Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	
Universal Service	)	WC Docket No. 05-337
	)	
Use of Auctions to Determine High-Cost	)	
Universal Service Support	)	

COMMENTS OF
THE SOUTH DAKOTA TELECOMMUNICATIONS ASSOCIATION, CAMERON COMMUNICATIONS, LLC, CLEAR LAKE INDEPENDENT TELEPHONE COMPANY, HANSON COMMUNICATIONS, INC. HARRISONVILLE TELEPHONE COMPANY, HILL COUNTRY TELEPHONE COOPERATIVE, INC., HINTON TELEPHONE COMPANY OF HINTON, OKLAHOMA, INC., SMART CITY TELECOM, SOUTH SLOPE COOPERATIVE TELEPHONE CO., INC., TOWNES TELECOMMUNICATIONS, INC. AND WIGGINS TELEPHONE ASSOCIATION

These comments are submitted on behalf of the referenced incumbent rural telephone companies (the "Rural USF Coalition") in response to the Federal-State Joint Board's August 11, 2006 Public Notice on the subject of reverse auctions to determine high cost universal service funding. The Rural USF Coalition's members represent 46 companies and represent a broad geographic reach, from Florida to the western states. Despite such geographic separation, the companies all provide telephone exchange and access services in high cost, low population density areas, and all are recipients of high cost USF support.

These comments initially discuss the fact that the reverse auction proposal is a proposed solution to a problem which deserves more scrutiny by the Joint Board, i.e. dramatic growth in the size of the fund. This problem is given almost no discussion in the Public Notice, however, but warrants such an examination before auctions are discussed as the primary solution.

These comments next discuss the practical and legal considerations of the auction concept. The Rural USF Coalition urges the Joint Board to expand its focus beyond the proposal set out in the Public Notice, and to consider other, non-auction, solutions. In recent years, through a combination of state and federal policies relating to competitive ETC designation, the fund has acquired a sort of pork barrel characteristic. As a result, many areas which could not support even an incumbent rural LEC without USF funding, have as many as 5 or 6 Eligible Telecommunications Carriers ("ETCs"), all receiving high cost funding. The federal USF revenues available from such high cost areas, for competitive ETCs having no appreciable infrastructure, surely provide a business case for those seeking competitive ETC status. The Rural USF Coalition is confident that the Joint Board is aware of this circumstance, and urges it to address the root causes of this phenomenon as discussed herein.

The Joint Board Should Further Examine The Basis And Purpose Of Auctions

The Rural USF Coalition commends the Joint Board's further inquiry into the high cost universal service funding mechanism. We respectfully submit, however, that the reverse auction mechanism is the wrong solution to a problem which, itself, is insufficiently focused in the Public Notice. In this respect, the Public Notice states that, by limiting the number of supported networks in each area, and by selecting the most cost-effective proposals, "...auctions could minimize the burden on customers providing the support." Id., para. 4.

We respectfully suggest that the Joint Board's inquiry should go further than this. For instance, what is the relative "burden" on customers now, in a historical context, and why does it exist? As the Joint Board is no doubt aware, the primary reason for dramatic growth in the high cost fund is a combination of the FCC's classification of rural ILEC revenue requirements as "subsidies",[1] which have been transferred by the FCC into the high cost fund, together with the practice of allowing competitive ETCs – particularly in the wireless industry – to report almost every telephone as a supported line. It is not surprising, then, that competitive ETC certification has become a cottage industry, supporting business plans designed around USF revenues. For instance, The Wall Street Journal Online ("WSJ") reported that, according to a J. P. Morgan analyst, $40 million in universal service support that Western Wireless (now ALLTEL) was to have received at the time, "should be 100% accretive to Western Wireless margins as there are no costs associated with USF" W.S.J., May 14, 2003. Since that time, it appears that support for ALLTEL/Western Wireless has continued to grow. Second quarter USAC projections indicate that the Company's annualized high cost draw, for South Dakota alone, will be approximately $27.3 million. This is against a total annualized draw of approximately $54.3 million for South Dakota's Incumbent Local Exchange Carriers ("ILECs").

Indeed, in 2003, the FCC characterized the high-cost support amounts distributed to competitive ETCs as "growing at a dramatic pace." Federal-State Board on Universal Service, CC Docket 96-45, Memorandum Opinion and Order, Virginia Cellular, LLC Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia, 19 FCC Rcd 1563 (2004), at para. 31. High cost support for competitive ETCs has continued its rapid growth since that time. It appears that,

[1] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fourteenth Report and Order and Twenty-Second Order on Reconsideration, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, Report and Order, 16 FCC Rcd. 11244. ("MAG Order")

nationwide, competitive ETC high cost support grew approximately 115% from year-end 2004, to year-end 2005.

Against this background, the Joint Board is urged to focus on these important statistics that underlie the growth of the high cost fund. Why has the fund grown as it has, and what industry sectors appear to be causing that growth?

We respectfully suggest that the answers to these questions will lead away from rural ILECs as the source of any growth related problems. These companies have followed through in plowing back their resources into facility-based investments.

Recent data from rural ILECs in South Dakota illustrate this point. The South Dakota Telecommunications Association's (SDTA) membership consists of 29 rural, incumbent LECs. Collectively, they provide telephone service to 79.5% of South Dakota's land mass, and to more than 150,000 access lines. Collectively, they own more than 13,000 miles of buried fiber optic line, and have invested almost $300 million in capital infrastructure, since 2001 alone. The largest communities served are Brookings (pop. 18,504), Brandon (pop. 5,693), Hot Springs (pop. 4,129) and Pine Ridge (pop. 3,171). According to data from the U.S. Census Bureau and the South Dakota Public Utilities Commission, the rural ILECs have an average of 2.17 access lines per square mile served.

One of SDTA's members has calculated its projected local rates if universal service support were not available to support its service offerings. Its residential rates are currently $16/month; its business rates are currently $25/month. Without universal service support, these monthly rates would be $159.00 and $168.00, respectively. These calculations were based on financial data as of year-end 2005, and are not expected to have changed in any material respect, since.

In sum, well-intended as it is, the Joint Board's inquiry about reducing USF-related consumer "burdens" through the auction process is misfocused. The Joint Board is urged to look more closely at the growth of the fund itself and what factors have caused the growth. The Rural USF Coalition suggests that, measured against such data, one must conclude that there is no problem to be addressed by auctions, vis-à-vis the rural ILEC industry. The Joint Board's time better will be spent considering the wisdom of allowing competitive ETCs to recoup USF revenues based upon incumbent LECs' costs, or considering whether auctions should be used but limited to the competitive ETC sector only. Aside from these very real public policy concerns, we respectfully submit that significant legal problems would attend any FCC attempt to impose USF-related auctions.

Significant Legal Issues Must Be Resolved Before The Use Of Auctions

The Joint Board's Public Notice notably seeks comments on the legal issues and framework which attend the reverse auction proposal. Public Notice, para. 6. The Rural USF Coalition submits that there are at least two legal issues which must be addressed satisfactorily before entertaining an auction proposal. The first issue concerns the language of the federal universal service statute itself, and how that may be squared with an auction for USF support. The second issue concerns the FCC's ability to circumvent the U.S. Supreme Court's decision in Smith v. Illinois Bell Telephone Co., 282 U.S. 133, 75 L. Ed. 255, 51 S.Ct. 65 (1930) ("Smith") requiring the allocation and recovery of interstate costs. These points will be discussed in order.

The Universal Service Statute Presents A Significant Hurdle

As recognized in the Public Notice, section 254(b)(5) mandates, by the word "shall", that both the FCC and the Joint Board, base their policies for preserving and advancing universal service, upon principles that include "specific, predictable and sufficient" Federal and State support mechanisms. 47 U.S.C. § 254(b)(5). The imposition of an auction requirement for universal service support is a step backward from these requirements.

For example, it is not uncommon for rural telephone infrastructure projects to be financed through a combination of internal and external funds. The uncertainty of winning either an initial or successive auction for USF will introduce a substantial element of unpredictability both for the lender and the borrower. Consider, for instance, the circumstance of a banker trying to justify a normal debt amortization on a project which is financed by an auction award, but which expires before the loan amortization period. The instant auction proposal, thus, not only appears to violate the plain language of the statute requiring "predictable" USF mechanisms, but introduces the likelihood that auctions will retard, rather than advance, universal service funding given the creation of such financing roadblocks and consequent frustration of infrastructure development projects.

The "sufficiency" requirement of the statute likewise appears at odds with an auction. In this respect, the very idea of a reverse auction – to reduce the amount of support to the maximum amount possible – barely belongs in the same sentence as 'sufficiency'. The Commission has explicitly examined and rejected non-embedded cost methodology for determining rural telephone company universal service support. MAG Order, 16 FCC Rcd at 11256. The notion of reducing such presumptively lawful amounts through an auction mechanism clearly runs contrary to the sufficiency requirement of section 254, especially where the ILEC's costs are closely regulated, at least by the FCC, and in most cases, by the states.

Smith v. Illinois Bell Requires Recovery Costs

As the Joint Board may be aware, the U.S. Supreme Court in Smith v. Illinois Bell, long ago imposed the requirement that non-traffic sensitive costs be parceled out between the interstate and intrastate jurisdictions. Since that time, this Commission and the Courts have repeatedly addressed the recovery of such costs, and have rejected arguments that they are a subsidy. Rural Telephone Coalition v. FCC, 838 F.2d 1307, 1315 (D.C. Cir. 1988) quoting, MCI Telecommunications Corp. v. FCC, 675 F.2d 408, 416 (D.C. Cir. 1982). The high cost fund now distributes amounts associated with non-traffic sensitive ("NTS") costs, both as a result of the Commission's MAG order transferring carrier common line revenue requirements into the USF mechanism, and historic developments in recovering NTS costs among interstate tariffs and separate high cost funding. To be sure, the Courts have given the FCC latitude in the recovery of NTS costs. The FCC's imposition of end user charges is an example.[2] But, an auction proposal would sever the link between allocation of such costs, as required by Smith, and the under or non-recovery of such costs as appears almost certain to happen in an auction scenario.

The Rural USF Coalition accordingly urges the Joint Board to avoid constructing an auction foundation that is undermined both by statute and by Smith. The Joint Board's efforts better would be spent, we suggest, in examining ways to realign competitive ETC's USF support with their real costs, and to jettison the FCC's prior policies of using the fund as a dumping ground for legitimate, rural ILEC revenue requirements.

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[2] Naruc v. FCC, 737 F.2d 1095 (D.C. Cir. 1984)

Conclusion

The proposed reverse auction proposal is, at the least, premature and imperiled by legal requirements. The size of the high cost fund is a legitimate public policy concern and the Rural USF Coalition members share concerns about its sustainability.

The Joint Board should closely examine, however, the causes of this phenomenon. In a nutshell, we submit, the growth primarily is attributable to two sources. First are the FCC's prior policies which have shifted substantial ILEC revenue requirements into the high cost fund. Second are the FCC's policies favoring the distribution of USF dollars to competitive ETCs, regardless of their underlying costs.

The Joint Board is urged to examine these phenomena and to recommend remedies that more directly address these root causes of USF growth. The auction proposal may reduce the size of the fund through simple blunt force, but the rural ILECs who have already wired rural America (and their customers) will be the primary victims.

As previously discussed, the auction proposal also presents substantial legal issues. The current regulatory framework imposes carrier of last resort, and a host of service features and service obligations, upon rural ILECs. At the same time, their interstate rates are regulated on a rate of return basis.

The auction idea represents a piecemeal approach that changes the balance of these two aspects of interstate operations. Such a radical departure should be rejected in favor of a comprehensive reexamination of the regulatory compact, both as a matter of good policy, and of law.

In conclusion, the Rural USF Coalition agrees that the size of the high cost fund is a potential problem for sustainabiliity. The auction proposal does not address the cause of growth in the fund, is unlawful for at least the reasons outlined herein, and the Joint

Board is urged to better tailor the solution to the root causes of growth in the high cost fund.

Respectfully submitted,

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