (GVNW) is a management consulting firm that provides a wide variety of consulting services, including regulatory and advocacy support on issues such as universal service, intercarrier compensation reform, and strategic planning for communications carriers in rural America. The purpose of these comments is to respond to the Public Notice concerning the concept of reverse auctions released by the Commission on August 11, 2006 in the above-captioned docket.

It appears that the discussion of a reverse auction approach is geared to reduce the size and growth of federal high-cost support programs. We respectfully request the Joint Board and Commission consider the issue in the context of continuing to achieve the statutory mandates of TA 96. As we will discuss in these instant comments, implementing a reverse auction program to determine universal service support could jeopardize the provision of universal service in rural areas. Without the reasonable prospect of an opportunity to recover infrastructure costs, investment will not continue to be deployed in many sparsely populated and high-cost to serve areas. We respectfully request that the Joint Board and Commission recognize the unique service circumstances of rural carriers. While the discussion proposal in the Public Notice appears to envision that there would be one wireline broadband winner and one mobility winner of a reverse auction, we are concerned as to any unintended consequences of a reverse auction mechanism.

We recommend that the Joint Board issue a report to the Commission with respect to the reverse auction proposal that would not include rural wireline carriers in an initial implementation period. Topical areas are addressed in the order presented in the Public Notice.

OVERALL APPROPRIATENESS OF AUCTIONS

<u>Reverse Auctions raise significant public policy issues for high cost to serve areas</u>

Implementing a reverse auction approach for rural carriers could have unintended consequences, including an inability to raise capital and evolve appropriate levels of service. We discuss capital market issues on page 6.

As presently defined, it appears that a key to the success of a reverse auction approach is an exacting statement of work. As with any fixed-price bidding system, the success of the contract will depend entirely upon the quality of the statement of work that forms the basis of the proposal. We anticipate that the Commission would intend to define a static set of supported services. Since any services outside of this definition will not qualify as supported services, the ability to evolve services capabilities is seriously compromised as the auction winner will have no incentive to spend beyond the proscribed service level. This seems contradictory to the administration's goals and Congressional support present for an evolution to broadband networks.

LEGAL ISSUES AND FRAMEWORK

While the discussion proposal in the Public Notice appears to envision that there would be one wireline broadband winner and one mobility winner of a reverse auction, we are concerned as to any unintended consequences of a reverse auction mechanism.

If an existing rural wireline carrier were to be unsuccessful in a reverse auction proceeding, it is unclear in the Public Notice as to how the Commission would intend to address confiscation issues.[1]

In a rate-of-return regulatory environment, the overarching principle that the Commission should adhere to is that rate-of-return carriers are entitled, as a matter of law, to a full recovery of their costs in providing interstate services.

Further, it would appear from the data currently in the record that reverse auctions do not constitute the competition that was envisioned in TA 96. One may argue that such competitive bidding is actually anti-competitive per TA 96, at least with respect to a customer's access to competitive alternatives. In the described reverse auction approach, carriers are only on an equal basis once every bidding cycle.

JURISDICTIONAL ROLES

Reverse auctions would create an uncertainty with respect to capital recovery and retard the deployment of rural infrastructure

Rural carrier telecommunications networks necessitate investing large amounts of capital in inherently long-lived plant assets. These investments are possible when lenders have a reasonable certainty of debt repayment[2] and investors/stockholders/cooperative members are afforded an opportunity to receive a compensatory rate-of-return.

[1] While Chairman Martin indicated in his statements to Senator Stevens on September 12, 2006 at the Senate Commerce, Science and Transportation Committee hearing that an adequate transition would be contemplated, it is not clear that the Commission may supersede intrastate depreciation rates in light of the *Louisiana* standard.

[2] Conversely, lenders available to rural carriers will be unwilling to provide new capital if there is significant uncertainty regarding the ability to meet principal and interest obligations.

Under the proposed reverse auction scenario, universal service support would not be predictable over the long term. After the contract period expires, support for an area would be re-auctioned. In the subsequent period, the initial bidder, who will have made long-term investments to serve a rural area, would only retain its revenues if it submitted the winning second bid. This type of uncertainty would certainly not provide sufficient incentive for efficient, long-term investment strategies that are prerequisite to infrastructure deployment in low density, high cost to serve areas of the country.

A reverse auction solution ignores the major root cause of recent fund growth

Competitive carriers are the recent root cause of universal service fund growth. Furthermore, none of the funding received by Competitive Eligible Telecommunications Carriers is subject to a cap. As noted in a recent article in the OPASTCO Advocate: "*For example, from 1999 through 2005, CETCs enjoyed a growth rate of 235% in high cost funding. This compares to a very flat growth rate for RLEC funding – the annual growth rate for RLEC high cost funding was only 0.6% in 2005*."[3]

The authors further added: "*Furthermore, they have essentially no requirements or obligation to enhance or improve their networks to better serve rural consumers. Indeed, for CETCs, the opportunity to receive high cost funding has proven to be 'found money'. In 2006, it is an estimated $1 billion in USF funding – continuing the staggering growth rate [seen in the above graph.] Clearly, the growth of the USF is not due to 'inefficient' RLECs or abuses on the part of rural carriers. Rather, we need to discipline the CETC process. If the FCC and other policy makers would require CETCs to be*

[3] Smith, Jeffry H. and Fox, Michael, OPASTCO Advocate, *Universal Service Policy Debate Should Use Facts, Not Fiction,* September, 2006, page 4, referencing publicly-available USAC data

compensated based upon their own costs, and demonstrate that they are using this funding for improved service in rural areas, rural consumers would benefit greatly, and the fund would not be experiencing the growth pressures it is today."[4]

SUPPORTED AREAS

County boundaries may result in some citizens not "counting"

The definitional issue of what basis to use for a supported area is of great interest to rural carriers. While the Public Notice appears to indicate that a county basis is being considered, a rural incumbent carrier exemption is also mentioned. Such an exemption would be appropriate if a reverse auction approach were used. Depending on how the concomitant rules for such an approach might be drafted, conducting the reverse auctions on a county boundary basis may create some issues for many carriers that operate in large counties that have diverse cost characteristics. One of the reasons that universal service is working today is that virtually all customers are accounted for within some eligible carrier's service territory. These "carriers of last resort" (COLR) stand ready to serve even the most remote and isolated customers.

An initial review indicates that many county boundary lines differ from the current COLR areas, which could create a disincentive for the "county winner" to serve outlying customers of rural carriers.

For example, Marion County in Oregon contains the state capitol, Salem, and the county is served by 10 wireline companies including Qwest. Two large regional or national carriers, Century and Verizon, have a presence in Marion County. There are

[4] Ibid, pages 4-5.

also 7 rural carriers who serve the rural portions of Marion County that the large providers chose not to serve: Cascade Utilities, Inc., Gervais Telephone Company, Monitor Cooperative Telephone Company, Mt. Angel Telephone Company, People's Telephone Company, St. Paul Cooperative Telephone Association, and Stayton Cooperative Telephone Company. Depending on the percentage of coverage required in the county, a carrier could in essence bid for Salem and ignore the remainder of Marion County.

The same situation of ten wireline carriers serving in a county is present in Clackamas County, adjacent to the Portland area. Qwest, Verizon, and Century all serve in Clackamas County. The seven rural carriers serving Clackamas County include Beaver Creek Cooperative Telephone Company, Canby Telcom, Cascade Utilities, Inc., Clear Creek Mutual Telephone Company, Colton Telephone Company, Molalla Communications Company, and Monitor Cooperative Telephone Company. For counties like Clackamas County that are near major metropolitan areas (e.g.., Portland), the issue of urban growth boundaries (known by a variety of names depending upon the state) could serve to exacerbate the situation in a county based auction approach as the more rural areas of the county will stay that way due to city or state laws. Depending on how any density type metric might be measured, areas of a county could in essence become ignored by the auction winner.

This same issue exists in several other states "west of the Mississippi." For example, in the state of Texas, the following table indicates some of the counties that are served by a large national carrier as well as a rural carrier.

Texas County Name	**Serving Wireline Carriers**
Culbertson and Hudspeth	Dell Telephone Cooperative and Windstream
Fayette	Colorado Valley Telephone Coop., Inc. and Verizon
Jackson	Ganado Telephone Company, Inc., LaWard Telephone Exchange, Inc. and AT&T (formerly SBC)
Polk	Lake Livingston Telephone Co., Livingston and AT&T
Zapata	Border to Border Communications and AT&T

In the state of New Mexico, we find the following multiple companies serving in these counties:

New Mexico County Name	**Serving Wireline Carriers**
Chaves and Lea	Leaco Rural Telephone Cooperative and Qwest
Otero	Tularosa Basin Telephone and Qwest
Roosevelt	Roosevelt County Rural Telephone Coop. and Qwest
Union	Baca Valley Telephone Co., Inc. and ENMR

The public policy question that must be answered is: How would the Joint Board and Commission propose to mitigate a large carrier from low balling a bid to win the auction, and then ignore the low-density portion of the county? While this may not be important to 90+% of the county's customers, it is of vital importance to the potentially disenfranchised 10%. We encourage the inclusion of the rural incumbent carrier exemption in any county-based approach to reverse auctions.

OPTIMAL AUCTION STRUCTURE

From a rural carrier perspective, the first phase is for others

When the Commission considered the reverse auction concept a decade ago, there was not public consensus on how to structure competitive bidding to make it reduce the overall amount of support.[5] And, a decade ago, the decision was made to not pursue reverse auctions. If the current Commission chooses to "reverse" this prior decision, we respectfully submit that carriers other than rural wireline carriers should be the subject of such an experiment. Given the uncertainty regarding such an approach, and the lack of empirical data as to what constitutes a successful auction scenario, we believe rural carriers are not the proper subset on which to experiment in this regard.

Rural carriers often are the only provider of ubiquitous and high-quality service[6] in a service area. Such a phased-in approach is offered in the discussion proposal at page 9 of the Public Notice.

QUALITY OF SERVICE OBLIGATIONS AND ENFORCEMENT

The Public Notice properly raises questions concerning quality of service issues.

Without adequate network performance standards firmly in place, the Commission will have fired the starting gun for a race to the bottom in terms of service quality

The enforcement of service quality standards could be a difficult task for the Commission. In a competitively bid contract scenario, the purchasing party has the obligation to enforce the terms of the contract upon the bidder. At the same time, the financial incentives for the winning bidder are to perform the work at a lower cost than

[5] Recommended Decision, CC Docket No. 96-45 (Federal-State Joint Board on Universal Service), November 6, 1996, paragraph 334.
[6] Rural carriers are measured against the 99.999% standard of reliability, not the "fewest number of dropped calls" as cellular carriers claim in their network and cable television advertisements.

was bid. In order to prevent this natural incentive to cut costs resulting in a degradation of service, some form of oversight by a regulatory authority would be required.

Reverse auctions would create no incentive to invest after the contract, and would be especially acute in the later years of a contract cycle. For example, carriers would be unable to justify investing in long-lived assets in the eighth or ninth year of a ten year contract period when faced with the possible loss of support in year eleven.

Other important policy questions that the Commission must consider include:

* How does the Commission propose to monitor the winner's performance?
* How does the Commission intend to handle when carriers exit high cost to serve markets if they are not the successful auction bidder?
* What are the "costs" for winners that are ultimately unable to perform?

Historically, the "carrier of last resort" (COLR) designation has provided a reasonable assurance that customers in remote regions of the country will have access to communications services. An important part of the COLR package has been the availability of universal service support. The proposal does not appear to address an adequate fallback position for customers in rural areas where the "winner" is unable to meet its commitment.

The Commission has previously recognized that the costs of rural carriers are higher than non-rural carriers. This was demonstrated empirically in the Rural Task Force's (RTF) White Paper 2,[7] and this research was corroborated in NECA's *Trends in Telecommunications Cost Recovery: The Impact on Rural America* report released in October, 2002.

[7] "The Rural Difference", Rural Task Force White Paper 2, released January 2000.

In *The Rural Difference*, the Rural Task Force quantitatively detailed key differences between urban and rural carriers, including but not limited to differences in costs for switching capacity and various expenses and overheads that were driven by differences in the rate calculation denominator.

These differences remain in place. A recent example of the challenges facing rural carriers serving extremely remote areas is found in an article in US Telecom's *Communications Crossroads* Summer 2006 edition. In the cover story *Going the Distance*, the challenges facing Alaska carriers are documented. In the portion of the article about Cordova Telephone Co-op, the story states:

Cordova lies at sea level, but just one mile away – and 2,500 feet up, atop Heney Ridge – is a key microwave and cellular relay station that enables the co-op to send a microwave signal for nearly 35 miles and cell signals for 20. The relay station is covered by snow seven months a year, winds routinely hit 200 miles an hour and snow sticking to the antenna routinely builds out horizontally as much as 15 feet.

Without very careful consideration of all the implications of a reverse auction mechanism, one unintended consequence of reverse auctions in rural areas would be to leave many customers as if they were standing near the Cordova antenna - out in the cold.

MULTIPLE SUPPORT WINNERS

If the Commission is determined to experiment with reverse auctions, we believe the concept reflected in the discussion proposal about one wireline broadband winner and one mobility winner deserves consideration. This approach would be consistent with the view that many consumers have with respect to their communications service providers. While many consumers utilize a wireline service provider to meet their mobility needs, consumers still depend on the wireline service provider for a ubiquitously available and 99.999% reliable service, to meet needs with regards to E-911 functionality, as well as in many cases to provide a more affordable local calling package.

And, the mobility provider depends on the wireline provider in its call completion architecture. Current wireless, VoIP, and satellite networks require a connection to land line infrastructure to provide full functionality. This network reality is documented in *Wireless Needs Wires: The Vital Role of Rural Networks in Completing the Call*, published by the Foundation for Rural Service in March, 2006. This paper states in part:

> *Without thoughtful consideration by policymakers of the challenges of providing wireless services in rural America, as well as the dependence of wireless services on wireline networks, portions of the nation are likely to remain underserved . . .Most importantly, one must recognize that without the underlying wireline network, wireless networks could not exist in their current form. In spite of this obvious fact, large wireless carriers and policymakers alike continue to pursue practices and policies that will in fact undermine the critical wireline network. While discussions on how to modify reciprocal compensation, access charges, and universal service continue, attention must be placed on ensuring these mechanisms are capable of maintaining the fiscal health of that wireline network.*

TREATMENT OF INCUMBENT LEC

While we interpret the options outlined at the end of the Public Notice to reflect awareness as to stranded investment issues for potential COLR auction losers, an important policy question to be addressed is: Which jurisdiction is responsible for stranded investment?

If the answer is that some responsibility should rest with the intrastate jurisdiction, it seems ironic that the states that most need support for universal service as part of a national public policy directive would be the ones most severely impacted by the growth in a national fund that has been caused in part by the Commission not proscribing a more rigid discipline for granting eligible carrier status.

The United States has enjoyed economic prosperity in part because of rational national public policy approaches in the communications arena. We encourage the Joint Board and Commission to remain consistent with the Commission's long-standing history of differentiating between sizes of carriers in order to provide equitable solutions to regulatory challenges.

Respectfully submitted

Via ECFS, in only WCD No. 05-337 per Commission instructions, on 10/09/06

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